Sri Lanka
State of the Economy Report 2016

Chapter 16
Financing the SDGs

by
Chantal Sirisena

16. Financing the SDGs

16.1 Transitioning to SDGs from MDGs

Financing for sustainable development is an integral part of the development discourse in the post-2015 UN development agenda. Efforts are already under way to explore ways in which new resources can be mobilized and used effectively to meet the next generation of goals. Quantifying the financing needs is a necessarily imprecise and complex process and, therefore, studies vary widely in their estimates. According to UN estimates, annual financing needs for infrastructure alone, amount to US$ 5-7 trillion globally. A further US$ 3.5 trillion will serve the unmet need for credit for small and medium-enterprises.[1] Aggregating industry estimates suggests that meeting the new goals could require as much as US$ 11.5 trillion a year (US$ 172.5 trillion over the 15-year time frame, although this omits the potential for synergies between industries). This number eclipses the estimated financing needs of the MDGs, which were estimated at $40-60 billion a year.[2]

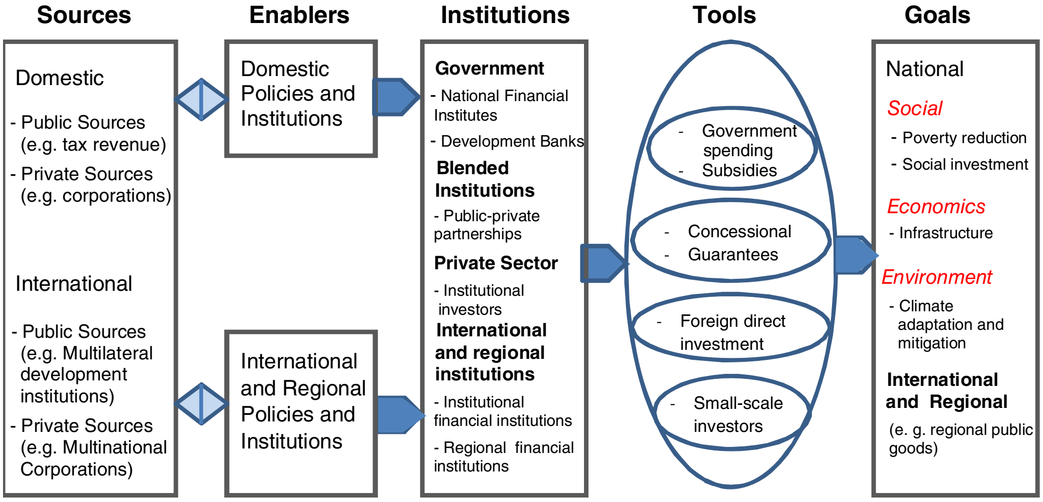
Therefore, financing for development requires a holistic approach, one that encompasses all stakeholders and also enables developing countries to better finance their own development. The reform agenda will need to improve domestic resource mobilization, including by strengthening tax administration,

Financing for development requires a holistic approach, one that encom-passes all stakeholders and also enables developing countries to better finance their own development.

[1] UN (2014), "Report of the Intergovernmental Committee of Experts on Sustainable Development Financing", United Nations, New York.

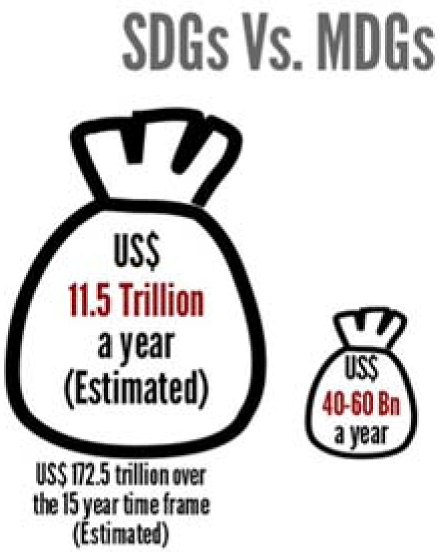
[2] Devarajan, S., *et. al*. (2003), "Development Goals: History, Prospects and Costs", World Bank Policy Research Working Paper, World Bank, Washington, D.C.

