FREE NETWORK POLICY BRIEF SERIES

Anders Olofsgård, SITE
June 2017

Financing for Development: Two Years after Addis

At the Third International Conference on Development Finance in Addis Ababa on July 13—16, 2015, the world committed itself to an action agenda to raise resources to realize the 2030 sustainable development goals. The question is how much progress the world has achieved two years down the road, when the initial enthusiasm and commitments are no longer in the immediate spotlight. This policy brief reports on the discussion from a conference on this topic, Development Day 2017, held in Stockholm on May 31.

The year 2015 has been lauded as a landmark year for sustainable development. As many as three major global agreements were negotiated and signed: the 2030 Agenda for Sustainable Development; the Paris Agreement on Climate Change; and the Addis Ababa Action Agenda (AAAA) on Financing for Development. The latter may be less known, but is essential to the ambition to achieve the first since it concerns how to finance the necessary investments to achieve the Sustainable Development Goals (SDG). The AAAA identified seven action areas spanning both the public and the private sectors, and involving both domestic revenues and international transfers (domestic public resources, domestic and international private business and finance, development cooperation, trade, debt and debt sustainability, systemic issues and science, technology and innovation). This event focused primarily on international commercial private capital flows, and indirectly on development cooperation as a facilitator and catalyst for such private transfers.

Combining good business and good development

A major theme of the conference was combining good business with good development. Should private companies also take responsibility for environmental and social sustainability, or is the "only business of business to do business"? If firms do engage in sustainability investments, does it eat into profits or does it rather create a competitive edge? Reading business journals, it is easy to get the impression that there is a win-win situation. This picture is, however, based on rather limited information and the relationship is fraught with methodological challenges as both profitability and sustainability investments may be driven by other factors (such as competent leadership), and firms performing well may have the capacity and feel the obligation to invest part of their surplus into corporate social responsibility (CSR). Hence, there may be a question of reverse causality.

At the conference, new research was presented using data on investments in low and middle-income countries from the International Finance Corporation that includes both measures of financial rates of returns and subjective ratings of environment, social and governance (ESG) performance. Simple correlations suggested a significant positive relationship, or a win-win situation. However, once care was taken to identify a causal effect from ESG on profits, the results became insignificant. That is, the causal effect of ESG investments on profits seemed neither positive nor negative. However, when looking at broader measures of private sector development, the results suggest that both profits and ESG investments have a positive impact on sector development. This implies that there are good reasons for the public sector to encourage ESG activities even beyond the direct sustainability benefits through for instance public-private partnerships but also regulations that encourage good behavior.

How should results like these be interpreted? The presentation spurred an interesting debate on what are reasonable expectations and whether "the glass is half full or half empty". It was emphasized that systematically beating the market should not really be expected from any group of investments, so a half-full interpretation seems more plausible.

This debate also came up in a panel discussion on institutional investments in developing countries, and where the growing success of green bonds was presented. Though still small in absolute size (1-2% of the bonds coming to the market are green bonds), there has been an impressive growth in the last 3-4 years. Currently, the Swedish bank SEB is cooperating with the German government in developing a green-bond market in emerging markets. Some of the lessons emphasized from the green-bond market were the importance of being clear towards investors about the motivation and the value proposition, to package the information in a credible way emphasizing independent verification, and to continuously monitor and give feedback to investors.

From the institutional investor side, it was mentioned how important it is to tell investors a compelling story. This may be easier with regards to environmental sustainability relative to social sustainability, both in terms of conveying the urgency and in developing indicators that can be monitored and communicated. It was also argued that even though there are initiatives out there, emphasizing how sustainable investments can be competitive in terms of profitability (such as green bonds), it would also help to change the relative price on the other end of the spectrum, i.e. through regulations, taxes or other instruments that can make investments with particularly negative externalities less profitable.

Finally, an overarching theme of the discussion was the challenge to have institutional investments reach the places with the most needs, i.e. the fragile and least developed countries. If this is to happen, pension funds and insurance companies have to be allowed to take on more risks, and it would be essential to reduce the corporate risk in public-private partnerships (more on this below).

In a second panel discussion, different Swedish corporate initiatives, emphasizing sustainability, were showcased. For example, the Swedish steel producers' association, Jernkontoret, showcased the Swedish steel industry's vision 2050 with the target of domestically based steel production using hydrogen and with zero CO_2 emissions. Another example is the Sweden Textile Water Initiative, launched in 2010 by major Swedish textile and leather brands together with the Stockholm International Water Institute, has created the first guidelines for sustainable water and wastewater management in supply chains. Currently working with 277 suppliers in 5 countries, the initiative features clear win-win situations and is now self-sustaining and in the process of going private.

Skandia, a major Swedish insurance company, emphasized the business costs of socially unsustainable situations with examples from the costs in Sweden of sick leave, and the costs for protection and security for Swedish retailers and mall developers. Positive preventive work focusing on rehabilitation and the development of blossoming and inclusive neighborhoods were featured. These examples showcased how the SDGs are feeding into the thinking and planning of the private sector in Sweden, and how important it is to identify the business cases for thinking about sustainability in order for this to become mainstream.

However, the case for private capital to be the panacea for reaching the SDGs is by no means obvious. The non-governmental organization Diakonia pointed out that for every dollar flowing into a developing country, more than two dollars are lost. The biggest loss is coming from illicit financial flows, and within this category, tax evasion is the biggest problem. While the private sector is key to development, the main contributions this sector can do for development is to pay taxes where they are due, abide by international standards, and be transparent and accountable to the citizens and governments in the countries where they operate.

