

PAYING FOR ZERO:

Global Development Finance and the Post-2015 Agenda



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by Hiroto Arakawa, Sasja Beslik, Martin Dahinden, Michael Elliott, Helene Gayle, Thierry Geiger, Torgny Holmgren, Charles Kenny, Betty Maina, Simon Maxwell, John W McArthur, Mthuli Ncube, Ory Okolloh, Zainab Salbi, Mark Suzman, Virgilio Viana, and Jasmine Whitbread

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Comments are welcome and should be sent to thierry.geiger@weforum.org.

INTRODUCTION

The frontier challenges of global development finance have changed dramatically since the launch of the Millennium Development Goals (MDGs) nearly fifteen years ago. At the beginning of the 2000s, official development assistance (ODA) levels were hovering at historic lows as a share of developed countries' national incomes, most of the world's poorest people lived in low-income countries (LICs), and many developing countries were perceived to be stuck on either a track of low-growth austerity or one of 'growth without human development.' In the years since, economic indicators have steadily improved throughout the developing world, aid and public investment have ramped up significantly in selected sectors, and a range of global breakthroughs has been registered in key areas like headcount poverty, health and primary education.

The positive news is that the developing world's tremendous overall economic progress means that an ever larger number of countries have developed the economic capacity to tackle their most pressing anti-poverty and broader sustainable development priorities through their own domestic resources. Several low-income countries sustained enough economic growth to graduate to official middle-income status. The simple distinction between 'donor' and 'developing' countries has been replaced with a more nuanced and complex range of partnerships and interdependencies. A variety of new donors and actors has emerged, and South-South cooperation is on the rise.

But there are many new challenges too. One is simply that several global policy conversations are now taking place in parallel, each with its own actors, language, and areas of technical emphasis. In the absence of a common framework to connect the disparate conversations, key stakeholders risk talking past each other and failing to establish potential agreements. For example, some communities focus primarily on ODA transfers and the role of numerical commitments to achieve policy outcomes at scale. Others focus on public sector efficiencies and the means of implementation, aiming at micro-level analysis that can guide marginal funding decisions. Another community delves deep into the technicalities of expanding market-based financial instruments, rarely mentioning ODA. Still others are focused on transforming economies to operate within planetary boundaries. Among other topics, this includes climate finance, ranging from the public transfers required to tackle adaptation to the much broader market-linked mechanisms required to decarbonize economic production. Across all of these disparate communities, a common framework is needed to help link the conversations together.

A second dimension is that the global economic strains since 2008 have led to a difficult fiscal outlook across most developed economies. Many existing aid requirements and commitments are likewise falling short. This was most prominently displayed during the December 2013 replenishment of the Global Fund to Fight AIDS, TB, and Malaria, which could not raise the final US\$ 1 billion required to finance its budget for each of the coming three years, despite matching pledges offered by the United States and the United Kingdom. It would be inaccurate to conclude that current aid allocations are fully synchronized with underlying needs.

A fourth challenge is to promote investments in sustainability at all levels. This includes everything from fair labor practices to securing ecosystem services to accelerating the decarbonization of economies. Most current approaches remain ecologically insensitive and do not consider the imperative of changing business-as-usual development patterns. It is necessary to consider the scientific message that we are rapidly approaching, or have passed, some planetary boundaries. Ecosystem-friendly investment practices are growing but require a dramatic scaling up. More investments need to be established to incentivize green technologies and regulation.

A fifth challenge is that the largest share of investments for sustainable development will need to come from the private sector, but a variety of market failures prevent those investments from coming to fruition. For example, a growing number of companies have realized the potential for innovative 'bottom of the pyramid' solutions that also address environmental challenges, but the value of ecosystem services has to become more visible to all societies. For these and other solutions to be taken to scale, complementary public sector investment incentives will be required, quite separate from traditional aid transfers for priorities like health or education.

A sixth challenge is that the geography of poverty has become more complex. A majority of extremely poor people today live in middle-income countries (MICs) that have growing resources at their disposal, including those mobilized by national development banks, but might still lack the domestic capacity fully to alleviate poverty and address inequality. Over the past decade the international development finance system has made tremendous gains in increasing the financing available for low-income countries, but countries newly classified as lower-middle-income (LMICs) now face the risk of an unintended drop-off in external financing as they still strive to tackle domestic priorities.

Moreover, a growing share of poor people is concentrated in fragile and conflict-affected areas, where institutions that would enable public and private investments are weak or nonexistent, and efforts need to be made to establish a functioning environment for government and business, alongside other key institution-building efforts. Meanwhile, losses of biodiversity and ecosystem services have reduced resilience to climate change. Although this affects all societies, poor people are most vulnerable.

A seventh challenge is taking shape as a product of the issues listed above: potentially redefining ODA. Amidst the complex evolving financing environment, the respective roles and definitions of ODA and other international financing sources might well need to be clarified and updated. For example, it might not make sense to count a cancelled dollar of dormant debt principal as equal to a net transfer of a dollar. It might also be worth reconsidering whether supporting refugee settlement in developed countries merits counting as ODA. The political pressures surrounding such debates can be especially strong in environments focused on identifying value-for-money in development assistance. It is therefore crucial that redefinitions not be used as an excuse to pursue cosmetic short-cuts or dilution of ODA commitments. For example, efforts to count a wider range of security-focused peacekeeping initiatives as ODA should not be encouraged.

An eighth challenge lies in the complex interplay between development goals and development finance. It is premature to specify precise financing needs or mechanisms before the world has set a next generation of post-2015 goals. But it is broadly acknowledged that in the absence of adequate resources or even commitments to provide adequate resources, goals are unlikely to be achieved. Thus the considerations of sustainable development finance must evolve in step with the global discussion on post-2015 goals, without getting unduly ahead of, or indeed behind, that discussion.

Amidst such a shifting terrain of post-2015 global development finance, this paper aims to distill core needs, challenges, and opportunities as a respectful contribution to the ongoing debates and deliberations. It does not aim to be comprehensive. Instead it aims to highlight some key parameters and opportunities that stakeholders might wish to consider.

Building on the work of the recent UN High-Level Panel of Eminent Persons on the post-2015 Development Agenda (2013), and also the 'Getting to Zero: Finishing the Job the MDGs started' paper prepared in 2012 by some of the co-authors of this paper, here we adopt the title 'Paying for Zero.' The word 'zero' aims to signal a broad theme of transformation for sustainable development: eliminating extreme poverty, eliminating pernicious forms of inequality and social exclusion, and eliminating unsustainable economic activities that place too high a burden on environmental assets. Zero is intended as a constructively provocative concept, if not absolute in technical terms.