Figure 16.1
Schematic Framework of the Sources of Financing for Sustainable Development



Source: Schematic Framework taken from ESCAP (2015), “Sustainable Development Financing: Perspectives from Asia and the Pacific” United Nations Economic and Social Commission for Asia and the Pacific, Bangkok.

better harnessing natural resource revenue, and curbing illicit financial flows. Governments also have a catalytic role to play in attracting private sector financing, such as in infrastructure investment.[3]



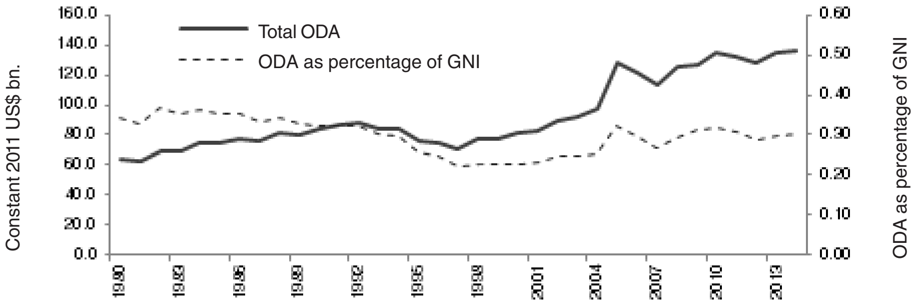
16.2 The Role of Official Development Assistance (ODA)

Aid has historically been an essential component of the financing agenda, helping low-income countries to accelerate growth above what would otherwise be achievable. ODA represents the third largest capital inflow into developing economies, after FDI and remittances. Despite the shift in attention towards harnessing alternative sources of finance, ODA will remain a critical input to achieving the new goals. This is particularly true of the poorest economies and fragile states with limited access to capital markets.

Goal 8 of the MDGs "Develop a Global Partnership for Development" outlines

[3] World Bank (2013), “Financing for Development Post-2015”, World Bank, Washington, D.C.

Figure 16.2
Trends in ODA



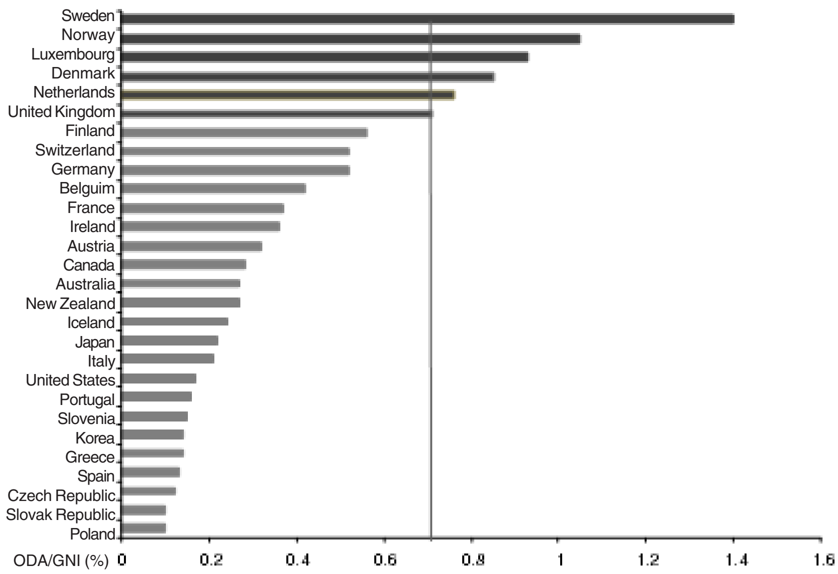
Source: Data taken from OECD (2015), "Development Co-operation Report 2015: Making Partnerships Effective Coalitions for Action", OECD, Paris.

