Section 5
FINANCING THE SDGs

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Although a series of measures have been introduced to stabilize the financial system at the global level, it still remains vulnerable and continues to be unstable. Access to finance by many groups continues to be limited and the financial system remains weak in directing savings to meet long-term investment needs (UNEP, 2015). This in turn has a direct negative effect on financing sustainable development and the achievement of SDGs. Ensuring the financial sustainability of policies, plans and programs is key for achieving sustainable development.

The financial system as currently designed is not geared to supporting sustainable development. Efforts are therefore needed to align the financial system at the international and national levels to support sustainable development. It is becoming increasingly recognized that there is a need to integrate sustainability into the financial system in order to yield short and long-term benefits (UNEP, 2015).

"Sustainable financial system is therefore one that creates, values and transacts financial assets in ways that shape real wealth to serve the long-term needs of an inclusive, environmentally sustainable economy."
UNEP Inquiry Report, 2015

The financial and economic crisis that emerged in 2008 has underscored that the current development paradigm has its shortcomings. This has prompted UNEP to launch the Green Economy Initiative, which emphasizes investing in environmental and natural resources as an essential requirement for achieving sustainable development.

It has been estimated that the financial requirements needed to transition to a green economy and implement sustainable development activities worldwide is in the tune of US$ 1.05-2.59 trillion annually. This figure is less than one tenth of the total annual global investment (measured by global Gross Capital Formation). If we were to allocate an annual level of funding of US$ 1.3 trillion, a 2 percent of global GDP will be required to finance sustainable development (UNEP, 2011). Applying the same percentage of 2 percent for Arab countries to support sustainable development activities, an additional amount of US$ 57.38 billion (GDP US$ 2.869 trillion – 2014) annually would need to be allocated for greening the Arab economies.

According to the United Nations Conference on Trade and Development (UNCTAD), it is estimated that US$ 5-7 trillion annually is needed to finance the SDGs (World Investment Report 2014). Developing countries alone will require US$ 3.9 trillion annually. Currently US$ 2.5 trillion are being provided leaving a gap of US$ 2.5 trillion (UNEP, 2015). It is estimated that the financing gap in Arab countries for achieving SDGs is between US$ 80-85 billion annually in 2015 and 2016. These estimates should be considered as indicative as they do not take into account possible synergies between SDGs and variations in level of spending and commitment to the SDGs in Arab countries (ESCWA, 2015).

However, it should be emphasized that apart from securing additional financial resources, focus should be on the mobilization and the redirection of existing local financial resources, both public and private, towards supporting sustainable development activities. Moreover, policy coherence and harmonization will go a long way towards achieving this objective, as it does not make any economic sense to maintain conventional investment options, while at the same time aiming to channel funds to support new and innovative environment-friendly sustainable investments.

A. GOOD GOVERNANCE

Adopting sustainable development policies, if properly designed and implemented, is likely to generate sufficient funding to support sustainable development activities. Domestic resource mobilization supported by public policies are key for achieving sustainable development. These policies include good governance, adequate fiscal space, countercyclical fiscal policies, and measures to combat corruption (UN-DESA, 2015).

One of the challenges facing several Arab countries is illicit finance flows and money laundering. Efforts should be made to reduce and eventually eliminate these practices, including combating tax evasion by national and transnational corporations. The International Monetary Fund (IMF), the World Bank, and the United Nations should be called upon to assist in that matter. International and regional institutions may be called upon to publish estimates on the composition and volume of illicit financial flows. As per paragraph 25 of the Declaration of the Finance for Development Conference held in Addis Ababa in July 2015, Arab countries should be encouraged to ratify and accede to the United

Nations Convention against Corruption as a means to detect, deter, prevent and counter corruption and bribery, and recover stolen assets to the country of origin (UN-DESA, 2015).