The world faces a series of extraordinary challenges and opportunities on the sustainable development agenda, so we believe a clear vision of innovation and success is necessary when mapping out the terms of generational goals. Many global achievements under the MDGs would have been considered starry-eyed or impractical as of 1999. Fifteen years later, we hope a new generation of equally pressing goals will make the same leaps from vision to practicality to success in the years to come.

NEEDS

Post-2015 development finance must be considered across multiple dimensions. As articulated and agreed in the seminal Monterrey Consensus of 2002, 'Each country has primary responsibility for its own economic and social development, and the role of national policies and development strategies cannot be overemphasized' (United Nations, 2002; para. 6). At the same time, the Consensus goes on to clarify that, 'Domestic economies are now interwoven with the global economic system and, inter alia, the effective use of trade and investment opportunities can help countries to fight poverty. National development efforts need to be supported by an enabling international economic environment (ibid.).'

For many but not all countries, aid is a central component of the enabling environment, as articulated in Monterrey's paragraph 39:

'Official development assistance (ODA) plays an essential role as a complement to other sources of financing for development, especially in those countries with the least capacity to attract private direct investment. ODA can help a country to reach adequate levels of domestic resource mobilization over an appropriate time horizon, while human capital, productive and export capacities are enhanced. ODA can be critical for improving the environment for private sector activity and can thus pave the way for robust growth. ODA is also a crucial instrument for supporting education, health, public infrastructure development, agriculture and rural development, and to enhance food security.'

Following Monterrey, reference agreements informing global partnership have continued to evolve, including the 2005 Paris Declaration on Aid Effectiveness, the 2008 Accra Agenda for Action, and the 2011 Busan Partnership for Effective Development Cooperation. The Busan agreement recognizes a global community 'united by a new partnership that is broader and more inclusive than ever before, founded on shared principles, common goals, and differential commitments for effective international development' (Busan Partnership, 2011; para. 1). It further asserts that, 'Aid is only part of the solution to development,' (para. 28), and recognizes, 'the central role of the private sector in advancing innovation, creating wealth, income and jobs, mobilizing domestic resources, and in turn contributing to poverty reduction' (para. 32). The Busan agreement also stresses the growing role of South-South and 'triangular' cooperation, whereby developing countries can both provide and receive assistance. The principle of common but differentiated responsibilities means that high-income countries should follow-through on their commitments, but also that emerging middle-income economies should be encouraged to contribute to global poverty reduction and the provision of global public goods.

A. COMPONENTS OF POST-2015 FINANCE

To date there has been no comprehensive analysis of the amounts required to finance any potential post-2015 sustainable development frameworks, and we do not attempt to provide such an estimate here. However, we note and welcome the fact that development finance is high on the agenda of the UN General Assembly's Open Working Group on post-2015.

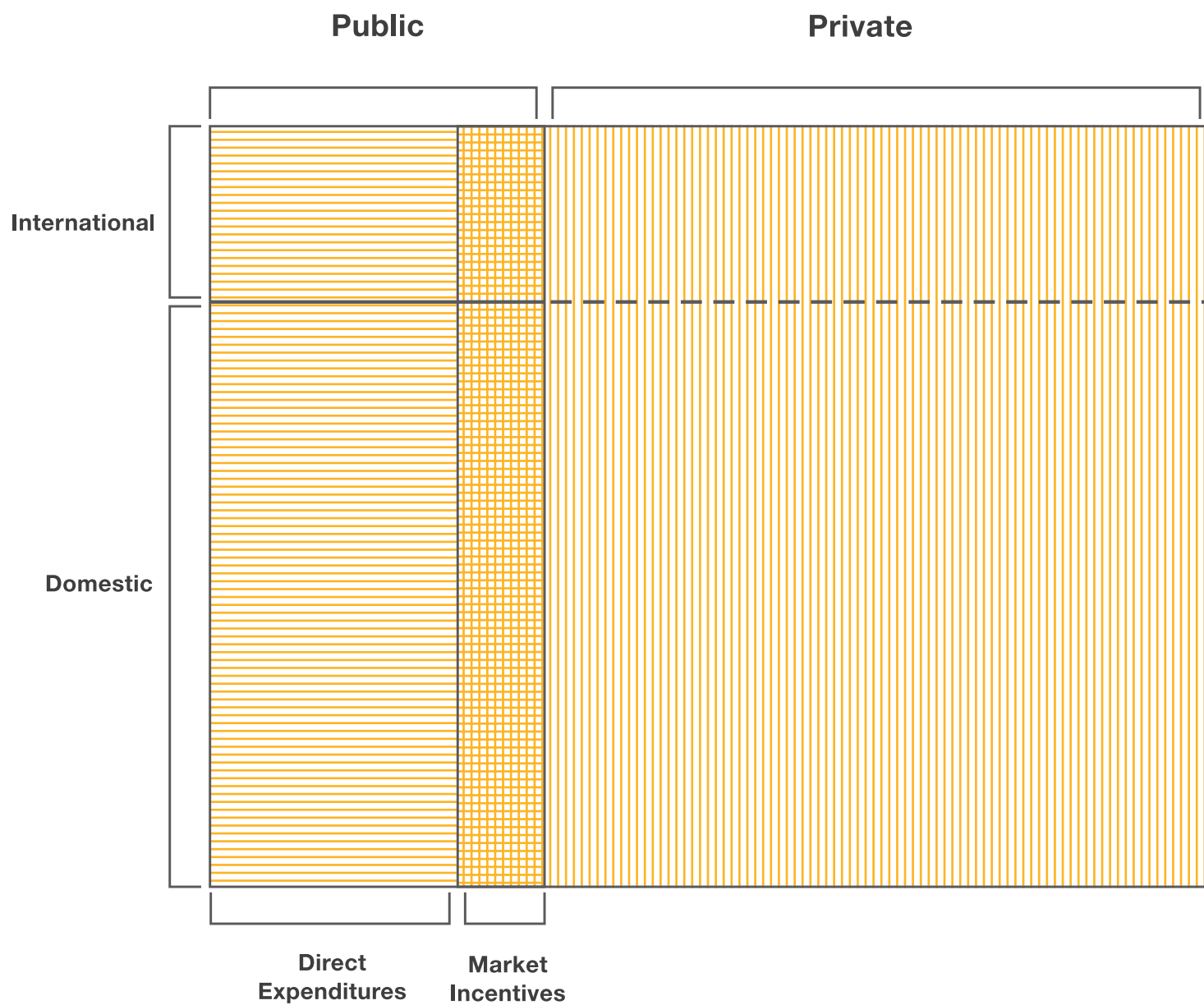
Our starting point is to clarify the different types of country-level finance required, as outlined schematically in Figure 1. These are separate from the financing required to provide global public goods like disease control, ecosystem services, public safety, the international trade and financial system, greenhouse gas mitigation, and scientific research around global challenges like health and food production.