commitments of developed nations in providing ODA, market access and debt relief to developing nations. It stipulates that net ODA from donor countries should reach at least 0.7 per cent of Gross National Income (GNI), and net ODA to the least developed countries should make up 0.15 per cent of GNI. Overall trends suggest ODA has been rising steadily, increasing in real terms by 83 per cent from 2000-2015 (Figure 16.2). However, the overall commitment remains significantly below target; preliminary estimates for 2015 show net ODA from the 28 member countries of the Development Assistance Committee (DAC) was US$ 131.6 billion, representing only 0.30 per cent of GNI. Moreover, the Euro Zone crisis and turmoil in the Middle East and North Africa (MENA) have impacted on a number of traditional donors reducing the availability of ODA. In 2015, aid spent on refugees in host countries more than doubled in real terms to US$ 12 billion as an unprecedented 1.5 million refugees claimed asylum in OECD countries.[4]

Given the budget constraints confronting many DAC donors, a substantial increase in ODA is unlikely in the near future to meet the investment jump required.

[4] OECD (2016), "Development Aid Rises Again in 2015, Spending on Refugees Doubles," Development Co-operation Directorate, Organization for Economic Cooperation and Development, Paris.

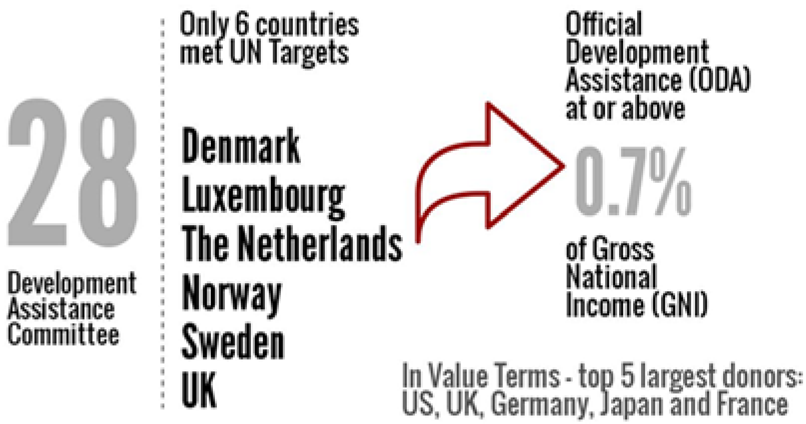
Figure 16.3
ODA Commitments of DAC Member Countries, 2015



Source: Estimates taken from OECD, "ODA Preliminary Data 2015 – Press Release".

Only six of the 28 DAC countries - Denmark, Luxembourg, The Netherlands, Norway, Sweden and the UK - met the UN target to keep ODA at or above 0.7 per cent of GNI (Figure 16.3). In value terms, the top five largest donors were the US, UK, Germany, Japan and France.

Aid remains an essential source of funds in countries where private investment and capital market access is limited. However, given the budget constraints confronting many DAC donors, a substantial increase in ODA is unlikely in the near future to meet the investment jump



required for the transition to the new development agenda.

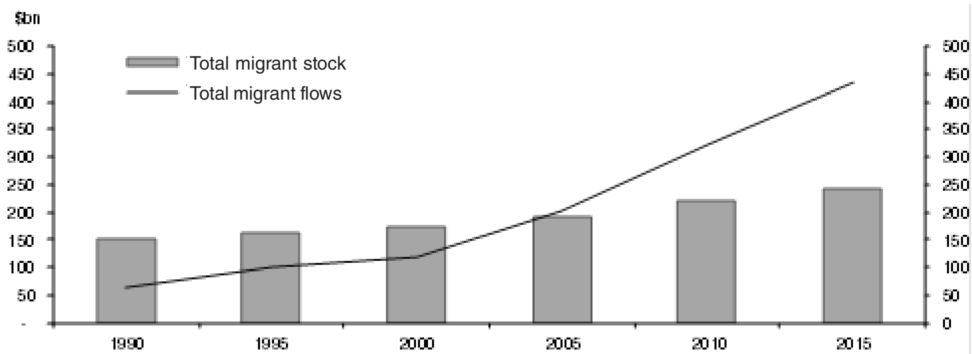
16.3 The Broader Financing for Development (FfD) Agenda

The Third International Conference on Financing for Development (FfD) was held in July 2015 in Addis Ababa, Ethiopia. The discussions centred on the various financing strands that could be explored and developed in conjunction to drive the SDGs. On the agenda were methods for improvements in domestic public resources, domestic and international private finance and investments, international development cooperation, international trade, and debt restructuring. However, the weak global backdrop for the conference was a known headwind - with flat-lined under-investment in global public finance.