> *"Governance architecture can promote the development of a financial system that is sensitized to sustainable development."*
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> UNEP Inquiry Report, 2015

Efforts should be made to introduce regulatory frameworks that increase transparency and accountability of private companies and financial institutions, as well as the public sector. Moreover, investing in research and development and efficient data gathering, analysis and dissemination systems are critical in supporting sustainable development efforts.

B. SUSTAINABLE CONSUMPTION AND PRODUCTION

Arab countries import about a third of traded cereals worldwide (World Bank and FAO, 2012). With increased population levels and water scarcity, Arab countries are faced with a rather serious food security problem. Adopting more sustainable consumption and production patterns would result in the more efficient use of natural resources and other factor inputs in the various sectors. Efficiency in food consumption for example will result in savings in food consumption as well as energy and water consumption. About 85 percent of water consumption in Arab countries is used for agriculture. Adopting efficient and sustainable agricultural practices in the agriculture sector will result in a large amount of water savings. Moreover, reducing the import of food in subsidies for food products, energy and water can generate financial resources that can be directed towards financing sustainable development activities, realizing the objectives of SDGs, and addressing climate change concerns.

C. PRIORITY INVESTMENT AREAS

1. Investing in Human Capital

A necessary prerequisite for achieving sustainable development and encouraging domestic and foreign investment is the availability of professional and skilled labor needed to support sustainable development. Investing in modern education systems that emphasize research and innovation is critical in making a transition towards a green and sustainable economy. Investing in the education system should be complemented by investments in the health system. Additional investment needs for education for developing countries is estimated at US$ 22 billion, while for health the estimated amount is about US$ 24 billion annually to meet the SDGs. Funding required at the global level for addressing climate change mitigation is estimated at US$ 380-680 billion and for climate change adaptation US$ 60-100 billion annually (Schmidt-Traub and Sachs, 2015). It is estimated that Arab countries would need between US$ 110 billion to US$ 150 annually to address climate change adaptation and mitigation (ESCWA, 2015).

2. Investment in Natural Capital

In addition to the importance of investing in human capital, investing in natural capital is considered to be a cornerstone for achieving sustainable development. Apart from oil, the export of natural resources represents a major source of income. The sound management of natural capital is therefore essential to maintain the sustainability of natural assets in the region. This includes investing in ecosystem services, as well as agricultural products, sub-soil mineral resources, surface natural resources such as phosphate, marble, and sand. In order to enhance the value of these resources, efforts should be made to invest in value addition and processing of natural resources. Governments should provide the necessary incentives and regulatory framework to encourage public and private sector investment in natural capital. It is estimated that investment in ecosystem services and biodiversity alone requires US$ 6 billion annually at the global level (Schmidt-Traub and Sachs, 2015).

3. Investment in Infrastructure

One of the constraints for attracting investments in sustainable development projects is the lack of adequate infrastructure. It is therefore important that Arab countries allocate sufficient funding for investment in infrastructure. This includes investment in water and sanitation, renewable energy, sustainable communities, and environment friendly road and transportation networks. This can partly be achieved by providing incentives for private sector investment and through PPP. It is also proposed that Arab countries develop a long-term transboundary program for infrastructure

INTEGRATING SUSTAINABILITY CONSIDERATIONS IN THE FINANCIAL SYSTEM

- Integrate sustainability risk factors into credit analysis
- Introduce requirements to disclose policies on sustainability
- Introduce requirements for reporting on sustainability performance annually
- Create green investment funds and banks
- Enhance sustainability capabilities of policymakers and financial regulators
- Develop financial literacy programmes to include sustainability considerations
- Incorporate sustainability considerations into financial markets and asset purchase programmes
- Integrate environmental and social considerations in lending operations
- Promote diversity of financial institutions in terms of geographical coverage, size and business model
- Restrict financial transactions that result in social and environmental costs
- Facilitate lending for priority sectors, green investment
- Facilitate lending for private sector, including SMEs
- Align fiscal incentives for savings, lending, investment, and insurance with sustainability
- Introduce standards and regulations to facilitate capital raising such as green bonds
- Promote knowledge and training on sustainability to undertake fiduciary responsibility

Source: UNEP Inquiry Report, 2015

development that promotes linkages and trade between Arab countries. Blended finance through PPP, combined with clear accountability mechanisms encourages private sector engagement in sustainable development projects.

