Mobilizing Finance for SDGs: Issues and Policy Implication

I. Background

An estimated total of 5-7 trillion USD will be needed annually for developing countries to achieve the Sustainable Development Goals (SDGs) by 2030. However, development financial flows to developing countries currently account for only 400 billion USD per year, thus highlighting the need to expand development finance. Although official development assistance (ODA) should be increased in order to achieve the SDGs and the 0.7% ODA/GNI target set by OECD DAC member countries, the prospect of increasing the total volume of ODA looks dim when considering the mounting constraints placed on the donor government’s budget. Therefore, the role of private finance will likely become more important to support the growth and development of developing countries. In this context, there has been growing global effort, led by the OECD DAC to adopt the Total Official Support for Sustainable Development (TOSSD) as a new way of measuring official flows and private flows mobilized by the official sector, to support sustainable development.

This research aims to derive implications for the development finance policy of South Korea as an emerging donor. It explores ways to mobilize and better utilize diverse financing sources for the SDGs by conducting a statistical analysis of official financial flows including ODA and other official flows (OOF) and identifying their determinants of allocation, respectively. A case study of Senegal and the Philippines, two of Korea’s ODA priority partners, was carried out in order to assess changing development finance trends and emerging challenges and understand their perspective on the TOSSD.

II. Trends & Determinants of DAC Development Financing

1. Trends in ODA and OOF

The research examines the characteristics of official development finance by donor, sector, and income level of partner countries. We distinguish the financial flows into ODA and OOF and examine any differences in each financial flow. OOF is a category of flows that does not satisfy the concessionality criteria and grant elements of ODA and is used for commercial purposes in general.
As illustrated in Figure 1, ODA represents the majority of official finance flowing into developing countries over the past decades. For the period of 2012 and 2016, the average ODA volume disbursed by the DAC donors amounted to $127.2 billion. For the same period, DAC donors disbursed $2.8 billion at average as OOF and $10.9 billion as export credits. The aggregate amount of ODA, OOF and export credit, $140.9 billion, represents the lower bound of available finance that could be calculated as the TOSSD.

**Figure 1. Trends of official financial flows by DAC donors to developing countries**

<table>
<thead>
<tr>
<th>Year</th>
<th>ODA</th>
<th>OOF</th>
<th>Export Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$127.2 billion</td>
<td>$2.8 billion</td>
<td>$10.9 billion</td>
</tr>
<tr>
<td>2016</td>
<td>$127.2 billion</td>
<td>$2.8 billion</td>
<td>$10.9 billion</td>
</tr>
</tbody>
</table>

**Figure 2. DAC donor’s allocation by Income group: ODA vs OOF**

- **Income Group**
  - Low Income Countries
  - Lower-Middle Income Countries
  - Upper-Middle Income Countries

<table>
<thead>
<tr>
<th>Income Group</th>
<th>ODA (%)</th>
<th>OOF (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income Countries</td>
<td>31</td>
<td>51</td>
</tr>
<tr>
<td>Lower-Middle Income Countries</td>
<td>31</td>
<td>47</td>
</tr>
<tr>
<td>Upper-Middle Income Countries</td>
<td>31</td>
<td>47</td>
</tr>
</tbody>
</table>

**Figure 3. Sector allocation by DAC donors: ODA vs OOF**

- **Sectors**
  - Production
  - Humanitarian
  - Economic Infrastructure & Services
  - Social Infrastructure & Services
  - Others

<table>
<thead>
<tr>
<th>Sector</th>
<th>ODA (%)</th>
<th>OOF (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production</td>
<td>50</td>
<td>20</td>
</tr>
<tr>
<td>Humanitarian</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Economic Infrastructure &amp; Services</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Social Infrastructure &amp; Services</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Others</td>
<td>10</td>
<td>10</td>
</tr>
</tbody>
</table>

**Figure 2. DAC donor’s allocation by Income group: ODA vs OOF**

ODA and OOF also differ in the sectors they are focused in, with more than one-third of ODA concentrated in social infrastructure and services while OOF is mainly focused in production sectors and economic infrastructure and services.

**Figure 3. Sector allocation by DAC donors: ODA vs OOF**

2. Determinants of ODA and OOF Allocation

In order to analyze the determinants for the provision of ODA and OOF respectively, the study estimates regression models that include the population size of the country, income level,
FDI, openness, and business environment as explanatory variables. The objective of the empirical analysis is to see if we find any difference in the statistical significance of the parameter estimates in each model using ODA and OOF respectively as a dependent variable. The results of estimating fixed effect model specification show that the provision of ODA is positively related with a smaller size of recipients and lower level of average tariffs, however the GDP per capita and FDI inflows are not statistically significant explanatory variables.