Overall, the agreements received a mixed reception from the international development community. Many observers had initial hopes of more specific pledges and larger commitments. However, much energy was required simply to maintain the forward momentum of the collaborative effort for FfD. The outcome document, nine months in the making, will form the memorandum of understanding for development financing for the next 15 years.

In the document, there were some promising new commitments that can play an important role for the SDGs. For example, the commitment to a 'new social compact', targeted at carrying forward the progress made by the MDGs and eliminating extreme poverty. This commitment focusses on the delivery of social protection and essential public services for all. Major strides forward in addressing financing for universal secondary education targets came in the form of scaling up international investments such as the Global Partnership for Education. In light of infrastructure's large share of the SDG investment gap, elevated infrastructure efforts were well-received (including launching a new global infrastructure forum to improve alignment among the world's diversity of infrastructure-focussed efforts). Women's equal economic rights were addressed with a pledge to undertake legislation and administrative reforms to give women equal access to men for

Figure 16.4
Remittances and Migrant Stock



Source: UN Population Division, “Trends in International Migrant Stock: The 2015 Revision” and World Bank, “Annual Remittances Data”.

ownership and control over land, credit, inheritance, natural resources, and other forms of property. Commitments were also made to improve municipality financing in order to tackle their technological and technical limitations, keeping pace with the devolution of expenditures and investments in sustainable development to the sub-national level.[5]

Additional initiatives were announced outside of the formal text. Amongst the most promising was the Addis Tax Initiative under which the US and other developed countries will double support for helping developing countries to build their domestic resourcing systems. Another is the Global Partnership for Sustainable Development Data, targeting the strengthening of data ecosystems which could herald a new approach to public accountability systems.

Another financing opportunity addressed in the outcome document was the role of remittances. These flows are significant and although the majority of remittances go to basic goods for receiving households, studies indicate that globally about US$ 80 billion - 20 per cent of remittances - could be available for investment purposes if such options were readily available.[6]

16.3.1 Remittances

Global diaspora resources represent a key source of funding for development. There are an estimated 244 million migrants in the world,[7] and they sent an estimated US$ 435 billion in recorded remittances to developing countries in 2015 (an increase of 2 per cent over the previous year). Actual remittances are perceived to be much higher, as many resources are transferred through informal channels.[8] These resource flows represent more than three times the value of development aid.

5 McArthur, J. (2015), "What Happened at the Addis Financing for Development Conference?," Brooking Institute, Washington, D.C.

6 Nwanze, K.F. (2015), "Empowering Families to Finance Development with Remittances and Diaspora Savings", available at http://www.brookings.edu/blogs/future-development/posts/2015/07/08-financing-remittances-diaspora-nwanze.[7] "Trends in International Migrant Stock: The 2015 Revision", available at www.unmigration.org.

7 "Trends in International Migrant Stock: The 2015 Revision", available at www.unmigration.org.

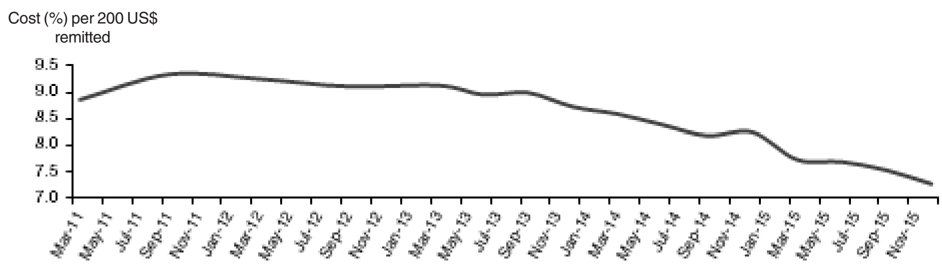
8 World Bank (2013), "Financing for Development Post-2015", World Bank, Washington, D.C.

