The impact of the coronavirus (COVID-19) crisis on development finance

24 June 2020

This note discusses the consequences of the COVID-19 crisis on financing for sustainable development in low- and middle-income countries eligible for official development assistance (ODA). Levels and trends in domestic and external financing already fell short of the SDG spending needs prior to the COVID-19 crisis. The current global context, however, risks a significant reduction in the financing available to developing economies. In sum, external private finance inflows to developing economies could drop by USD 700 billion in 2020 compared to 2019 levels, exceeding the immediate impact of the 2008 Global Financial Crisis by 60%. This exacerbates the risk of major development setbacks that would, in turn, increase our vulnerability to future pandemics, climate change and other global public bads. While official development finance is an important countercyclical force in the short-term and tax revenues remain the only long-term viable source of financing for many public services, no single source of development finance can take up this challenge alone. Actors in development finance and beyond need to collaborate closely to “build back better” for a more equitable, sustainable and thus resilient world.

Introduction

Prior to the COVID-19 crisis, levels and trends in domestic revenues and external flows to developing economies were already considered insufficient to support the Sustainable Development Goals (SDG). With high levels of public debt and additional pressures induced by the pandemic on all major sources of development finance, low- and middle-income countries may struggle to finance their public health, social and economic responses to COVID-19. Early observations point to massive debt and equity outflows from developing economies that accompany a drop in remittances, and ripple effects on domestic finance already solicited by the unfolding public health and economic crises. In this challenging context, how can we avoid a development finance collapse that would send millions back into poverty, and compromise our capacity to reach the SDGs, our common blueprint for a stronger, fairer, and more sustainable world?

This note draws upon research carried out in the context of the *OECD Global Outlook on Financing for Sustainable Development* (OECD, forthcoming[1]) and outlines the current and projected impact of the COVID-19 pandemic on major sources of financing required to deliver support to developing economies.

Key messages

- **The COVID-19 crisis is hitting developing economies at a critical moment.** Prior to the crisis, financing had already fallen short of the spending needs to achieve the SDGs by 2030, and fiscal space was limited by rising public debt levels and servicing costs.
- **The COVID-19 crisis risks creating major setbacks in financing for sustainable development. Domestic resource mobilisation will suffer as economic activity is reduced.** Inflows of external private finance are projected to drop by USD 700 billion compared to 2019 levels, exceeding the impact of the 2008 Global Financial Crisis by 60%. Fiscal space is likely to narrow further with rising domestic spending and exchange rate movements against the USD.
- **In the short term, official development finance should be leveraged to contain the drop in other sources of financing.** Already scarce resources coupled with the economic impact of the crisis imply that developing economies might struggle to finance adequate public health and social and economic responses. No single source of financing will be enough to close the COVID-19 financing gap.
- **In the medium-term, actors in development finance and beyond need to collaborate closely to "build back better" for a more equitable, sustainable and thus resilient world.** In development finance, while domestic resource mobilisation will remain the only long-term viable source of financing for many public goods and services, building back better will require action from all financing sources with the common goal to aid national sustainable development strategies. Beyond development finance, there is, for instance, a need to revitalise trade and, in the case of small island developing states, promote a sustainable ocean economy.

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The coronavirus (COVID-19) pandemic is hitting developing economies at a critical moment

At the onset of the COVID-19 crisis, financing for sustainable development was already in a critical condition (OECD, 2018[2]). In 2014, UNCTAD had estimated the SDG financing gap in developing economies at USD 2.5 trillion (2014[3]). More recently, Gaspar et al. (2019[4]) estimated that low-income countries would need to spend, on average, an additional 15.4 percentage points of gross domestic product (GDP) and emerging economies an additional 4 percentage points of GDP to fill their SDG spending gaps. While the gap can be explained in part by sub-par spending efficiency, it is well established that pre-COVID-19 levels of domestic and external resources were insufficient to meet the SDGs (UN SG, 2019[5]). In addition, margins of manoeuvre to close the gap had been limited by high debt levels.

Pre-COVID-19 domestic finance

Prior to the COVID-19 crisis, tax revenue, the major form of domestic public resources and single largest source of development finance, had been insufficient in a large number of countries, particularly in comparison to the SDG spending needs. Out of 124 countries eligible for official development assistance (ODA) with published data on tax revenue in 2017,[1] more than one third (46) have had tax-to-GDP ratios below 15%, which is a widely considered benchmark for effective state functioning and to promote economic development (Gaspar, Jaramillo and Wingender, 2016[6]). Almost two-thirds of countries in this sample (79) had collected tax revenue below 20% of GDP.[2]

Further, it appears that average growth in tax revenue to GDP had decelerated in recent years. For a sample of 26 African countries, unweighted average tax-to-GDP ratios had remained stagnant at around 17.2% between 2015 and 2017 (OECD, 2019[7]). In response to the Global Financial Crisis in 2008-09, average tax revenue declined in lower and upper middle-income countries (Figure 1). Since then, average revenue collected as a share of national income had not fully recovered with average growth remaining bumpy and fairly stagnant over a medium perspective. In contrast, low-income countries experienced more persistent increases in average tax revenue over 2002-17 but growth had decelerated somewhat after 2012. In Latin America and the Caribbean, tax revenues had been slowly increasing as a result of favourable economic conditions in 2017 and 2018, but the more recent resource price falls and social unrest meant that the revenue outlook had been weakening even prior to the COVID-19 crisis (OECD et al., 2020[8]).

Other domestic resources similarly provide important financial means for spending and investment in support of sustainable development. Analysis carried out for the OECD *Global Outlook on Financing for Sustainable Development* (OECD, forthcoming[1]) suggests that domestic savings had been increasing in developing economies as a share of GDP between 2016-18 but savings had remained significantly smaller in low-income than middle-income countries. Domestic private investment is the main source of fixed capital formation but data availability is only comprehensive for around one-third of developing economies. The domestic financial sector plays a central role in intermediating savings and borrowing (respectively investment) but access to financial institutions and markets had remained more limited in low- and lower middle-income countries, and borrowing costs are often high.