4. Subsidies

In addition to their market distorting effects, subsidies represent a major burden on government budgets in most Arab countries. This is in addition to the negative impacts on resource use represented in the inefficient allocation and use of resources and increased volumes of generated waste and pollution.

At the global level, fossil fuel consumption subsidies amounted to US$ 493 billion in 2014, lower by US$ 39 billion from the previous year. This amount is more than four times the value of subsidies for renewable energy (International Energy Agency, 2015). Energy subsidies in the MENA region (including Iran) amounted to US$ 237 billion in 2011, which is equivalent to 22 percent of government revenues (IMF, 2014). Energy subsidies amounted to US$ 43.52 percent in Saudi Arabia, 20.28 percent in Egypt, 18.15 percent in UAE, and 10.59 percent in Algeria (AFED, 2015).

"Sustainable development requires changes in the deployment and relative value of financial assets and their relationship to the creation, stewardship and productivity of real wealth."

UNEP Inquiry Report, 2015

As for food subsidies as a percentage of GDP, it represented 2.1 percent in Syria, 1.8 percent in Jordan, 1.3 percent in Egypt, and 0.7 percent in Morocco (World Bank, FAO, IFAD, 2009). Several Arab countries have already taken steps to phase out energy subsidies. Those included Bahrain, Egypt, Jordan, Kuwait, Oman, Morocco, UAE, and most recently the Kingdom of Saudi Arabia (Ministry of Finance, Budget document, Kingdom of Saudi Arabia, 2016). Phasing out subsidies in the Arab region, apart from contributing towards more sustainable consumption and production and consequently the efficient use of resources, is expected to save billions of dollars annually that can be used to support sustainable development activities.

5. Taxes

Taxes are one of the main income generating sources for governments. According to the IMF, there is a need to enhance the national capacities in Arab countries to enable more efficient tax collection systems in the region. Arab countries with relatively high tax effort include Morocco and Tunisia, followed by Egypt, Jordan, Lebanon, and Algeria (ESCWA, 2015). However, tax systems need to be designed not just simply to raise funds for government coffers, but also to influence attitudes towards more sustainable patterns of consumption and production.

Regressive tax systems harm people, particularly poor income groups, women, minority groups and under privileged communities. In order to ensure the equitable distribution of wealth and that the tax system does not represent a burden on middle and low income families, a progressive tax system should be introduced. Tax systems need to be reviewed to ensure that they are pro-poor and pro-environment.

Moreover, the informal sector constitutes a high percentage of the economy in most Arab countries.

Five steps are proposed to embed financing for sustainable development at the heart of tomorrow's global financial system and deliver the much-needed transformation. These steps build on country-level experience in advancing ambitious plans to ensure that the financial system fulfils its historic purpose of meeting long- term needs, engages key international institutions effectively and develops the new generation of methods and standards that can institutionalize sustainable development in the governance and practice of financial and capital markets worldwide.

ACCELERATORS OF TRANSFORMATIVE FINANCE

1. National financial market reform and development plans to embrace consideration of the Sustainable Development Goals and Paris climate commitments, and vice versa.
2. Financial technology mobilized to support the accelerated alignment of the financial system with sustainable development, particularly for developing countries.
3. Public finance to undergo a disciplined analysis and, as required, redeployment to align to the Sustainable Development Goals and Paris climate commitments.
4. Investing in awareness-raising and building key capabilities, so that the financial community can effectively implement new approaches and plans.
5. Development of common methods, tools and standards to enable sustainable development priorities to be measured and incorporated into financial practice.