SDGs and the Addis Ababa Action Agenda on FfD advocate the need for reductions in the costs of transacting remittances. The target is to reduce the average transaction cost of migrant remittances by 2030 to less than 3 per cent of the amount transferred. Competition is the most effective method of reducing costs. It follows that the cost of transferring funds is found to be highest in smaller remittance markets. The Agenda commits to a further goal of ensuring no remittance corridor charges amount to more than 5 per cent by 2030, an ambitious ceiling for these smaller markets. According to World Bank estimates, cutting prices by 5 percentage points can save up to US$16 billion a year in transaction costs.[9]

Data from Remittance Prices Worldwide (RPW) shows that the global average cost of sending remittances was 7.3 per cent in 2015 compared with an average of 8.8 per cent in 2011 (Figure 16.5). Although significant progress is being made, average costs remain far above the targets stipulated in the FfD Agenda.

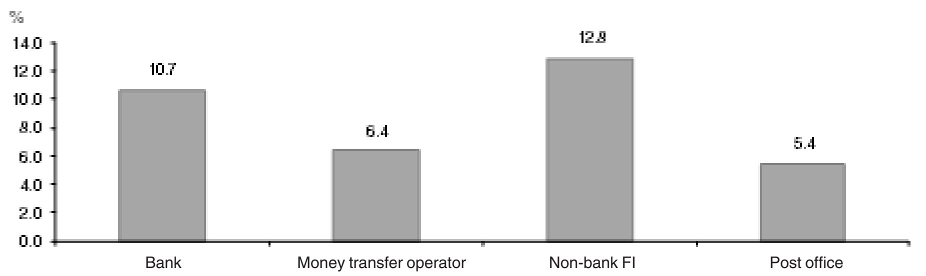
There is also significant disparity in the costs of transacting through different types of intermediaries. Non-bank financial institutions have the highest costs at 12.8 per cent, owing to the higher costs that they themselves incur in facilitating the transfer (Figure 16.6). The FfD Agenda will seek to increase coordination among national regulatory authorities to remove

Figure 16.5
RPW Index on Transfer Cost



Source: World Bank, "Remittance Prices Worldwide".

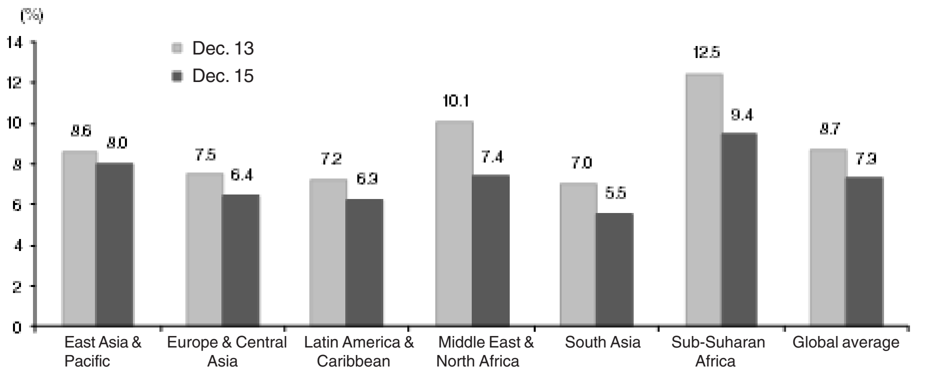
Figure 16.6
Remittance Costs by Intermediary Type



Source: World Bank, "Remittance Prices Worldwide".

[9] World Bank, Remittances Worldwide database at https://remittanceprices.worldbank.org/en

Figure 16.7
Remittance Cost by Region



Source: World Bank, "Remittance Prices Worldwide".

obstacles to non-bank remittance service providers accessing payment infrastructure. Increased pressure to transparently disclose pricing will further incentivize a reduction in these costs.

Figure 16.7 illustrates the disparity in pricing between regions. All regions have seen declines in costs since 2014 with the largest improvements in Sub-Saharan Africa (-3.1 per cent) and MENA (-2.7 per cent). South Asia has the lowest costs at just 5.5 per cent but still remains above the Agenda's 5 per cent target.