The image in Figure 1 is not drawn to any particular scale, but is instead drawn to describe the different inter-locking components involved in the overall financing agenda. They span two dimensions: on the horizontal dimension, public versus private; on the vertical dimension, domestic versus international. The line between international and domestic private finance is dotted, since market-based capital is highly mobile across borders. The size of each rectangle within the diagram differs by country situation. The top-left 'box' represents aid transfers, of special importance to low-income countries which require significant support – more so than, for example, upper-middle-income countries, which likely require little if any external support.

In line with the original Monterrey Consensus, post-2015 success will hinge on ensuring that each piece of the puzzle is adequate in size and nature to its particular task. The different forms of capital should be seen as complements rather than substitutes. They are not interchangeable bargaining chips (e.g., Gates, 2011). Some areas like public health are fundamental responsibilities for public finance, even when market-based instruments can be used to leverage private dollars. And public investments often have complementarities across sectors, such as when immunizing a child improves that child's educational outcomes through improved attendance and increases the family's economic outcomes through fewer parental days off work and lower out-of-pocket treatment costs.

Meanwhile private capital already forms the biggest pool of global investment, and will undoubtedly continue to do so, already at a level of roughly US\$ 18 trillion per year. For post-2015, one key priority is to ensure that private investment is of the appropriate scale, form, and orientation to ensure goals for sustainable development are met. Private actors respond to incentives, so public policies are required to reduce risk, increase investor return, and strengthen regulatory environments in areas where increased private investment is desired. In many cases – especially for priorities like agriculture, energy, and transportation – this will require governments to address market failures by creating large scale incentive mechanisms, whether through policy reforms, risk guarantees, preferred credit, or other instruments. Thus many of the most critical global private investments will be contingent on adequately scaled public instruments.

FIGURE 1: Components of Post-2015 Sustainable Development Finance



At the same time, the trillions of dollars of private investment have little bearing on the direct public expenditures that are required at both domestic and global levels. Adequate domestic resource mobilization will be crucial across all countries, recognizing that more developed countries generally have greater capacity to generate resources. And international public resources, in the form of official development assistance, will continue to be crucial, even if the dollar values might look small at first glance when compared to private flows, including equity and foreign direct investment.

Well-directed aid flows can play many distinct roles in the development process. Aid is often essential for achieving direct aims (such as achieving public health goals in low-income countries), for providing a variety of regional and global public goods and, when properly deployed, for catalyzing and attracting broader private resources. For example, the GAVI Alliance has fostered many private sector-linked innovations in the health care industry, ranging from advanced market commitments to speed the development of new vaccines, to the International Finance Facility for Immunizations, which issues government-backed bonds in financial markets to make funding immediately available for vaccines. In addition, aid-backed public sector budgets can provide counter-cyclical support in times of economic crisis, as they did following the global financial crisis. They can also serve as a vehicle for supporting policy-enhancing reforms. Over time, well-designed aid programs can play a major role in boosting the magnitude of private resources invested in developing countries. This is especially notable in infrastructure sectors like energy and transport.

It is therefore crucial that the international community places special emphasis on the need to protect and enhance properly-targeted ODA budgets as a central component of the post-2015 agenda. A foreign aid dollar typically remains the hardest dollar to mobilize, even when directly financing the world's most explicit life-saving programs.

We further note the strong practical overlap between the 'sustainable development finance' and 'climate finance' agendas. In practice, much of the desired climate agenda will be achieved through climate-friendly investments in energy and transport systems. Important political factors have led the climate and sustainable discussions to be pursued through parallel diplomatic tracks. Nonetheless, many of the climate achievements will be realized through the successful orientation of project-level investments for sustainable development.

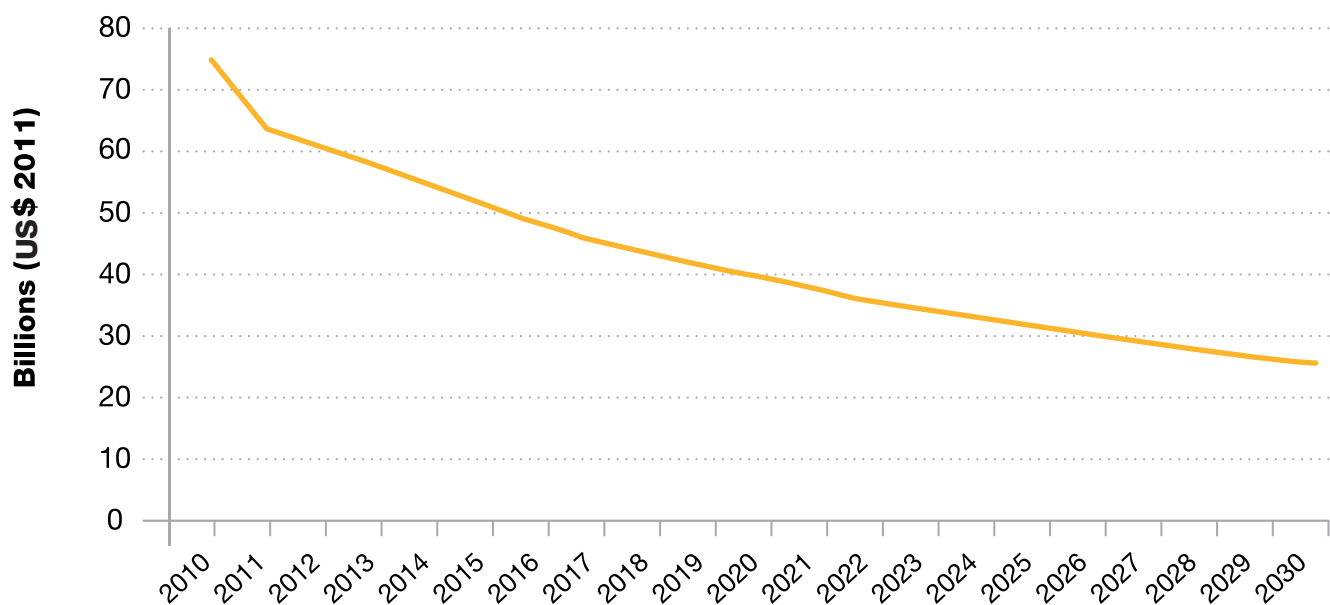
The project and country-level mechanisms are again separate from many of the global public goods, including scientific research and emissions management systems, that will best be produced through global public investment and coordination. This is one of many reasons why it is not acceptable for climate budgets to 'cannibalize' aid budgets. Short-sighted zero-sum thinking between different categories of post-2015 finance will only hurt the world's ability to achieve a successful post-2015 agenda. Encouraging financing with multi-dimensional benefits will be crucial for a variety of sustainable development priorities.