Swedwatch, used two examples from Borneo and what is now South Sudan, to illustrate how investors at times turn a blind eye towards human rights and environmental abuses by private multi-national companies. Transparency, due diligence in evaluating human rights risks prior to investment decisions, and a readiness to push for compensation and remedy if abuse is still unearthed were pointed out as key components to avoid this type of malpractice.

Development cooperation as facilitator for private flows

The second main theme of the day dealt with the ability to use development cooperation as a catalyst for private investments.

Swedfund, the Swedish government's development financier, emphasized the need to move fast and find a business model in which one dollar spent becomes ten dollars on the ground. Based on a business model around three pillars (societal impact, sustainability and financial viability) Swedfund focus on areas with relatively high risk and where private capital are in short supply, with the hope to foster job creation, inclusive growth and poverty reduction.

Sida, the Swedish main aid agency, showcased their guarantee instruments. Through partnerships with bigger actors such as the International Finance Corporation (IFC) of the World Bank group as well as local banks in developing countries, Sida can shoulder part of the default risks involved when trying to reach more high-risk investors (such as small and medium sized enterprises) with great potential development impact. In this way, one dollar from the public aid budget can lure a multiple of dollars in private capital towards sustainable development.

The OECD Development Assistance Committee (DAC) emphasized that governments generally lack a policy for how to deliver official development assistance (ODA) in a sustainable way and a strategy for how to enable capital flows from the private sector. A DAC initiative to better track all financial flows going towards development, beyond just ODA, was presented.

From the Center for Global Development, the case for using public resources to facilitate private sector insurance mechanisms against human disasters was presented (concessional insurance). Benefits emphasized from explicit insurance contracts included faster and better-coordinated payouts, more certainty that compensation will come, incentives to invest in disaster prevention (to reduce premiums) and involvement of commercial insurance professionals.

Importantly, though, it was emphasized that it is crucial that aid money are truly complementary in the sense that they crowd in private investments that otherwise would not have taken place (and not end up subsidizing private investors in donor countries). It was also emphasized that donors must not forget about the focus on the poorest and people in fragile states.

In some environments donors must shoulder 100% of the risk to lure private capital. In those cases alternatives must be considered. Sida emphasized the importance to match financial instruments with the appropriate context, i.e. there is a need to identify where different instruments should be used. For instance, big institutional investors need investments that are manageable, predictable, and of a reasonable size. Aid agencies can help through subsidized risk management, but also by helping build strong institutions in partner countries that can work as counterparts, and encourage public-private collaborations to package investment deals and reduce information asymmetries.

Where are we now?

Turns out that this is not a simple question to answer. The Ministry for Foreign Affairs presented the Swedish government's priority areas – strengthening the implementation of SDG 5, 8, 14 and 16 (all goals can be found here: https://sustainabledevelopment.un.org/?menu=1300) – and reported from a recent follow-up meeting at the UN.

In principle the Addis Agenda identifies action areas and connects areas and actors, which makes it possible for systematic follow-ups, and an inter-agency task force produces an annual report of the general state of the implementation of the Addis Agenda. The Swedish government has produced a report on the implementation of the AAAA covering all seven action-areas with examples of progress. This initiative was commended at the UN meetings, and together with the private sector engagement, as showcased during the 2017 Development Day, it paints a rather positive picture of progress and engagement in Sweden.

However, globally, there are many uncertainties and challenges. The Center for Global Development reported on the budget proposal of the US president, which among other things includes a 32% cut to topline funding for the Department of State and Foreign Operations. There are also plans to eliminate the Overseas Private Investment Corporation and to zero out US food assistance. On the other hand, in this fiscal year, the US Congress (controlled by the Republicans) increased the amount going into foreign aid compared to what previous president Obama suggested. What will eventually come out of the current president's budget proposal for the coming fiscal year is thus highly unclear.

Participants at the conference

Rami AbdelRahman, Sweden Textile Water Initiative

Frida Arounsavath, Swedwatch

Owen Barder, Center for Global Development

Eva Blixt, Jernkontoret

Magnus Cedergren, Sida

Penny Davies, Diakonia

Raj Desai, Georgetown University and the Brookings Institution

Ulf Erlandsson, Fourth Swedish National Pension Fund (AP4)

Måns Fellesson, Ministry for Foreign Affairs

Charlotte Petri Gornitzka, OECD-DAC

Anna Hammargren, Ministry for Foreign Affairs

John Hurley, Center for Global Development

Lena Hök, Skandia

Måns Nilsson, Stockholm Environmental Institute

Mats Olausson, SEB

Anders Olofsgård, SITE

Anna Ryott, Swedfund

Elina Scheja, Sida

Anders Olofsgård

Stockholm Institute of Transition Economics
Anders.Olofsgard@hhs.se
www.hhs.se/site

Anders Olofsgård is currently Deputy Director at the Stockholm Institute of Transition Economics (SITE), and Associate Professor at the Stockholm School of Economics. Before that he was Associate Professor at the Edmund A. Walsh School of Foreign Service, Georgetown University. He earned his Ph.D. in Economics from the Institute for International Economic Studies (IIES), at Stockholm University, in 2001.

Olofgård's primary research areas are political economy, development and applied microeconomics, and he has published widely in both economics and political science journals. He has also been a visiting scholar at the research department of the IMF, and done work for among others the World Bank, USAID and the Swedish Parliament.