Competition is essential to lower these costs. Large remittance corridors by volume tend to have a greater number of money transfer operators and more competition, leading to lower prices and more transparency. Prices are decreasing in bigger volume corridors, but remain high in smaller remittance markets, involving transfers to smaller countries that are typically far more dependent on remittances as a share of GDP.[10] The most transparent are money transfer operators (MTOs) - with 98 per cent disclosing full information to their customers; for banks, this figure is 76 per cent whilst Post Offices are just 45 per cent.[11]

16.3.2 Climate Finance

Linking climate finance and development finance ensures that in striving to achieve sustainable development, sustainability and climate effects are considered collectively such that one does not adversely impact the other and vice versa. Developed countries have committed to mobilizing US$ 100 billion a year by 2020 for climate action in developing countries. This initial commitment was made at COP15 in Copenhagen in 2006 and there has been significant progress in meeting this goal. Climate finance funds reached US$ 52 billion in 2013 and US$ 62 billion in 2014.[12]

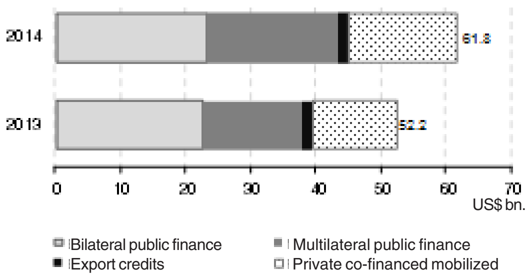
[10] World Bank (2013), "Financing for Development Post-2015", World Bank, Washington, D.C.

[11] World Bank (2013), "Migration and Development Brief 20", World Bank, Washington, D.C.

[12] OECD and Climate Policy Initiative (CPI) (2015), "Climate Finance in 2013-24".

Developed countries have committed to mobilizing US$ 100 billion a year by 2020 for climate action in developing countries.

Figure 16.8
Mobilized Climate Finance in 2013 and 2014, by Funding Source



Source: Climate Policy Initiative, OECD.

Total finance from all sources reached in excess of US$ 391 billion in 2014, of which 62 per cent came from private investment and 38 per cent came from public climate finance (Figure 16.8). Public actors can set the groundwork for global climate finance by reducing the costs and risks of climate investments, strengthening knowledge and technical capacity, and paving the way in new technologies and enhancing the confidence in such investments.

Carbon pricing policies, such as carbon taxes or emissions trading combined with auctioning of allowances, are all promising concepts in their scope to mobilize larger private investment. The use of pricing policies can alter incentives such that low-carbon technologies become more competitive, thereby levelling the playing field for private companies committing to these substantial investments.

An innovative tool for generating climate finance is cap-and-trade schemes. The 'cap' sets a limit on the quantity of emissions that a company can release. The idea is that this limit is lowered over time as companies become more efficient and less pollutive. The 'trade' element creates a market for emission allowances, incentivizing companies to maximize their energy efficiency and come in under their allocated limit. In doing this, they are able to profit from selling their unused credit on the carbon markets. The scheme also creates incentive for project developers to invest in low-emissions projects (these include renewable energy, waste management, reforestation) as these generate carbon offsets which can also be sold on the carbon markets.

Overall, the size of these markets remains small and is yet to become mainstream. The total value of the carbon market reached a peak of US$ 176 billion in 2011. However, since then, external factors (Euro Zone recession and commodity markets slump) have driven down the price of carbon credits, limiting their capacity to incentivize good practices. Low carbon prices mean that, left to market forces, existing technologies largely remain more attractive than green technologies.

16.3.3 New Financing Instruments

The Post-2015 FfD Agenda also addresses the need for innovation of new financial instruments. Instruments should be constructed such that they facilitate investment from specific target markets. Some of the examples include diaspora bonds, infrastructure bonds and blended finance.