B. ENDING EXTREME POVERTY ≠ ENDING AID

Monterrey's multi-layered approach to finance must be kept in mind when considering the pivotal post-2015 challenge of eliminating extreme poverty, defined as people living under PPP\$ 1.25/day. The World Bank has already established a target of achieving this goal by 2030, defined as less than 3 percent of the developing world population. Projections for 2030 have been published by Chandy et al. (2013), whose 'baseline scenario' shows, with full caveats regarding the risks of projections, that the share of the developing world living in extreme poverty is currently on course to decline to slightly more than 5 percent by 2030, approximately 386 million people, down from perhaps 18 percent today.¹ The goal of ending extreme poverty by 2030 is within reach, but it will not be achieved without significant effort.

Chandy et al. have also calculated the extreme poverty gap through to 2030, representing the conceptual value of dollar transfers that would be required to bring everyone in the world up to the PPP\$ 1.25/day standard of income or consumption. The results are captured in Figure 2. As of 2014, the gap is roughly US\$ 55 billion, a dramatic decline from even 2005, when it was of the order of US\$ 100 billion (Chandy and Gertz, 2011). Note that conceptually these figures do not form a proxy for ODA requirements, for several reasons. For example, they do not account for significant issues of targeting or delivery, nor the separate costs of providing minimum public services like health and education for extremely poor people, which typically add up to significantly larger aggregate flow requirements. Furthermore, economic growth typically represents a more sustainable and significant force for poverty reduction than direct transfers to poor people, for all their value.

FIGURE 2: Dollar Equivalent of Global Extreme Poverty Gap (projected "baseline")



Source: Chandy et al. 2013

¹ At the 2013 World Bank/IMF Annual Meetings, World Bank President Jim Yong Kim indicated that the latest figure is 17.7 percent of the developing world population.

The recent elevation of several major economies to middle-income status should not be confused with the longer-term challenges of eliminating extreme poverty. This is for two reasons. First, many MICs, especially those which are fragile states, will merit continued support, including humanitarian aid and technical cooperation for institutional strengthening. Highly vulnerable countries like small island developing states also face extensive costs in adapting to externally-driven climate change. In such cases, 'graduation' from aid needs very careful consideration and it will be important to ensure that emerging LMICs, especially those with extensive poverty challenges or entrenched pockets of poverty, do not face a stark drop-off in access to external finance. This might require a rethinking of thresholds and bolstering of concessional finance.

Second, many low-income countries still stand a long way from crossing the middle-income threshold. Assume, for example, that officially designated low-income countries with GNI per capita of less than \$1,035 present the most urgent case for external support. As of 2013, there are 36 such countries, with a total population of 846 million people. If all of those countries experience the same real per capita growth rates from 2012 to 2030 as they did from 2005 to 2012, then the corresponding number of countries in the same income category will shrink to 21 in 2030, with population of approximately 490 million.

This sizeable number of countries will likely continue to require aid for a significant period as a central component of their efforts to eliminate extreme poverty. **To that end, it is important not to confuse the end of extreme poverty with the end of aid.** Aid requirements are likely to become ever more targeted in the post-2015 era, and hopefully aid linked to support the elimination of extreme poverty can be phased out soon after 2030, but this is unlikely to be viable by 2030. There will also still be a major challenge to ensure that people who have moved out of extreme poverty also stay out of extreme poverty.

An equally profound issue is that the flip side of increasing incomes and declining poverty is an increase in the demand for food and energy. Food production will need to grow by approximately 70 percent by 2050, and this will be a driving pressure for further deforestation. In the absence of major technological advances, climbing energy production will increase greenhouse gas emissions. These forces, combined with pollution and other environmental impacts, will increase the vulnerability of societies to climate change and reduce resilience. There is therefore a strong need to stimulate both public and private international financing for innovative solutions that transform economies away from business-as-usual development paths.

To that end, we stress that aid targeted to the end of \$1.25/day extreme poverty is very far from the only important use of aid. Indeed, the international community will likely continue to decide to tackle broader targets to guide aid allocations, including public health, education, global public goods, national poverty lines, and \$2/day poverty, in addition to other sustainable development priorities, all of which might require aid commitments up to the existing political threshold of 0.7 percent of developed countries' national incomes. Aid must continue to play a central role in the post-2015 framework.

C. REFERENCE COST ESTIMATES

Although there have not been any systematic assessments of post-2015 development financing needs, both Greenhill and Ali (2013) and the UN Task Team Working Group on Sustainable Development Finance (2013) have compiled summaries of best available sector estimates. Each individual sector estimate can only be analyzed on its own merits, and the numbers should not be added simplistically to one another, since methodologies differ and some assessments also have overlaps.

Noting that caveat, the UN Millennium Project (2005, Chapter 17) provided the most detailed bottom-up estimate of ODA financing needs to reach the MDGs, adding up to some US\$ 130-190 billion a year (in 2003 dollars). More recent studies of individual social sectors have estimated longer-range costs. For example, the Education for All Global Monitoring Report team (2013) estimates that the post-2015 education financing gap is US\$ 38 billion per year, roughly half for domestic and half for aid budgets. Based on a World Health Organization (2012) analysis, Ali and Greenhill estimate that roughly US\$ 27 billion of incremental investment is required for water and sanitation. For food security and nutrition, Schmidhuber and Bruinsma (2011) estimate an extra US\$ 50 billion per year is needed to eliminate hunger by 2025. The recent Lancet Commission on Global Health 2035 (Jamison et al., 2013) estimates that incremental investments of US\$ 57–91 billion per year in low- and lower-middle-income countries could save at least 10 million lives per year by 2035.

Incremental investment requirements in infrastructure are on the order of US\$ 1 trillion a year for developing countries and US\$ 2.7–3.2 trillion a year globally (UN Task Team, 2013). Required global investments in agriculture range from US\$ 50 to 80 billion a year. To achieve energy access for all, the International Energy Agency has calculated a need for US\$ 49 billion a year in investments up to 2030. To meet the UN goal on energy efficiency would require US\$ 250–400 billion per year in additional investments. Required investments in renewable energy are on the order of US\$ 500 billion annually.