[1] A total of 143 countries are ODA-eligible in 2020. Our data complements the OECD Global Revenue Statistics Database with IMF World Revenue Longitudinal Data and ICTD/UNU-WIDER Government Revenue Dataset.

[2] We are aware of tax-to-GDP benchmarks in the literature ranging from 12.5% to 25% of GDP. Such benchmarks are not definite and are generally based on cross-country comparison. The “optimal” level of tax revenue depends on the specific country context. Using a data set including more countries, Prichard (2016[63]) finds that 65 countries collected less than 15% of GDP in non-resource taxation.

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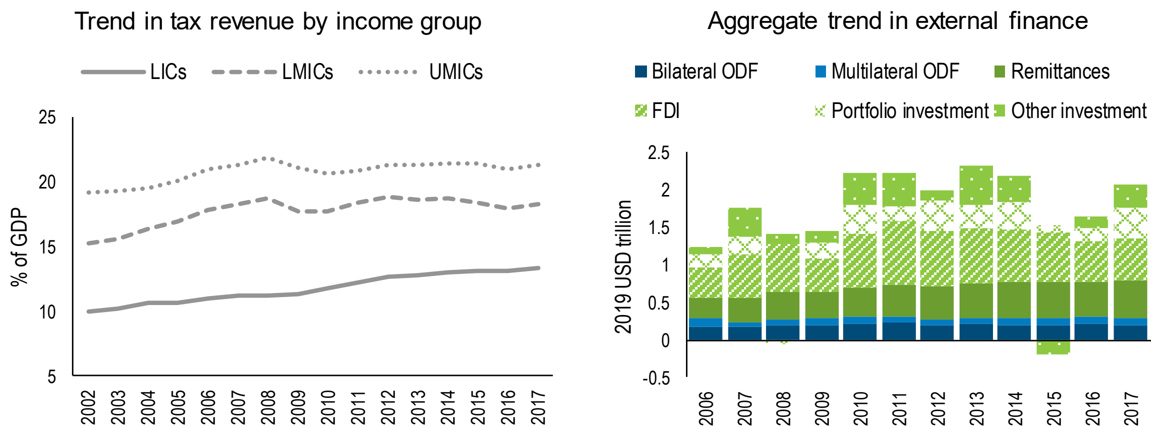
Figure 1. Pre-coronavirus (COVID-19) tax revenue and external finance had stagnated in ODA-eligible countries



Note: The left panel shows unweighted average tax-to-GDP ratios for 113 countries (i.e. balanced panel). World Bank classification for income groups is used. In the right panel, the largest sample possible for ODA-eligible countries was used for each year. Based on research for the *Global Outlook on Financing for Sustainable Development* (forthcoming[1]).

Source: Tax revenue based on OECD Global Revenue Statistics Database (2020[9]), IMF World Revenue Longitudinal Data (2020[10]) and ICTD/UNU-WIDER Government Revenue Dataset (2020[11]). Official development finance based on OECD DAC Tables 2a and 2b (2020[12]). Remittances based on KNOMAD Remittances Inflows (2020[13]). Foreign direct investment, portfolio investment and other investment are from IMF Balance of Payments (2020[14]) and refer to net incurrence of liabilities. World Bank World Development Indicators (2020[15]) are used to impute missing data on foreign direct investment.

Pre-COVID-19 external finance

The pre-COVID-19 situation had been similarly grim for net inflows of external finance received by low- and middle-income countries. While overall external finance had recovered from a sudden stop of capital flows in 2015 driven by slowing growth in emerging economies and stock market turbulence following a devaluation of the renminbi, the USD 2 trillion of total external finance observed in 2018 had remained below the 2013 peak (Figure 1, right panel). More specifically, foreign direct investment (FDI), portfolio investment and other investment (to a large part bank lending) had been lower than in 2013. In the same period, official development finance had remained stable and remittances had increased.

Pre-COVID-19 debt levels

Fiscal space to increase resources had become limited in a number of countries in the years preceding COVID-19. Median **public debt** among 59 countries classified as low-income developing economies by the IMF had risen from 38.7% of GDP in 2010-14 to 46.5% in 2017 and had stagnated subsequently (IMF, 2019[16]). For the same group of countries, debt servicing had represented, on average, 12.2% of government revenue in 2018, up from 6.6% in 2010 (Griffiths, 2019[17]). African countries experienced the highest debt-to-GDP ratios since countries in the region had received substantial debt relief through programs such as the Heavily-Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) (Calderon and Zeugack, 2020[18]). According to UNCTAD (2019[19]), total external debt stocks of developing economies and economies in transition had more than doubled from USD 3.5 trillion in 2008 to USD 8.8 trillion in 2018, or from 22% of GDP to 29%. As of late 2019, 33 out of 69 countries for which analysis had been carried out were classified “in debt distress” or at “high risk” (IMF and World Bank, 2019[20]).

In parallel, private debt levels had also been rising sharply (UNCTAD, 2019[19]). Across developing economies, according to UNCTAD, private debt increased from 79% of GDP in 2008 to 139% in 2017.

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This increase was particularly steep in a number of emerging economies[3] for which corporate debt had risen from 83% of GDP in 2008 to 145% of GDP in 2018. While much of the overall private debt is accumulated in so-called high-income developing economies (corresponding somewhat to the World Bank's upper middle-income classification), private debt levels had also risen in middle- and low-income developing economies and had done so at a faster rate than public debt levels.[4]

With limited resources and fiscal space, the COVID-19 pandemic could push developing economies into great financial difficulties. Not only does the crisis demand large financing to cushion the negative health, social and economic consequences, it will also likely widen the SDG financing gap for years to come when previous progress to achieve sustainable development is reversed and available financing declines.