Diaspora bonds and remittance-backed bonds have the potential to direct diaspora funds into infrastructure projects and other development projects in diaspora home countries. Diasporas tend to have lower perceptions of risk compared to traditional investors, due to existing ties to their home countries. This, combined with a certain willingness to 'give back' to their country of origin can help lower the cost of these funds. Evidence of home bias also makes these investments more stable than traditional foreign financing.[13]

India and Israel have been the first countries to successfully pioneer this funding strategy. Diaspora funds in India saved it from a 1991 BOP crisis and raised US$ 4.2 billion in 1998 to offset international sanctions imposed after nuclear tests, double the amount initially sought.[14] However, emulating their success has yielded mixed results. In 2009 and 2010, Nepal raised a fraction of its target when it offered yields below 10 per cent over five years on rupiah bonds, well below local rates at the time.[15] Moldova also decided against issuing diaspora bonds, concluding that Moldovans abroad who were willing to invest in its currency would prefer local bank accounts that pay 25 per cent interest.[16] The failure of Ethiopia's 2009 bond to fund a hydro-electric dam was attributed to the government's inability to convince investors it would repay the debt. The more recent second issuance raising funds for the Grand Ethiopian Renaissance Dam (GERD) aims to dispel these fears with new features such as payment of interest every six months. The bond also comes in denominations as small as US$ 50, ensuring that participation is not exclusive to wealthier citizens.[17]

Getting the pitch correct requires investment in knowledge of the diaspora's ties back home as well as their size, income and wealth characteristics. There are instances of countries attempting to build this capacity - Georgia as an example, established a Ministry of Diaspora Affairs and organises regular diaspora events in the capital. Maintaining diaspora ties to the country is essential as the first step to tapping into these capital flows.

Infrastructure bonds are another means of tapping funds for infrastructure investment in

13 Okonjo-Iweala, N., and D. Ratha (2011), "A Bond for the Homeland," *Foreign Policy*, May 24, 2011.

14 Ratha, D. (2007), "Development Finance via Diaspora Bonds: Track Record and Potential", Policy Research Working Paper 4311, World Bank, Washington, D.C.

15 Rahman, M. and T. Yong (2015), *International Migration and Development in South Asia*, Routledge.

16 Reuters (2016), "Countries Look to Draw Expatriate Cash with Diaspora Bonds", available at http://www.reuters.com/article/us-emerging-bonds-diaspora-idUSKCN0XE0ID.

17 Fatunla, D.M. (2012), "Are Diaspora Bonds Worth the Risk for Diaspora Africans?", available at http://www.huffingtonpost.com/dele-meiji-fatunla/diaspora-bonds-in-africa_b_1377010.html.

Table 16.1
Investment Needs and Private Sector Participation in Developing Countries

	2015 - 2030				
Sector	Estimated Current Investment (latest available year) $ billion	Total Investment Required	Investment Gap	Average Private Sector Participation in Current Investment	
		Annualized $ billion (constant price)		Developing Countries	Developed Countries
	A	B	C = B - A	Per cent	
Power	~260	630-950	370-690	40-50	80-100
Transport	~300	350-770	50-470	30-40	60-80
Telecoms.	~160	230-400	70-240	40-80	60-100
Water and sanitation	~150	~410	~260	0-20	20-80

Source: UNCTAD (2014), *World Investment Report 2014*, United Nations, New York and Geneva.

developing countries. New forms of financing can be achieved through the mobilization of local currency bond markets to issue project-specific bonds. The benefits lie in that they secure capital for a specific project. Repayments should also come from revenues generated by the project; thereby insulating the investment from the performance of other projects.

In order for these types of investment to flourish, governments need to establish the appropriate regulatory, supervisory and tax frameworks. For example, improving investment conditions and enhancing local market liquidity through government bonds will create stimulus for the growth of corporate bond markets. Thriving local bond markets ultimately facilitate infrastructure and asset-backed financing.

The success of these financial instruments often incorporates some form of public sector participation. For example, the success of infrastructure bonds in Chile and Peru stems partly from the presence of various guarantees.[18] In Peru, these were issued by the project operator as the project advances and carry a government certificate of completion. Peruvian pension funds were allowed to invest in these bonds from 2001 and have since established an infrastructure trust fund to invest in project debt.