Estimates of required investments in climate change mitigation range from US\$ 400 to 1,200 billion a year by 2030 on a global scale, and US\$ 200 to 700 billion for developing countries. Similarly, the figures for investment needs for climate change adaptation range from US\$ 50 to 170 billion per year by 2030 on a global scale and US\$ 20 to 100 billion a year for developing countries. The Conference of the Parties to UNFCCC has decided that by 2020 financing (public and private) should be made available by high-income countries in the order of US\$ 100 billion for climate change mitigation and adaptation investments in developing countries.²

² We stress that the costing figures listed here are not comprehensive across sectors. For example, they do not include costs for global ecosystem services and biodiversity management, which are also crucial elements of a post-2015 sustainable development agenda.

CONSTRAINTS

Many constraints need to be addressed if the appropriate mix of public finance, market incentives, and private finance are to be mobilized for the successful realization of a post-2015 framework. In the spirit of Monterrey, the following outlines some of the key constraints to mobilizing enhanced resources from domestic public finance, international public finance, and private finance.

A. CONSTRAINTS TO ENHANCED COUNTRY-LEVEL PUBLIC FINANCE

- **Challenges in domestic resource mobilization (DRM).** Public resources based on tax revenue form a key element of national finance. Tax policies need to strike the right balance between promoting equity among citizens, supporting private investments, and securing necessary revenues. Several constraints commonly need to be addressed. One is to ensure an appropriate tax policy to match the country situation, particularly in the context of rising inequality in some countries. This might include simplifying tax systems or shifting from indirect tax to direct tax, like value added taxes, to broaden main fiscal revenues. Other common constraints include widespread informal sectors and a lack of resources or capacity to build effective tax collection and administration. Direct support for revenue and customs sectors has attracted a minimal share of aid (around 0.1 percent of ODA annually).
- **Misalignments in prices and subsidies.** Many countries allocate significant subsidies for key commodities that could efficiently be corrected to generate resources and create greater efficiencies towards other anti-poverty or sustainable development priorities. It is particularly complex for governments to adjust them in cases where these subsidies have strong public support.
- **Inadequate transparency in budgeting.** Many countries still have inadequate transparency regarding their allocations of finance and the motivations driving those allocations. This can exacerbate inequalities when funding is allocated preferentially to particular groups. The same problem often applies to international donors, too.
- **Gaps in domestic institutions for development finance.** In many developing countries, the private financial sector is inadequately developed to mobilize resources for long-term capital investment projects, like infrastructure, or for small- and medium-sized enterprises (SMEs). Most developing countries do not have 'development banks' responsible for long-term investments in key areas like infrastructure, even though such banks have played a critical role in countries like Brazil (BNDES) and South Africa (DBSA). Many leaders of international financial institutions have previously looked unfavorably on public sector development banks, although views are changing. Such development banks require careful growth of capacity in order to ensure investment projects are selected and financed appropriately.

- **Illicit financial flows.** A variety of countries struggle with illicit financial flows. This is often pronounced in countries with significant extractive resource industries, where shortfalls in transparency between domestic and international actors lead to too many missed opportunities for equitable gains (Africa Progress Panel, 2013). A recent McKinsey and Company report indicates that the number of natural resource-driven developing economies has increased from 49 in 1995 to 65 in 2011 (Dobbs et al., 2013). Action is required in all jurisdictions, across developed and developing countries, to enhance transparency and release such illicit flows for development investments.
- **Volatility.** The volatility of private finance presents an ongoing challenge to governments. For example, more than US\$ 30 billion shifted out of emerging market debt funds between May and September 2013, prompted by the prospect of the U.S. Federal Reserve ‘tapering’ off its monetary policy of quantitative easing. This raises concerns for many developing countries that have recently issued government bonds for the first time. At a more structural level, infrastructure development often requires inter-generational cross-border investment that can withstand volatility. This raises the need for countercyclical financing by public institutions, including development finance institutions.

B. CONSTRAINTS TO ENHANCED INTERNATIONAL PUBLIC FINANCE

- **Mistrust in high-income country commitments.** Many in the international community no longer want to hear high-profile donor announcements, because they do not trust them to come true. The 2005 G-8 summit saw the most high-profile aid commitments of all time, yet the group failed to deliver its collective promises by at least US\$ 18 billion by 2010. Although the United Kingdom has notably this year become the first G-8 country to reach the 0.7 percent of GNI aid target – joining Denmark, Luxembourg, Norway, and Sweden, which have long adhered to that standard of burden-sharing – none of the other 10 countries (Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Portugal, or Spain) that made 0.7 commitments for 2015 are on track to deliver them, and the Netherlands has recently stepped back from its long-held adherence to the target. Nor did the 2009 G-8 L’Aquila commitments for agriculture come to full fruition. Two years after the conclusion of that initiative, donors had only disbursed 74 percent of their commitments. Many individual countries still have credibility, but as a group high-income countries need to rebuild trust that their leaders’ words matter.
- **Unclear approach to fragile and conflict-affected states.** A growing share of the world’s extremely poor people lives in fragile states, but the world does not yet have a clear model for successful long-term aid in these situations, nor a clear agreement on how to account for relevant financing (see Box 1 on page 15).
- **Financing ‘dips’ for lower-middle-income countries.** Over the past generation, net disbursements of official grants and concessional loans to low-income countries, including those from the International Development Agency (IDA), have expanded tremendously. Between the late 1980s and 2010-11, these flows more than doubled to US\$ 85 billion per year, and increased from 3 to 13 percent of recipient countries’ GDP (Kharas 2014; figures in constant 2005 US\$). Over the same period, non-concessional lending to LMICs, which includes flows from the World Bank’s International Bank for Reconstruction and Development

(IBRD) and the International Finance Corporation (IFC), remained steady in absolute terms at roughly US\$ 15 to US\$ 22 billion per year, but declined in relative importance from 0.7 to 0.3 percent of recipient countries' GDP. Indeed, over the 2000-2009 period, LMICs (and all developing countries) repaid more on loans than they received in gross disbursements (ibid.). The needed expansion of assistance to LICs has been accompanied by a drop-off in lending support for the same economies as they grow. At the same time, many newly designated MICs confront higher prices and higher expectations to deliver better quality services.