Coronavirus (COVID-19) risks major setbacks for financing for sustainable development

Domestic resource mobilisation is likely to suffer as economic activity plunges

The ongoing public health and economic crises will further deplete low- and middle-income countries' domestic public resources by affecting tax and non-tax revenues. We calculate that in response to the Global Financial Crisis, median tax revenue to GDP had declined by 1 percentage point, or 5.8%, between 2007 and 2010 for a subsample of 113 ODA-eligible countries for which time series data is available. At present, there are concerns that domestic public revenues could be hit more strongly as a consequence of the COVID-19 crisis due to the combined effect of several mechanisms:

- The plunge in global and domestic economic activity[5] affects all major sources of tax revenue. Estimates on tax buoyancy suggest that tax revenues could contract more strongly than economic output (OECD, 2020[21]). Lower corporate profits, declining consumption and increases in unemployment will, respectively, cause declines in revenue from corporate income taxes, goods and services taxes and personal income taxes (Kapoor and Buiter, 2020[22]). The decline in international trade, travel and domestic consumption will suppress revenue from consumption taxes on which the majority of low- and middle-income countries rely. The World Trade Organisation (WTO) projects global merchandise trade could decline by 13-32% in 2020 (WTO, 2020[23]). According to the World Tourism Organisation (UNWTO), international tourist arrivals

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[3] The emerging market economies referred to comprise Argentina, Brazil, Chile, China, Colombia, Czech Republic, Hong Kong (China), Hungary, India, Indonesia, Israel, Malaysia, Mexico, Poland, the Republic of Korea, the Russian Federation, Saudi Arabia, Singapore, South Africa, Thailand and Turkey.

[4] According to UNCTAD classifications (n.d.[64]) high-income developing countries are those with an average GDP per capita of more than USD 5 312 between 2013 and 2015, resembling an "upper" part of the World Bank's upper-middle income countries classification. Middle-income developing countries, respectively, are countries with an average GDP per capita between USD 1 181 and USD 5 312. Low-income developing countries are those with an average GDP per capita below USD 1 181. For comparison, for the current 2020 World Bank fiscal year, low-income countries are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of USD 1 025 or less in 2018; lower middle-income economies are those with a GNI per capita between USD 1 026 and USD 3 995; upper middle-income countries are those with a GNI per capita between USD 3 996 and USD 12 375; high-income economies are those with a GNI per capita of USD 12 376 or more (World Bank, n.d.[65]).

[5] In its more optimistic scenario, the OECD predicts a 6% contraction of world GDP in 2020 (OECD, 2020[66]). The World Bank (2020[67]) forecasts a recession of 5.2% of world GDP in 2020. For emerging market and developing economies, the World Bank expects an economic contraction of 2.5%. For comparison, in 2009 world GDP contracted by only 0.1% and output grew by 2.8% among emerging market and developing economies. Low-income developing economies are expected to grow by just 1% in 2020, down from an initial projection of 5.4% growth in January 2020.

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could fall by 60-80% in 2020 compared to 2019 (UNWTO, 2020[24]).[6] Shifting consumption during recessions towards goods that are often subject to reduced rates or exemptions could further decrease consumption tax revenue (Simon and Harding, 2020[25]).

- Many resource-rich countries who derive a high share of tax and non-tax revenues from commodities and natural resources will be particularly affected by the significant drop in global commodity prices (OECD, forthcoming[26]). Compared to GDP, low-income countries rely more strongly on natural resource rents than other income groups (Steel and Phillips, 2020[27]), and this dependence has increased over recent years (UNCTAD, 2020[28]).
- Governments are implementing a range of tax measures to lessen the burden on taxpayers and keep the cash-flows of businesses running; however, at the expense of lower public revenue, at least in the short-term. Measures include deadline extensions, payment deferrals and accelerated tax refunds (OECD/FTA, 2020[29]). As of mid-April 2020, 104 countries (including 46 ODA-recipients) had implemented tax relief measures (OECD, 2020[30]).

Taken together, these mechanisms could drastically lower domestic resource mobilisation in developing economies. For sub-Saharan Africa, World Bank (2020[31]) calculations suggest that government revenues could decline by 12% to 16% compared to a non-COVID-19 baseline scenario. As a consequence, fiscal deficits could deteriorate by about 2.7 to 3.5 percentage points of GDP. First evidence from monthly data supports this impression. In Peru, tax revenue decreased by 40% year-on-year in April 2020, while in Jordan, overall government revenue decreased by 49% year-on-year in April 2020.

Other domestic resources beyond public revenue will be affected, too. Domestic private investment is likely to decline due to the high degree of economic uncertainty, contraction of economic output, and binding liquidity constraints. The effect of the 2020 crisis on domestic savings depends on the relative change in consumption to that of national income. As one point of reference, gross domestic savings as a share of GDP had declined after the financial crisis in 2008 (OECD, forthcoming[1]).

External private finance is falling in the midst of global economic turmoil

The 2008 Global Financial Crisis showed that external finance to low- and middle-income countries is vulnerable to shocks. During the crisis, portfolio and other investment inflows instantly dropped (or even reversed to negative), while remittances and FDI decreased with a delay of one year (Figure 1). Current evidence suggests a greater and more immediate impact of the COVID-19 crisis. While countries will feel this impact differently depending on their respective finance mix and level (Figure 2), all are expected to experience financing drops.

[6] WTO (2020[68]) provides an analysis on the effects of declining global trade in 2020 on least developed economies. The drop in global tourism will be felt particularly in tourism-reliant economies such as many small developing island states. Tourism is a particularly labour-intensive sector and millions of jobs are at risk due to the decline of activity (UNWTO, 2020[24]). Additionally, tourism exports are a vital source of foreign currency so that the decline could lead to balance of payments problems.