Source: UNEP (2016). Financing Sustainable Development

It is estimated that the informal sector in Egypt constitutes 45 percent of the economy, and in Jordan it is 20 percent (ESCWA, 2015). Measures should be taken to integrate the informal sector in order to broaden the tax base. This should further be supported by enhancing the efficiency of the tax collection system. Governments should set national targets for enhancing domestic revenues as part of national development strategies (AFED, 2015). Moreover, Arab countries should seriously consider the introduction of a carbon tax due to its positive impacts on the environment and on addressing climate change concerns.

6. Trade

Revenue from export represents one of the main sources of income and finance. Trade policies, if properly designed, can be a main source for foreign exchange earnings needed to support sustainable development, job creation and growth. However, trade policies need to be designed to ensure the sustainable management of natural resources. On the other hand, investing in green products could enhance the competitiveness and market access opportunity for locally produced products, equipment, and technologies. To achieve this end, the long awaited Arab Trade Agreement should be negotiated and finalized to support Arab efforts in achieving SDGs and the implementation of other international environmental agreements.

7. Reviewing the Current Financial System

Mobilizing financial resources for SDGs requires introducing sustainability measures in the financial system. This is justified due to the following reasons:

a. Managing risk: Intervention in the financial system may be justified due to insufficient risk management resulting in negative environmental and social impacts.

b. Promoting innovation: This may be generated through the issuance of green bond markets by setting green standards to enhance investor confidence and improve market performance.

c. Strengthening resilience: It is estimated that losses due to natural disasters worldwide amount to US$ 250 billion to US$ 300 billion annually, which is likely to negatively impact the financial system, thus requiring an intervention.

d. Policy coherence: It is important to ensure that the financial system is in line with government policies aiming for a transition to a green and sustainable economy (Schmidt-Traub and Sachs, 2015).

8. Financial Institutions

Regulatory frameworks should be developed and introduced along with risk mitigation mechanisms to encourage and govern lending for sustainable development projects. These regulatory frameworks should be supported by incentive measures to support financial market stability. Equity considerations should be taken into account in introducing regulatory reforms making finance available to women, and middle and low income groups. This includes supporting micro finance cooperatives, development banks, agricultural banks, mobile network operators, mobile banking, and postal banks (UN-DESA, 2015).

9. International Public Finance

International public finance, both concessional and non-concessional, has an important role to play in supporting national efforts to finance sustainable development activities. It should also be used to encourage domestic public and private finance. However, there is a need to ensure that funding secured should be properly deployed in order to have the desired impact on sustainable development. In spite of the long standing commitment of developed countries to provide 0.7 percent of national income for Official Development Assistance (ODA), an average of only 0.3 percent has been achieved (ESCWA, 2015). The Addis Ababa Declaration has called upon developed countries to achieve the target of 0.7 percent of ODA/GNI and 0.15 to 0.2 percent ODA/GNI to least developed countries within the timeframe of the post-2015 agenda (UN-DESA, 2015).

Among the top Arab ODA receiving countries in 2014 were Syria US$ 4,330 million, Egypt US$ 3,532 million, Jordan US$ 2,699 million, and Morocco US$ 2,228 million. Yemen received US$ 1,150 million, Tunisia US$ 930 million and Sudan US$ 866 million in the same year (Development Aid at a Glance (2016), Statistics by Region, 6 edition, OECD).

It should be noted however, that over the last four decades, Arab aid has continued to represent an increasing percentage of total global aid. It is estimated that Arab Official Development Assistance accounts for 13 percent of total ODA and three quarters of non-DAC ODA (World Bank, 2015a). Not only this, but Arab Aid in the form of ODA, particularly from Saudi Arabia, Kuwait, and the United Arab Emirates to Arab and other developing countries averaged 1.5 percent of their combined Gross National Income (GNI) during the period 1973-2008 (World Bank, Arab Development Assistance: Four Decades of Cooperation, 2010).