- **Limitations in concessional finance.** A number of developing countries have reached borrowing limits set by international financial institutions (IFIs) including the World Bank, but still require increased access to finance in order to meet their investment priorities, especially in infrastructure. This suggests a need: to revisit the lending capacities and leverage ratios of the multilateral development institutions; to expand non-lending IFI instruments like guarantees; to create new infrastructure-focused international financial institutions; or to allow for greater public non-concessional lending among developing countries.
- **Challenges of multilateral replenishments.** Most donor countries divide their ODA between bilateral and multilateral channels. Multilateral programs often provide greater effectiveness and lower transaction costs for development results, but can also present coordination challenges compared to direct oversight and predictability of bilateral programs. For example, donors often confront back-to-back multi-year replenishments cycles that are not coordinated across multilateral institutions, and thereby face difficulty matching funding commitments to strategic priorities from year-to-year.
- **Unclear international climate finance mechanisms.** Many leading climate finance mechanisms are not properly functioning. The 2009 Copenhagen Accord committed to support developing countries with \$ 100 billion per year, as of 2020, to tackle climate change. But it is not clear how or if this commitment will be met. Meanwhile, the lack of international agreements on emission reduction targets has left carbon-trading systems close to a collapse. Clear agreements are also needed to support mechanisms such as the reduction of emissions from deforestation and forest degradation.

BOX 1: POST-2015 FINANCING IN FRAGILE AND CONFLICT-AFFECTED STATES

An active debate is currently underway regarding principles for financing post-2015 humanitarian interventions, especially in fragile states. Fragile states are home to one fifth of the population of developing countries and a third of those living in extreme poverty. They are also the most aid-dependent states in the world. With the share of the world's extreme poor found in fragile states set to rise to a half by 2018, post-2015 financing strategies for conflict-affected and fragile states (CAFS) will be essential. Ending extreme poverty requires sustained assistance for both short-term and protracted crises.

One central issue is to secure the long-term financial support needed for development in CAFS. Many donor governments consider these states to be too insecure with too many governance challenges to receive development funding. This results in a tendency to rely on short-term, humanitarian interventions at the expense of longer-term programs, despite the fact that longer-term commitments are necessary to help people build resilience to future shocks. This is particularly important in light of the growing scientific evidence regarding climate shocks and the onset of conflict (Hsiang et al, 2013).

In addition, too little investment has been made in helping these states build the systems needed to increase tax revenue and manage public expenditure. Fragile states still only collect an average of 14 percent of their GDP in taxes, but only 0.07 percent of official development assistance (ODA) to fragile states is directed towards building accountable tax systems (OECD, 2014). Ideally, donors can fund service provision by NGOs or other development actors at the same time as efforts are being made to strengthen national systems for service delivery. The latter often entails strengthening state capacity, advocating for improved governance, and supporting the demand for accountable public services.

Whilst humanitarian assistance and development aid must be delivered as part of a coordinated strategy, they have distinct and separate purposes. Humanitarian assistance is defined as assistance and action designed to save lives, alleviate suffering, and maintain and protect human dignity during and in the aftermath of emergencies. In practice it can be difficult to define exactly when other types of assistance begin, but the distinct aims of humanitarian and development finance should not be blurred, not least because merging them risks a reduction in either or both. In addition, the key principles of neutrality and impartiality must be retained for humanitarian assistance. The politicization or militarization of humanitarian assistance risks the lives of humanitarian workers and undermines its effective delivery.

C. CONSTRAINTS TO ENHANCED PRIVATE FINANCE

- **Legal and administrative constraints.** Many countries face gaps in legal frameworks and institutional administrative capacities that stand as the most important constraints in promoting private investment, and are particularly acute in the realm of green investment and green energy development.
- **Regulatory ambiguity and unintended negative consequences for long-term investment.** A variety of recent international financial regulations have been proposed or introduced with the intention of promoting financial stability. However, the same regulations have prompted concerns regarding inadvertent incentives towards short-term lending and potential negative impacts on investors' incentives to commit to long-term investment. Similarly, the OECD has also pointed out how anti-monopoly policies in the electricity sector can end up obliging the unbundling of ownership for generation and transmission facilities, which can discourage investors' desire to make needed investments in green technology (Kaminker et al., 2013).
- **Shortfalls in 'bankable projects'.** One increasingly recognized challenge is a shortfall of bankable projects that can deploy private finance with sound prospects for adequate rate of return. The G20 has identified this as a critical bottleneck with respect to infrastructure and recommends the international community work to jointly build capacity to enhance existing project preparation facilities (High Level Panel on Infrastructure, 2011). This is particularly challenging for small- and medium-sized enterprises, which have limited ability to access finance at startup and venture phases. Risk sharing and mitigation form the biggest gaps to formulating bankable projects, so more and better risk sharing mechanisms are required between public and private sectors across all project stages.
- **Inadequate mechanisms to manage long-term intergenerational political risk.** A number of major global investment funds would be pleased to make long-term investments in sustainable infrastructure, but the most significant constraints are perceived to be long-term political, regulatory and administrative risks. Uncertainties could take the form of many aspects of project implementation, change of contract terms, risk of nationalization or expropriation, or even outright cancellation. Mechanisms to bear such long-term political risks are being established by the Multilateral Investment Guarantee Agency (MIGA) but need to operate at a much greater scale, a point that has been made repeatedly over the past decade (e.g. World Economic Forum, 2006). As one long-term investment leader recently privately stated, 'We need MIGA on steroids.' The absence of adequate institutional mechanisms prevents the shift away from business-as-usual investment patterns, which is imperative in the face of the planet's ecological boundaries.
- **Inadequate incentives to ensure private investment's positive impacts.** Many countries have inadequate safeguards, regulations, reporting requirements, and incentives to ensure investments promote desirable economic, social and environmental outcomes. Meanwhile, efforts to scale up 'impact investments' – those that aim to generate measurable positive social, environmental, and financial returns – are still in their infancy.

- **Under-leveraged alternative sources of finance.** Additional private resources need to be mobilized for sectors that are traditionally less conducive to private financing, such as public education, social protection or support to SMEs. A range of innovative financing mechanisms are currently being developed, for example Development Impact Bonds (DIB), which are a sub-category of social investment bonds that aim at linking socially-oriented funds – both public and private – with the achievement of targeted development outcomes.
- **Inadequate coordination with, and excess policy uncertainty for, private investors.** Many large-scale institutional and private investors would be interested in making sustainable development-focused investments, but they are operating in an uncertain policy environment. Most large-scale investors have a formal mandate to maximize returns, so it is difficult for them to allocate more than a limited share of their portfolios to sustainability-focused projects under such circumstances.
- **The problem of small money.** Inclusive growth requires the strengthening of the ‘missing middle’ and the growth of SMEs. Financing remains too limited, although increasingly available, for microenterprises like subsistence farming or survival entrepreneurship. Very often the minimum loan size available is far larger than what an SME needs and is able to contract.