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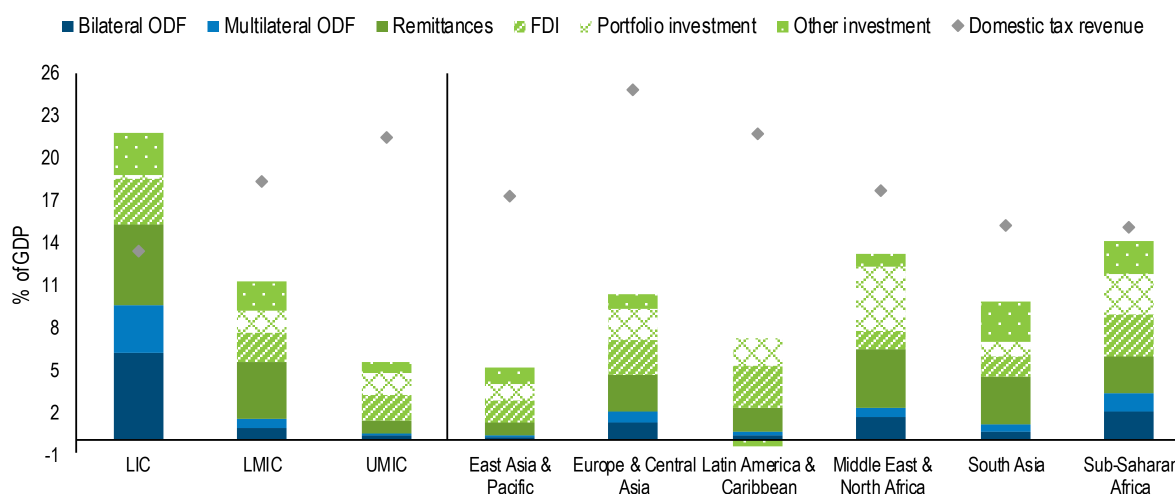
Figure 2. The finance mix and level in ODA-eligible countries differs by income group and region



Note: The values represent averages across the % of GDP levels of the country group members. For the external finance share, this average is weighted by GDP. Weighting was not performed for the tax revenue figure to ensure consistency with other OECD publications. World Bank classification for income and regional grouping.
Source: Tax revenue based on OECD Global Revenue Statistics Database (2020[9]), IMF World Revenue Longitudinal Data (2020[10]) and ICTD/UNU-WIDER Government Revenue Dataset (2020[11]). Official development finance based on OECD DAC Tables 2a and 2b (2020[12]). Remittances based on KNOMAD Remittances Inflows (2020[13]). Foreign direct investment, portfolio investment and other investment are from IMF Balance of Payments (2020[14]) and refer to net incurrence of liabilities. World Bank World Development Indicators (2020[15]) are used to impute missing data on foreign direct investment.

External private investment plummeted following the 2008 Global Financial Crisis. It is thus not surprising that we already see that the global economic fallout from COVID-19 has led to a flight to safety. However, the magnitude of this short-term reaction is unprecedented:

- In March 2020 alone, the IIF Capital Flows Tracker (IIF, 2020[32]) observed USD 83.3 billion of non-resident portfolio outflows from emerging markets. This is twice as high as the non-resident portfolio outflows after the 2008 Global Financial Crisis and more than the cumulative non-resident portfolio inflows to emerging markets in 2019. For now, this unprecedented outflow episode seems to have halted. Debt flows to emerging markets recovered in April and May 2020, and although outflows of equity continued, this has happened at a slower pace. Yet, the extent of this recovery is minor compared to the March outflows, so that cumulative portfolio outflows remain large (IIF, 2020[33])
- OECD analysis indicates a significant slowdown across all FDI components (OECD, 2020[34]). On the one hand, FDI via reinvested earnings, an increasingly important FDI component, is likely to suffer, but the impact varies greatly across sectors. According to Refinitiv (2020[35]), there will be large year-over-year drops in multinational earnings in the energy, consumer discretionary, industrials and materials sectors. Multinationals in the health care, technology and communications sectors will, however, see increased earnings. As the primary and manufacturing sector are especially prominent in FDI flows to developing economies, these countries are likely to be hit harder. On the other hand, FDI flows will be impacted due to adjustments in equity capital flows, regardless of the mode of entry. First, completed cross-border mergers and acquisitions dropped globally in the first quarter of 2020. Second, announced FDI greenfield investment, which for developing economies is more important than cross-border mergers and acquisitions, declined significantly in the first two months of 2020. With the whole world having entered lockdown in March, the effect is likely to have magnified since (OECD, 2020[34]).

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Projections for external private investment support this foreboding evidence. Portfolio and other investment flows are not likely to recover quickly, given that the COVID-19 pandemic is still unfolding in most developing economies, possibly leading to a second wave of portfolio outflows and further reduced capital inflows. Even if international capital flows recover in the second half, the IIF (2020[36]) projects portfolio and other investment flows to drop by 80% and 123% compared to 2019, respectively. OECD projections indicate that even in the most optimistic scenario, global FDI will drop by at least 30%, with flows to developing economies likely falling more strongly (OECD, 2020[37]). The World Bank (2020[38]) projection of a 35% drop of FDI flows to developing economies supports this figure. After the financial crisis of 2008, global FDI dropped with a lag of one year and affected developed economies more adversely than developing ones. This time, the impact on FDI will be immediate. It will also hit the weakest hardest, as sectors most prominent in FDI flows to developing economies will be most affected.

For **remittances**, the COVID-19 impact is expected to be immediate and stronger than the 7% year-on-year drop observed in 2009. Again, the first few months since the outbreak of the pandemic gave an indication of the magnitude of the impact. While remittances to Mexico have proven to be relatively resilient so far, a different picture emerges when looking at the top three countries in terms of remittances as a share of external finance – Guatemala, El Salvador and Kyrgyzstan. In these three countries, the largest monthly year-on-year drop of remittances between 2007 and 2009 ranged from 16% to 34%. For April and May 2020, the same data already show record year-on-year drops ranging from 20% to 62%.