Except for that of the income of recipient countries, the majority of the parameter estimates of the OOF model were not statistically significant. This is because allocation of OOF is determined not by the characteristics of the partner country but by the commercial aspects of the projects. The correlation between individual explanatory variables and OOF was not statistically significant. This indicates that the macro characteristics of the recipient country may not be major factors when a donor makes a decision on providing OOF. The nature of OOF is less concessional and therefore, the provision decision of such financial resources would be made based on the profitability of the project itself rather than the country’s economic circumstances as a whole. An empirical analysis on determinants of FDI may be more relevant for the analysis of OOF. Also one should be cautious when using the OOF data from the OECD Creditor Reporting Systems (CRS) database since OOF reporting from DAC member countries is yet on a voluntary basis.

III. Case Study

One of the main distinguishing features of the research is how it handles development finance issues from the perspective of the partner country. We selected the Philippines and Senegal for our case study, where we analyzed the financial needs and recent trends of inflows in the area of development finance. Our study also identifies differences in the perspectives and responses of partner countries regarding private funding, based on a literature review, stakeholder interview and field visit. The focus of the study was to derive challenges to mobilize private finance and understand the role that official development finance plays toward attracting private finance to support its growth, and finally to clarify the role of ODA throughout changes in the development finance landscape.

The results of the case study show a general decrease in ODA and increase in private finance in the Philippines and Senegal, taking into account that the total inflows to Senegal are significantly lower.

Figure 4. Trends of external financial in-flows to the Philippines and Senegal: ODA, OOF and FDI

The research confirms that both countries have expectations for TOSSD as a statistical method to track, monitor and manage the diversifying external financial inflows. Furthermore, both

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countries shared a lack of sufficient data on the participation of private finance in infrastructure projects through public-private partnership mechanisms, as well as a lack of capacity to monitor and manage the projects. One perspective to be highlighted was that the financial inflows from emerging donors such as China and Islamic financial institutions should be included in TOSSD. In this changing development architecture, ODA could play a significant role in the newly emerging challenges such as coordination between development objectives and commercial objectives, capacity building in a partner country’s government and local private sector, debt management, transparency and results management, and risk management.

IV. Policy Implications

The Korean government plans to expand the size of its ODA to 0.2% of its GNI by 2020 and, in particular, has announced the policy direction of expanding the size of development finance by mobilizing private finance through development financial instruments. While the legal instruments necessary to utilize development financial instruments have been established by the revision of the Economic Development Cooperation Fund (EDCF) Act and its enforcement decree in 2016, this has not led to the active identification of development projects that utilize diverse financial instruments to leverage private finance other than ODA. As the international society is yet to reach an agreement on the principles of so-called blended finance, it would be a practical approach for the Korean government to actively participate in the international dialogue and ongoing process of establishing standards and implementing principles, after which they can be introduced into national policies.

Blended finance incorporates a diverse range of stakeholders – such as donor countries, donor agencies, partner countries, and private sector participants – meaning that the capacity to coordinate the diverse needs of these stakeholders is crucial. A donor government must acquire technical and legal expertise, knowhow as well as networks and partnerships established in the field if it is to take advantage of diversified financial instruments properly. Also required is the capacity to evaluate whether these financial instruments are being properly utilized. To this end, Korea should improve its capacities and visibility in the international society, as well as strengthen partnerships through participation in large-scale blended finance facilities.

In the changing landscape of development finance, the strategy for providing financial flows to developing countries needs to be diversified by the income level of partner countries. In order to implement SDGs, there is consensus that development results should be maximized by combining ODA, OOF and private finance. To this end, the diverse and distinct environments at each partner country should be taken into consideration: their level of economic development, income level, capacity of the government and private sector, political, economic and social environments, policy on private investment, and institutional framework. For example, many middle-income countries show a high dependence on domestic funding or remittances for their development. Therefore, in these cases it is more important to expand concessional assistance on tax policy, institutional reform on tax, and tax administration while supporting these partners to construct a mechanism that can fully take advantage of domestic financial resources or remittances as development finance. However, in the case of lower-income countries,
lack of capacity is the main challenge and thus it becomes more important to assist them to strengthen the capacity of their human resources and institutions to utilize private finance.

This research suggests that the results of international dialogue on development finance and the necessity to diversify the utilization of development finance according to each country’s capacity level and environment should be incorporated into Korea’s development cooperation policy such as the Country Partnership Strategies (CPS). The Korea’s 3rd CPS, which will be established in 2020, should function as a partnership strategy to link and combine private finance and various public development resources beyond ODA, which will be included in TOSSD. However, a thorough analysis of the changes in development needs and trends in partner countries is a prerequisite for a new development cooperation strategy.

When considering the potential risks that the utilization of private funds may accompany, it will be necessary to establish an ex-ante and ex-post risk management framework. Even in cases where the private sector engages in development projects, it is important to ensure development objectives are met and development effectiveness remains a priority. Another essential consideration is to apply existing principles of aid effectiveness, such as alignment with partner countries’ systems and participation by the local community. Furthermore, a results management framework to monitor and evaluate ongoing processes should be constructed to review the effectiveness of development projects.  

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