OPPORTUNITIES

One defining feature of the 'almost-2015' environment is the paradox of global savings imbalances. While many high-income economies face budget deficits and aggregate dis-savings, many emerging markets have accumulated surplus savings. China, for example, has about US\$ 3 trillion in foreign reserves and a generally high savings rate. Meanwhile, many parts of the private sector are awash with cash. For example, US private companies are estimated to have as much as US\$ 1.5 trillion dollars in surplus cash. At the same time, many low-income African countries are behind in achieving MDG targets, partly because of the shortage of resources. But these same countries are experiencing economic growth and creating more room for domestic resource mobilization. Remittances from abroad also remain strong, and natural resource discoveries offer new hope.

Amidst the needs and constraints, there is a variety of promising opportunities for registering gains towards a successful post-2015 financing framework. This section looks into the opportunities for enhanced development finance, again across the respective dimensions of country-level public finance, international public finance, and private finance. We stress that these points do not aim to be comprehensive, but only aim to draw attention to leading possibilities.

A. OPPORTUNITIES FOR ENHANCED COUNTRY-LEVEL PUBLIC FINANCE

- **Enhanced tax revenue systems:** Tax revenues can be scaled up by strengthening tax collection systems. Every dollar invested in improving tax collection systems can lead to hundreds of dollars in increased tax revenue.
- **National bond issuances.** Some countries, such as Kenya, are launching domestic bonds targeting infrastructure investments. They will join countries like Ghana, Nigeria, Rwanda and Senegal that have all issued euro bonds to access global capital markets.
- **The dividend of tackling inequalities.** Enhancing the equity focus in development strategies can increase the cost-effectiveness of national programs (UNICEF, 2010). Moreover, poverty can be reduced by inclusive growth, and all poverty forecasts (including those cited above by Chandy et al.) hinge on assumptions regarding both growth and distribution. Drivers of growth that enable a reduction of inequalities – such as labor-intensive manufacturing, construction, enterprise growth and small-holder farming – can generate a faster poverty reduction pattern and reduce the need for public financing by fostering economic inclusion.
- **Putting a price on ecosystem services.** Countries can estimate the value of ecosystem services, such as watersheds, oceans, and forests, to develop instruments that capture relevant externalities for local economies. Similarly, natural assets like biodiversity can be given positive valuations to create incentives for their ongoing protection.

- **Improved natural resource revenue management:** Most illicit flows are linked to transfer pricing, under-invoicing, or unfavorable contracts and corruption in the natural resource sector. As mentioned earlier, these outflows are probably most severe in a limited number of countries, but some have estimated them to be as much as US\$ 50 billion annually in Africa alone (Boyce and Ndikumana, 2012). Re-orienting these dollars to domestic systems will provide huge boosts to local sustainable development progress.

For both renewable and non-renewable resources, proper management begins with common global standards of transparency and accountability, as emphasized by Kofi Annan and the Africa Progress Panel (2013). The Natural Resource Charter can be an important tool helping countries channel non-renewable resources into broad-based sustainable development. Public-private transparency initiatives like ‘publish what you pay’ and the Extractive Industries Transparency Initiative can also play an important role. Both multinational companies and their host countries need to support disclosure.

Crucially, contracts need to apply objectively fair standards of royalties and taxes. This is an area where knowledge transfer initiatives to build government capacity for negotiating with large multinational corporations can play an important role. In cases where countries enjoy unduly advantageous contracts negotiated under questionable circumstances, these might need to be renegotiated. One option is that revenues raised should be managed through sovereign wealth fund structures that not only determine optimal asset allocation but also ensure good returns, while investing in development projects and programs. There may be a role for direct transfer of natural resource revenues to citizens.

B. OPPORTUNITIES FOR ENHANCED INTERNATIONAL PUBLIC FINANCE

- **Enhanced leverage for Multilateral Development Banks (MDBs) and ODA:** MDBs will continue to use their ‘soft windows’ such as the International Development Association (IDA), the Asian Development Fund (ADF) and the African Development Fund (AfDF) as sources of development funding for LICs. However, ODA also needs to set aside resources for partial risk guarantees to lower risk for investment in fragile states. Such partial risk mitigation will leverage the grant resources ten-fold by crowding in private sector investments.
- **New MDBs and infrastructure funds:** The BRICS countries (Brazil, Russia, India, China, and South Africa) have already announced an intention to launch a ‘BRICS Bank’ to fund mainly infrastructure investments, with a potential capitalization of US\$ 50 billion. As mentioned earlier, many countries have national development banks that play a key role in mobilizing finance for domestic purposes, and some are now larger than the World Bank. A new multilateral bank, or a broader proposed global infrastructure facility, would contribute to closing the large infrastructure deficit in LICs and MICs. The African Development Bank has proposed establishing an ‘Africa50 Fund’ for infrastructure by tapping into foreign reserves of African central banks, plus global and local pension funds.

- **Coordinated multilateral replenishments.** Major multilateral institutions can coordinate their replenishment requests and calendars to match the needs as defined by the forthcoming post-2015 goal framework, and thereby provide ample notice to funding partners regarding how the required resources need to align across institutions.
- **Multi-pronged capacity investments for sustainability.** There are growing examples of how donor agencies can support emerging markets to implement large-scale sustainable development projects successfully. In Indonesia, for example, the government has been striving to establish a policy framework for combatting climate change, supported by various donors. The Japanese International Cooperation Agency (JICA) provided a Climate Change Program Loan to support the government on three phases of policy reform. At the same time, JICA supported the government's policy to pursue geothermal development and implement incentive mechanism to promote private investment, including guarantees, exploration funds, and feed-in tariffs. Grants were also directed towards improving administrative capacity, for instance through government tender procedures.

C. OPPORTUNITIES FOR ENHANCED PRIVATE FINANCE

- **Engaging pension funds and private investment companies.** Pension funds, insurance companies, investment companies, and private equity funds can all play a pivotal role in post-2015 finance. Institutional investors manage a combined US\$ 71 trillion in total assets, an enormous potential source for long-term investment. Globally, these entities are currently suffering from low investment yields, while return opportunities in low-income regions remain higher, even on a risk-adjusted basis. It is crucial to engage asset owners at the international level, in order to redefine and redevelop their investment policies and related implementation strategies regarding sustainable development and key climate issues.
- **Inclusive business models:** Some global companies use outsourcing and inclusive models that create opportunity for local communities. For example, Coca Cola outsources coffee growing while South African Breweries outsources barley growing. More could be done by other companies in the space of such inclusive business models.
- **Corporate sustainability metrics.** Sustainable development criteria can be applied to corporate activity at all levels, ranging from accounting and audit systems to annual reports, especially for public companies (UN-GSP, 2012). A changed incentive scheme can spur more investments towards sustainable development. These criteria can be applied by the boards of sovereign wealth funds, pension funds, stock market regulators, stock exchanges and credit rating agencies, government procurement bodies, and international organizations. In order for all companies to feel the incentive to follow such criteria, it is crucial that they be implemented at the top of the 'investment food chain.'