The main reason for this impact is that sending countries experience unprecedented economic shocks which translate into lower incomes of individuals transferring remittances. In the United States, the country from which most remittances originate, job losses within only four weeks since mid-March 2020 equalled the number of jobs that had been created since the 2008 Global Financial Crisis (CNBC, 2020[39]). Similarly, migrants' jobs will be at risk as oil-dependent sending countries will struggle due to the oil-price drop that again topped the post-2008 experience (UNCTAD, 2020[28]). The current recovery from this oil-price drop is slow, with rising oil-prices in May 2020 being well below pre-COVID-19 levels (IEA, 2020[40]). Despite the COVID-19-induced US dollar appreciation partially counteracting these effects, the World Bank (2020[38]) projects that remittances to developing economies will shrink by 20% in 2020 compared to 2019.

Altogether, **projections suggest that inflows of external private finance to ODA-eligible countries in 2020 could plunge by USD 700 billion compared to 2019 levels** (see Figure 3). With all sources of external private finance falling immediately, this presents an unprecedented pressure and financing void for developing economies, exceeding the post-2008 Global Financial Crisis experience by 60% and equalling 35% of the 2018 level of external finance.

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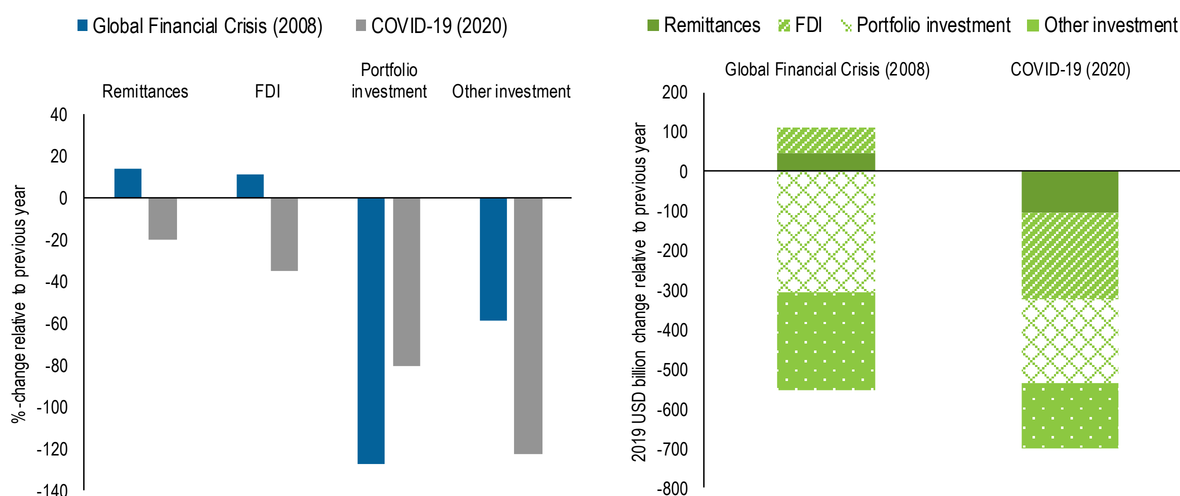
Figure 3. The overall COVID-19 impact on external private finance in developing economies is estimated to be USD 700 billion and could exceed the impact of the 2008 financial crisis by 60%

Change in net inflows relative to pre-crisis year



Note: All data refer to ODA-eligible countries as of April 2020. The sudden stop of capital flows in 2015 is not shown here, as it would have included a USD 556 billion drop relating only to the People's Republic of China. For details on the estimated COVID-19 impact on external private finance, the interested reader is referred to the Methodology.
Source: Historical remittance data based on KNOMAD Remittances Inflows (2020[13]). Historical foreign direct investment, portfolio investment and other investment are from IMF Balance of Payments (IMF, 2020[14]) and national central bank data, and refer to net incurrence of liabilities. World Bank World Development Indicators (2020[15]) are used to impute missing data on foreign direct investment. COVID-19 projections are based on combining historical data with projections from World Bank (2020[38]) (remittances and FDI) and IIF (2020[36]) (portfolio and other investment).

Official development finance can be a catalytic resource during the crisis but could be under budget pressure too

Official development finance has proven to be a key resource and countercyclical flow in past crises (OECD, 2020[41]). Official development assistance (ODA), in particular, has played a key role in promoting health and social protection systems in developing economies – which are among the central pillars for countries' response to COVID-19. While the global economic recession, declining public revenue and the fiscal stimulus implemented by members of the Development Assistance Committee (DAC) could pressure ODA levels, DAC members have declared their ambition to "strive to protect ODA budgets" during the COVID-19 crisis (DAC and OECD, 2020[42]).

Ultimately, how official development finance will evolve in 2020 is a question of political will and global solidarity (OECD, 2020[41]). Since many ODA budgets had been finalised before the outbreak of COVID-19, the effect of the global economic recession on ODA levels might not be immediate but lagged. The OECD (2020[41]) has outlined three possible scenarios how ODA levels could evolve in 2020:

- Many countries have signalled political commitment in support of a global sustainable recovery. The COVID-19 crisis has exposed the interdependence of countries and the importance of global public goods. Increased solidarity could lead to increases in total ODA levels and would, in turn, increase ODA as a share of gross national income (GNI).
- As highlighted in its statement, DAC members have expressed their will to protect ODA levels. In fact, OECD DAC Peer Reviews have previously found that protecting aid budgets against short-term shocks to public finance is an established practice. If ODA levels were to be maintained at

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2019 levels, the ratio of DAC members' ODA over GNI would increase from 0.29% in 2019 to about 0.32% in 2020.

- Given DAC members' own budget pressure in 2020, the overall level of ODA could decline in 2020. The OECD calculates that if DAC members were to keep the same ODA to GNI ratios as in 2019, total ODA could decline by USD 11 billion to USD 14 billion, depending on a single- or double-hit recession scenario on member countries' GDP.