In Africa, with the main exception of South Africa, pension funds are still relatively new and infrastructure project investments are very few and highly restricted by regulations. However, progress is taking place slowly. Since 2009, the Kenyan government has issued five infrastructure bonds targeted at specific infrastructure projects. The bonds have maturities ranging from 8-20 years and have been packaged with more incentives than typical government bonds. These bonds have proved popular with pension funds, which have taken significant portions of the total issue. In addition, a Kenyan energy generating company (Kengen Ltd.) issued an infrastructure bond in 2009 to fund a number of new projects. The bond issuance raised more than 160 per cent

[18] Stewart,F. and J. Yermo (2012), "Infrastructure Investment in New Markets: Challenges and Opportunities for Pension Funds", OECD Working Papers on Finance, Insurance and Private Pensions, No. 26, OECD, Paris.

of the original target; pension schemes accounted for around 40 per cent of the total take-up.[19]

Blended finance is another option. Neither the public sector nor private sector is able to fill the financing gap alone. Blended finance use development finance to mobilize private capital flows to developing countries. Blended finance instruments serve to lower investment-specific risks. A recent survey of blended finance funds identified 74 pooled public and private funds, accounting for a total of US$ 25.4 billion in committed assets.[20] These funds are already having an impact in sectors where blended finance occurs most often, including climate resilience and clean energy; financial services; food and agriculture; healthcare; and infrastructure.

The construction and use of blended finance instruments requires careful planning. Outcomes in the past have seen the public sector taking on all the risk whilst the private sector earns the returns.[21] Projects involving blended finance, including PPPs, should share risks and reward fairly, include clear accountability mechanisms and meet social and environmental standards.

16.4 Conclusion

The outcome document adopted at the Financing for Development Conference in Addis Ababa set out a blueprint for financing the needs of sustainable development. Resources must be channelled into these 'new' forms of financing to plug the funding gap left by traditional forms of development finance.

The MDGs process was relatively successful for Sri Lanka. By 2013, Sri Lanka was on track to achieve 24 of the 26 targets laid out. However, the MDGs were less demanding for Sri Lanka due to the head start it had in a number of key areas including health and education. As early as the 1950s, policies had been in place to develop these areas and, therefore, the funding required to meet these goals was very achievable without recourse to the steps described. The SDGs by comparison pose a significant challenge for Sri Lanka, particularly in light of the country's weak domestic public finance situation. Furthermore, Sri Lanka's

The SDGs, by comparison to MDGs, pose a significant challenge for Sri Lanka, particularly in light of the country's weak domestic public finance situation.

[19] OECD (2015), "Risk and Return Characteristics of Infrastructure Investment in Low Income Countries", OECD, Paris.

[20] WEF and OECD (2015), "Blended Finance: A Primer for Development Finance and Philanthropic Funders", OECD, Paris.

[21] UN (2014) Report of the Intergovernmental Committee of Experts on Sustainable Development Financing.

graduation from low income to middle incomes status in January 2010 limits its access to concessional funding sources and thereby increases its reliance on international capital markets and other non-concessional sources of borrowing. In light of these trends, Sri Lanka needs to look to less traditional forms of financing in order to effectively meet its funding needs.

Sri Lanka is still relatively inexperienced in the new financing instruments explored in this chapter. Two potential areas that can be looked at in the near term are various types of bonds as financing instruments and raising volumes of remittances through lower transfer costs. In February 2009, the country attempted to generate funds from issues of diaspora bonds; however, the context of the final stages of the war and strained relations with sections of the diaspora organizations would have hampered demand significantly. Now, far-removed from these factors, Sri Lanka can re-examine opportunities to diversify its bond offering into diaspora bonds and infrastructure bonds.

Remittances are an important source of savings and investment for Sri Lanka. The main remittance transfer corridors for Sri Lanka are Australia, Canada, Italy, Qatar, Saudi Arabia, Singapore, Switzerland, UAE and United Kingdom. Transfer costs range from 14.6 per cent and 8.9 per cent in Switzerland and Australia to just 2.9 per cent in Singapore. For many higher cost source countries, averages are skewed by uncompetitive high bank charges in comparison to more specialized Money Transfer Operators. However, even excluding the banks, transaction costs from several of these source destinations are higher than the 5 per cent target cap level and, therefore, a reduction in line with FfD targets will ensure benefits in terms of encouraging remittance flows into Sri Lanka.

[22] Data available at https://remittanceprices.worldbank.org/.