10. Foreign Direct Investment

Net foreign direct investment (FDI) in most Arab countries is negative, which is mainly attributed to weak governance systems (ESCWA, 2015). FDI as a percentage of GDP was estimated at 27.73 percent in Mauritania and 19.64 percent in Djibouti, while in Lebanon and Libya it reached 6.39 percent, and in Egypt 2.04 percent (World Development Indicators, Doing Business 2015 - The World Bank Group).

Arab countries should design policies that encourage foreign direct investment with emphasis given to investments in innovative green technologies and sectors, and the engagement of local enterprises, especially SMEs. Priority for FDI should be directed to sectors that are not attractive for private sector investment, and with the highest potential for creating new jobs. Priority should be given to investment in areas that contribute to the diversification of the economy in industry, agriculture, and infrastructure. Arab countries in need of FDI should consider the use of insurance, investment guarantees, including through the Multilateral Investment Guarantee Agency to encourage FDI (World Bank, 2015a).

11. Arab National and Regional Development and Financial Institutions

National and regional banks have an important role to play in financing sustainable development. Efficient national and regional financial institutions, with sound lending frameworks and compliance and appropriate environmental and social safeguards can play an effective role in financing sustainable development, particularly in credit markets which experience financing gaps (World Bank, 2015a). This includes financing sustainable infrastructure, such as roads and transportation systems, water, energy, agriculture industry, tourism, housing and urban development, and technology development.

Financing SMEs should be encouraged in order to promote their integration in the development process in the Arab region. This can be achieved by allowing them to use collateral substitutes, reduce entry and exit costs, and provide exceptions to capital requirements.

Innovative financial mechanisms include development-oriented venture capital, blended finance, risk mitigation instruments, and innovative debt funding structures combined with risk management and regulatory frameworks (World Bank, 2015a). Arab national and regional development institutions established a Coordination Group (CG)[5] in 1975, which can provide an important source of funding for sustainable development goals in the Arab region. These institutions have been playing an important role in delivering development assistance to Arab and other developing countries. Their combined financing operations benefited over 140 countries across the globe with a total cumulative amount of about US$ 147 billion at end 2014, with a share of over 55 percent for Arab countries (Coordination Group Secretariat, Arab Fund for Economic and Social Development).

The CG institutions have pledged their support to achieving the SDGs in developing countries. The Arab countries can greatly benefit from the financing operations of the CG, covering various economic and social sectors, with due consideration to environmental concerns. Moreover, they have gathered vast experiences in the area of development cooperation, and they can help partner countries in the adoption and application of best practices in the preparation, evaluation, and implementation of development operations to ensure their sustainability and effectiveness.

12. United Nations, International Conventions and Funding Mechanisms

The United Nations and Bretton woods organizations and multilateral agreements offer another potential source of funding sustainable development. Meeting commitments with respect to international conventions offer funding opportunities for Arab countries. This includes the Global Environment Facility (GEF), global Strategic Plan for Biodiversity for 2011-2020 and its Aichi Biodiversity Targets, The United Nations Convention to Combat Desertification, the Montreal Protocol on Substances that Deplete the Ozone Layer, and the Climate Change Convention. In the latter case the Green Climate Fund (GCF) with a US$ 100 billion of pledged funding provide a funding opportunity for Arab countries. The challenge is developing well-designed and credible projects that qualify for funding through the GCF.

Arab countries should join calls for supporting efforts for governance reform in both the IMF and the World Bank to adapt to changes in the global economy, including supporting the implementation of SDGs and responding to the needs of Arab countries.

13. Civil Society and Philanthropic Organizations

Civil society has an important role to play in providing technical and financial support for sustainable development activities. Financial and non-financial contributions by philanthropic institutions can also play an important role in supporting sustainable development. Governments should encourage civil society and philanthropic organizations to provide financial and technical contributions towards sustainable development and aligning their activities with government policies, plans and programs. Development and humanitarian finance offer an opportunity for channeling those funds to support sustainable development activities. Arab countries, particularly those in post conflict situations, should create mechanisms for the management of development and humanitarian finance in the most efficient and effective way. This should be supported by capacity building efforts to strengthen national capacities and institutions to deal with conflict stricken areas in affected countries (World Bank, 2015a).