Fiscal space is likely to narrow further with rising domestic public spending and exchange rate movements against the dollar

The current crisis and trends in financing for sustainable development are exacerbating the limited fiscal space already facing many low- and middle-income countries.[7] Both the public health crisis and the socioeconomic shock necessitate large and immediate public spending on health, social protection, and economic relief and liquidity, not to mention the amounts that will be required in the post-crisis recovery. For instance, were African countries to implement the same (proportional) fiscal measures adopted by the largest EU economies, the OECD estimates that debt levels in Africa, all else remaining constant, would increase from 57.6% of GDP in 2019 to about 85% (OECD, 2020[21]). With rising spending needs and declining revenue, public debt is likely to increase further and sizeably in many countries. The risk of debt distress is particularly pronounced in the region's fragile and oil-rich countries, where a significant share of public debt is short-term and expensive, often extended on non-concessional terms by private creditors and with repayment sometimes tied to strategic natural assets (OECD, forthcoming[26]).

Increases in debt servicing costs will further reduce the available fiscal space. Debt servicing costs had already risen before the crisis (Griffiths, 2019[17]) but the devaluation of many countries' currencies against the US dollar raises debt servicing costs as almost two-third of public external debt is USD denominated in low- and lower middle-income countries (IIF, 2020[43]). Adjusted risk evaluations and downgrades in countries' sovereign credit score as a result of the COVID-19 pandemic could further increase the cost of public borrowing, and limit countries' ability to mobilise fiscal resources on international capital markets.

Overall, the described divergence in available financing (supply) and spending needs (demand) amplifies the so-called "scissor effect" of sustainable development finance identified in OECD (2018[2]) which refers to a simultaneous drop in available financing and increase in SDG spending needs.

Short-term relief: Mobilise all sources of finance to meet the pressing needs

Already scarce resources coupled with the prospected impact of the COVID-19 crisis, imply that developing economies might struggle to finance adequate public health, social and economic responses. In the short term, official development finance will play an important countercyclical role – just as it has done in previous crises of global scale (Horn, Reinhart and Trebesch, 2020[44]). Indeed, multilateral and bilateral donors have taken first steps to support developing economies:

- The **International Monetary Fund (IMF)** has announced over USD 100 billion in emergency lending and USD 1 trillion it could mobilise for its members. The **World Bank Group** will lend about USD 150 billion in the next 15 months.[8]
- Despite tightening national budgets due to increased domestic spending, **members of the DAC** have declared to "strive to protect ODA budgets" (DAC and OECD, 2020[42]). Recent COVID-

[7] Fiscal space refers to the "room for undertaking discretionary fiscal policy relative to existing plans without endangering market access and debt sustainability" (IMF, 2018[69]).

[8] For more information, see IMF (2020[70]), IMF (2020[71]) and World Bank (2020[72]), World Bank (2020[73]).

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related commitments by bilateral donors might therefore reflect shifts in already planned assistance towards the health sector rather than increasing ODA budgets. Although crisis related funding seems to not have diverted ODA-funding from other areas in recent health crises such as the H1N1 pandemic and the Ebola outbreak (OECD, forthcoming, 2020[45]), limited capacity in partner countries' health sectors have meant stark consequences on other health areas: For example, in the space of 18 months, the Ebola outbreak in Guinea, Liberia and Sierra Leone led to a 75 per cent increase in maternal mortality across the three countries due to resources being diverted from the reproductive and maternal health sector (Davis and Bennett, 2016[46]). Thus, DAC members need to remain attentive to not only supporting the COVID-19 response but also to helping partners maintain all essential health services.[9]

- The G20 have announced a freeze on debt payments by the 76 IDA-eligible countries (G20 FMCBG, 2020[47]). The OECD estimates that the **G20 debt moratorium** will delay payments to public bilateral creditors worth USD 16.5 billion (OECD, 2020[48]).

However, the official development finance response has room for improvement. IMF members have so far not agreed to an allocation of special drawing rights of a similar or higher scale as in 2009. Bilateral donors are yet to show willingness to increase their ODA commitments which would be critical to avoid negative consequences when diverting funds from other important areas in support of the COVID-response. The G20 debt moratorium so far fails to engage multilateral and private actors in pausing debt payments, and ignores emerging economies that also face severe debt distress. The G20 could look at mobilising all sources of finance, including the private sector, and highlighting principles of development co-operation (effectiveness, ownership), with modalities such as south-south and triangular co-operation.

Even without these shortcomings, it will be crucial not to solely rely on official development finance in providing relief. The IMF (2020[49]) estimates that emerging economies will require at least USD 2.5 trillion of funding with reserves and domestic resources insufficient to meet these needs. **No single source of finance will be sufficient to close this COVID-19 financing gap.** It will require coordinated policy responses across all sources of the finance mix to "stop the bleeding" and avoid a collapse of financing for development that would trigger major setbacks in our collective progress towards the SDGs and a more resilient world to future global shocks. Official development finance will therefore need to be complemented along the following dimensions:

- A range of **tax policy and administration** measures can support governments' responses to maintain household and business liquidity and to protect employment.[10] In developing economies, however, a smaller tax base (e.g. due to larger informal economies), weaker tax administration capacity and more limited social protection systems may limit the effectiveness of some broad-based tax measures and, in turn, call for more targeted policy responses.
    - OECD (2020[50]), Steel and Phillips (2020[27]) and IMF (2020[51]) propose a range of targeted tax measures: Tax relief could be extended to small- and medium-sized enterprises (SMEs) and to regions or industries most affected (e.g. the travel, tourism and hospitality industry). Such relief measures could include income tax credits, rate cuts and exemptions, deadline extension and deferral, extended loss carry-back rules or limiting advance tax payments. Temporary exemptions of payroll taxes could help safeguard existing formal employment. Tax waivers on mobile money and cash transfers could maximise financial support to individuals

[9] The results of an ongoing survey of bilateral and multilateral donor responses to the pandemic will shed more light on this and its findings will be published in future OECD publications and integrated in the 2020 edition of the OECD *Global Outlook on Financing for Sustainable Development* (OECD, forthcoming[1]).

[10] More detailed notes on policy responses are provided by OECD (2020[21]) for African economies, OECD (2020[74]) for emerging Asia, OECD (2020[75]) for Central Asia, OECD (2020[52]) for Latin America and the Caribbean, OECD (2020[76]) for MENA countries and OECD (2020[77]) for South East European economies.