- **Expanding private sector philanthropy:** Philanthropic organizations, established by private companies and individuals, have become significant funders of development. In many cases their investments are crucial for seeding new initiatives, such as the GAVI Alliance, and creating the opportunity for governments to scale up. It is likely that philanthropy in all corners of the globe will continue to grow as domestic entrepreneurs thrive and join efforts such as The Giving Pledge to allocate half of their wealth to philanthropy.
- **Innovative finance.** Innovations such as development impact bonds can jointly leverage public and private dollars to expand the pool of available resources towards targeted sustainable development success. They require strengthened evidence through field-testing and, if successful, should be brought to scale by public or private development actors in conjunction with the sustainable finance sector. Among other innovations, there is scope for countries with large global diasporas to launch 'Diaspora bonds' that target inflows from citizens living abroad. There are also significant opportunities to launch funds compliant with sharia law and Islamic finance.
- **Fast developing financial technologies:** Many developing countries in Latin America, Asia and Africa have developed remarkable technologies for service delivery in financial services, health services, education, among others. Kenya leads the world in mobile phone-banking, with M-Pesa. This is only one piece of ongoing innovations in expanding services at lower cost, including mHealth services in countries like Rwanda and mobile education access in South Africa. Organizations like GiveDirectly have also pioneered the use of mobile technology to facilitate unconditional cash transfers for social safety nets, to great effect. Distribution technologies are no longer a binding constraint to successful cash transfer programs.

CONCLUSIONS

Financing a transformational post-2015 sustainable development agenda will require policymakers and publics to amplify the key components of the current system that work well while addressing key constraints and exploiting new opportunities to match the evolving mix of needs and actors around the world. We highlight the following key conclusions to that end.

A HIGH AMBITION FOR SUSTAINABLE DEVELOPMENT FINANCE, SHARED BY ALL

1. Ambitious goals in the post-2015 sustainable development framework – addressing the reduction of poverty and inequality in all its forms while tackling the interwoven imperatives of global environmental sustainability – will require accompanying ambition and innovation in development finance.
2. Building on the 2002 Monterrey Consensus, primary responsibility for financing poverty reduction will rest with developing countries themselves. In addition, however, vital contributions will be made by international public and private finance, contributing both to national development and the provision of global public goods.
3. Development finance will increasingly be integrated across types. Flows from different sources will need to complement each other, with public finance leveraging additional private sector finance, and flows from all sources adhering to common standards of measurement and reporting regarding transactions, beneficiaries, and impacts. Transparency and accountability towards results must be a centerpiece of post-2015 finance.

ON OFFICIAL DEVELOPMENT ASSISTANCE (ODA)

4. The goal of ending extreme poverty by 2030 should not be confused with ending ODA by 2030. The need for ODA goes well beyond tackling PPP\$ 1.25/day poverty, for example in public health or the provision of global public goods, in addition to other sustainable development priorities. Even a fully successful extreme poverty agenda will likely require targeted support beyond 2030; and ODA will also be needed to help lift poor people above higher thresholds, such as PPP\$ 2/day.
5. The principle of common but differentiated responsibilities means that high-income countries should follow-through on the commitments they have promised, but also that middle-income countries (MICs) and emerging economies should be encouraged to make contributions to global poverty reduction and the provision of global public goods.
6. ODA will need to prioritize the poorest countries, and programs within those countries which target the poorest people and which most effectively reduce poverty.
7. The vast majority of the needs of MICs will be financed through domestic resource mobilization and access to international markets. However, many MICs, especially those which are fragile states, will merit some continued aid, including for humanitarian purposes and technical cooperation for institutional strengthening.

8. Graduation from aid needs very careful consideration. It will be necessary to ensure that emerging lower-middle-income countries (LMICs), especially those with large numbers of extreme poor, do not face a stark drop-off in access to external finance. This might require a rethinking of thresholds and bolstering of concessional finance.
9. There will be pressure to redefine ODA so as to include a wider range of peace-keeping activities. In principle, this should not be encouraged. Similarly, it is not acceptable for climate budgets to 'cannibalize' other components of aid budgets.
10. Improving the capacity of developing countries to mobilize their own resources should be an important element of ODA. In many cases, and without imposing unwanted conditionalities, it will be necessary to invest significantly in broadening the tax base, raising tax revenues, and combating fraud. International coordination should also be strengthened to avoid situations where tax policies in developed countries undermine developing countries' capacity for domestic resource mobilization, for example in the areas of illicit financial flows.
11. Strong partnerships will also be required, consistent with the core principles of aid effectiveness (such as those outlined in the Paris, Accra, and Busan outcome documents) between traditional and new donors, including emerging official donors and the large number of impact investors and philanthropic organizations.

ON PRIVATE SECTOR INVESTMENTS AND RESPONSIBILITY

12. The private sector will play a major part in providing development finance post-2015, often partnering with governments and civil society. It is also important to recognize the non-financial private sector contributions that can be extremely valuable, including core business, shared value, and 'do no harm' contributions. It is essential that responsible business practices be promoted among national and international companies. Mandatory reporting is one way to promote high standards and accountability.
13. Governments will need to improve the policy and regulatory environment for enterprise creation and growth and for promoting investments that create jobs.
14. Greatly enhanced public instruments are needed to accompany and incentivize the amount and nature of private finance that will be required to achieve a post-2015 sustainable development agenda. The biggest ticket investments are in infrastructure, energy, and agriculture (including water), all of which will typically require some degree of 'blending,' whether in the form of risk guarantees, advantageous long-term borrowing instruments, or other appropriate structures.
15. Innovative tools can also play an important role in leveraging and expanding available public sector resources, as has been the case with the Advanced Market Commitments for vaccines and the International Finance Facility for Immunizations. The growing importance and sustainability focus of large institutional investors, including sovereign wealth funds, can provide critical opportunities for innovation.

ON THE LINKS TO CLIMATE FINANCE

16. The global challenge of climate financing extends far beyond traditional ODA. In addition to the structural transformations required to achieve a low-carbon global economy, there will be need for specific resources, public and private, to address climate change mitigation and adaptation in middle-income and low-income countries.
17. Many of the private and public infrastructure investments for sustainable development will be the same ones that determine the future of the world's climate change mitigation and adaptation efforts. Despite the political divisions, the practicalities of financing poverty eradication, sustainable development and climate change mitigation and adaptation are deeply interwoven. Promoting financing that brings multi-dimensional benefits is key to addressing these challenges.



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