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and households. Reduced taxes on digital communications could help enforce social distancing and reduce the cost of working remotely.

  - **Social assistance measures** are critical for social protection and are more common in developing economies than social insurance or short-time work schemes (OECD, 2020[50]). These measures may be more able to reach individuals, but challenges in targeting workers in the informal economy must also be addressed. OECD (2020[52]), for example, identifies that 65% of informal workers do not benefit from any form of social protection. Social assistance measures could include direct cash transfers, recurrent minimum income, or subsidies to the poorest. To identify and target the most vulnerable, local authorities could be key. Linking registration to such programmes with formal tax registration could help broaden the tax base after the crisis (Steel and Phillips, 2020[27]).

- **Investment policy** will be an important tool to cushion the impact of the crisis on external private investment flows (OECD, 2020[37]).[11] In response to capital outflows, developing economies with sufficient fiscal space should relax macro-prudential policy. Capital account policy can involve easing inflow controls and, in extreme cases, introducing outflow controls, which should be coordinated internationally. To respond to the slowdown of FDI flows to developing economies, donor and investment policy communities should coordinate to mitigate global value chain disruptions and create additional incentives to maintain investment in these countries. Investment policy can also help mitigate the medical supply shortage if governments incentivise businesses to shift their production and imports towards essential healthcare goods and services.[12]
- The recovery of **remittance** flows will mainly depend on fiscal and monetary responses in developed economies. In addition to these macro-responses, policymakers in developed and developing economies can contribute by recognising remittance agents as essential services during lockdown and support remittance agents to manage their increased operating risks (World Bank, 2020[53]). While the average cost of sending remittances to G20 countries remained at 6.37% in the last quarter of 2019, it could be further reduced to reach the below-5% objective set by the G20.
- **Philanthropic donors** will need to jump in as well. Philanthropies are strongly represented in the health sector in developing economies: foundations as a provider group are the third largest funders in the health sector (Kim, Kessler and Poensgen, forthcoming[54]; OECD, 2020[55]). Given their greater flexibility and as a source of innovation, they can be an important complement to official development finance. Still, in total their contribution seems to remain limited in volumes compared to other sources of financing. A forthcoming OECD paper will shed more light on the philanthropic COVID-response.

Development co-operation providers could support these measures by assisting targeted tax and social assistance measures, supporting essential sectors both formal and informal (including health, finance, transport, tourism and retail), maintaining trade and investment flows by using innovative instruments (e.g. blended finance, trade finance, guarantees and equity), and facilitating remittances.

[11] While this note focusses on external private investment, developing countries need to mobilise domestic investment, too. In this domain, financial sector development in addition to identifying strategic areas of investment (e.g. industrial policy, infrastructure) is important.

[12] This is only a part of the investment policy considerations to be made. For more detail, the reader is referred to OECD (2020[37]) and OECD (2020[78]).

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Medium-term recovery: Build back better for people and planet

The COVID-19 pandemic reminds us of our global interconnectedness and common vulnerability to global public bads. It also reminds us that we are only as strong as our weakest link when it comes to facing global challenges. No one will be safe until everyone is safe. International co-operation with a focus on leaving no one behind, instead of a retreat into nationalism, is therefore required to fight the pandemic.

Once the pandemic is over, it will be key to apply the lessons learnt from COVID-19 to future global challenges. COVID-19 threatens to erase significant progress towards poverty eradication and sustainable development, and thereby to further widen the gap between developed and developing economies in their resilience to crises.[13] If we do not address these inequalities and accelerate progress towards the SDGs, the pandemic could be a mere teaser of worse global crises to come. With trillions to be mobilised for the post-COVID-19 recovery, we should use the opportunity to enhance crisis-resilience and to collectively put people and planet back at the heart of the agenda. We must not return to "business as usual" but we must **build back better**.

Building back better means integrating long-term risk management into policies and financing strategies while leaving no one behind. These risks encompass environmental, social and economic aspects and their interactions (e.g. biodiversity loss, climate change, migration) and could trigger the collapse of entire economies. Next to the political case of the need for a more equitable and resilient world, the economic case for taking an approach that considers long-term risks is strong. First, environmental, social and governance shocks risk lowering the long-term value of assets. Second, considering long-term risks does not imply forgoing short-term gains for long-term sustainability in a time of crisis. The transition to low-emission, climate-resilient economies is estimated by the ILO to create 18 million jobs net, while simultaneously supporting the 1.2 billion jobs (primarily in developing economies) that depend on direct ecosystems services (ILO, 2018[56]). Additionally, every USD 1 invested into climate-resilient infrastructure averages a USD 4 return that safeguards the productivity gains and job creation that infrastructure supports (Hallegatte, Rentschler and Rozenberg, 2019[57]).

The need to build back better applies to all actors of the development finance landscape – in developed and developing economies, and at the global level – with the common goal to aid national sustainable development strategies. Integrated National Financing Frameworks (INFF) could help to systematically link different financing sources with these national development plans. Importantly, building back better will also need to go beyond development finance by, for instance, revitalising trade and, in the case of small island developing states, contributing to a sustainable ocean economy.

A holistic financing approach to building back better

Building back better in terms of domestic resource mobilisation will require focussing on building effective tax systems in developing economies. With fiscal headroom highly constrained, domestic resource mobilisation, and taxation in particular, will remain the only long-term viable source of sustainable financing for many public services, not least healthcare. As such, many countries will need to identify ways to increase tax revenue through both **tax policy and tax administration** measures. The joint *Tax Inspectors Without Borders (TIWB)* initiative by the OECD and UNDP provides one of the promising avenues to support tax audit capacity in developing economies. At the same time tolerance of tax avoidance and evasion will be at an all-time low, reinforcing the need for further progress in **international tax co-**

[13] The World Bank estimates that due to COVID-19 40 to 60 million people could be pushed into extreme poverty (Mahler et al., 2020[79]). In the pessimistic scenario, this would "eliminate" the progress of the last three years in reducing extreme poverty lifting the number of people living in extreme poverty back to 2017 levels. However, estimates vary widely, Sumner, Hoy and Ortiz-Juarez (2020[80]) for example estimate that poverty could increase by 420-580 million people.

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ordination, led by the Inclusive Framework and Global Forum, to deliver strong outcomes for developing economies.

For external private investment, building back better calls for a **long-term investment approach** to better align with sustainable needs and to strengthen resilience in times of crisis. Just as the banking system was reformed to better address endogenous financial shocks following the 2008 Global Financial Crisis, the investment landscape can be reformed to better respond to social and environmental shocks. Investment and development co-operation policies can enhance the qualities of trade by promoting sustainable value chains and investment, enforcing high social and environmental standards, and building climate-resilient infrastructure.

Official development finance remains a vital source supporting countries and sectors left behind. It can help leverage other financing resources including support to strengthen domestic resource mobilisation, build public financial management capacity and mobilise additional private investment through blended finance. Official development finance can also contribute to further **reducing transfer costs of remittances**.

Building back better will also mean fighting the leakages in development finance. **Illicit financial flows** (including international tax evasion, corruption and money laundering) from developing economies are an important obstacle to securing sufficient financing for the SDGs. While figures are contested the High Level Panel on Illicit Financial Flows from Africa estimates that illicit financial flows from the continent could be as much as USD 50 billion per annum (UNECA, n.d.[58]). The consensus is that these illicit flows deprive developing economies of significant volumes of capital, outstripping ODA (OECD, n.d.[59]). Transparency and international co-operation are the key tools to address illicit financial flows, and while progress has been made since the 2008 Global Financial Crisis, many developing economies are still not part of, or benefitting from, new tools and agreements to increase transparency and co-operation. Attention should thus be given to continuing to increase transparency especially in the financial centres where illicit financial flows end up, and co-operation and exchange of information between financial centres and developing economies where illicit financial flows originate.

Building back better beyond development finance

As a key transmitter of goods and services, technology, and knowledge, **international trade is an essential means of building back better and implementing the SDGs**. Successive rounds of multilateral trade liberalisation, increasing numbers of preferential market access schemes and regional free trade agreements have created many more trading opportunities. Yet, global trade halted as the coronavirus broke out and current discussions around regionalisation and on-shoring could affect global value chains in the medium- to long-term. Further, obsolete or ill-adapted infrastructure, limited access to trade finance, onerous regulatory requirements, cumbersome border procedures and the need to comply with an ever-broader array of standards, increase the cost of doing business. This leads to the key risk that firms in developing economies, particularly micro and small- and medium-sized enterprises, will be priced out of international markets. **Aid for trade can help to tackle these barriers that limit the contribution of trade to sustainable and inclusive economic growth** (OECD/WTO, 2019[60]). The COVID-19 pandemic and the associated economic costs make this more urgent, but also more daunting.

Tourism, sea transport, and other ocean-based sectors are being highly disrupted, with large economic ramifications for many developing economies, including some of the most vulnerable countries, such as small island developing states. The impacts of the COVID-19 pandemic could have long-lasting effects on these industries. Nevertheless, it will be important for countries not to lose sight of the longer-term opportunities that a **sustainable ocean economy** can offer and to squarely integrate sustainability into stimulus packages and recovery efforts, with support from the international community. Governments and the international donor community have a critical role to play for integrating sustainability requirements into

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traditional financial services and investments, whether in financial markets (e.g. stocks and bonds), or in credit markets (e.g. loans or bonds) (OECD, 2020 forthcoming[61]).

All actors in development finance and beyond need to collaborate closely to shape the building back better agenda. This agenda needs to be centred on sustainability in all its dimensions. Only then can we make successful use of the SDGs as a blueprint for building a more equitable, sustainable and thus resilient world.

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Annex 1.A. Methodology

Deflator method

All numbers presented for external sustainable development finance volumes are expressed in 2019 prices using a global GDP deflator for the United States provided from the Federal Reserve Bank of St. Louis. That is, we multiply the financial flow of year t – originally in current USD – by

$$defl_{US,\ 2019} = \frac{GDPdefl_{US,\ 2019}}{GDPdefl_{US,\ t}}$$

to obtain the financial flow in 2019 USD.

Estimating the projected COVID-19 impact on external private finance

To estimate the projected COVID-19 impact on external private finance, we combine historical data for 2019 on remittances, FDI, portfolio investment and other investment with the percentage-drops of each component estimated for 2020 in other publications. The data sources of the historical data and the projected percentage-drops can be found in Table 1. Concerning 2019, data on external private finance was compiled as follows:

- For 2019 data on remittances, we are using preliminary figures from World Bank KNOMAD Remittance Inflows.
- For 2019 data on FDI, we assume that FDI has remained stable since 2018; this is based on information provided by UNCTAD (2020[62]).
- For 2019 data on portfolio investment and other investment, we complemented IMF BOP data with data from national central banks. The resulting countries included in the 2019 data yield a (absolute USD) coverage of 96% of portfolio investment to ODA-eligible countries and 88% of other investment to ODA-eligible countries in previous years. Assuming that the countries available in 2019 would account for a similar share of the total in 2019, we applied these shares to estimate total portfolio investment and other investment to ODA-eligible countries in 2019.

Table 1. Estimating the impact of COVID-19 on external private finance

	A		B		C = A*(1+B/100)	D = C-A
Unit	*2019 USD billion*		*%*		*2019 USD billion*	*2019 USD billion*
Flow	**2019e**	**Source**	**Expected drop in 2020**	**Source**	**2020f**	**Expected drop in 2020**
FDI	621	IMF BOP, WB WDI (2018)	-35	WB	404	-217
Portfolio investment	263	IMF BOP, national central banks	-80	IIF	51	-211
Other investment	135	IMF BOP, national central banks	-123	IIF	-30	-165
Remittances	534	WB KNOMAD (prelim.)	-20	WB	429	-105
Total	1553				854	-699

Note: Other investment excludes IMF lending and SDR allocations to match the IIF definition.

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