14. Remittances of Migrant Workers

In a number of Arab countries such as Egypt, remittances of nationals working abroad represent a considerable percentage of foreign exchange earnings. Governments are therefore encouraged to make available adequate financial services to nationals working abroad and migrants and their families in both home and host countries to facilitate the transfer of funds to their respective countries. This includes reducing average transaction costs. According to paragraph 40 of the Addis Ababa Declaration, countries should aim at bringing transaction costs to less than 3 percent of the amount transferred.

15. Private Sector

As referred to in section III on Implementation of the SDGs, the private sector has a very important role to play in investing in sustainable development. This is particularly so, as in several Arab countries existing public institutions neither have the technical nor the financial capacity to support sustainable development activities. The private sector has the financial and human resources and managerial skills to support sustainable development activities. It also has the practical experience and knowledge about existing situations, opportunities and constraints on the ground and how best to deal with them. The physical presence of the private sector and its direct contact with local communities and realities on the ground provide the private sector with first-hand information and knowledge about local circumstances, how best to engaged local communities and respond to their needs and priorities. The private sector, both domestic and foreign should be encouraged to support government efforts in designing and implementing sustainable development policies, plans, and programs, including through PPP. Providing the right incentive package for the private sector is expected to tap onto large financial resources that can be channeled to support sustainable development activities. This is particularly important in Arab countries, where government budgets are already overstretched.

Lack of human capacities and skills and innovation is one of the necessary requirements for achieving sustainable development. The role of the private sector in this regard cannot be but overemphasized. Arab countries should therefore encourage the private sector through a package of incentives to invest in capacity development and R&D.

Moreover, in most Arab countries domestic savings channeled through the banking sector and capital markets need to be stimulated (ESCWA, 2015). This can be achieved by ensuring stable and more predictable banking and exchange rate regulations that encourage savings by individuals and institutions. These savings can in turn be channeled to support sustainable development activities.

It should therefore be emphasized that regulatory frameworks supported by incentive measures should be introduced that direct private sector investment towards sustainable development projects. This is also in line with Monterrey that recommended the building up of transparent, predictable, and stable investment environment, with adequate enforcement of contracts, respect to property rights, sound macroeconomic policies and institutions (UN-DESA, 2015).

16. Debt Sustainability

Borrowing is another source of funding, that many countries in the Arab region rely on to support national development plans. Several Arab countries have reached a high level of public debt to GDP. In Lebanon the public debt reached 145 percent, while in Egypt it is 95 percent, Jordan 86 percent, and Morocco 77 percent (ESCWA, 2015). However, debt servicing and repayment represents a burden on several Arab countries, resulting in what may be referred to as a debt crisis situation. It is therefore essential to ensure debt sustainability through coordinated policies aimed at strengthening debt management through debt relief, debt restructuring, debt and financing. Analysis and principles such as those provided through the IMF-World Bank debt sustainability analysis, UNCTAD's principles on responsible sovereign lending and borrowing should be considered to ensure debt responsibility (ESCWA, 2015). Arab countries may consider developing guidelines for debtor and creditor responsibilities by borrowers and lenders to manage borrowing in a more sustainable way.

D. Innovative Finance Mechanisms

1. Results-based financing: Results-based financing offers an innovative source of finance which provides funding based on the results achieved from a project or activity. This approach promotes transparency, accountability, improved management and efficiency, and ownership (World Bank, 2015b).

2. Financial risk management mechanisms: These mechanisms are intended to leverage public funds and create incentives for private sector engagement by correcting market failures, reducing macroeconomic and climate-driven vulnerabilities. This may be achieved through government guarantees, blended finance, and derivatives. Such mechanisms provide insurance against risks, through risk sharing or full risk transfer (World Bank, 2015b).

3. Green Funding: New innovative funding can be generated through taxes, fees, and charges levied by governments to finance green investments and sustainable development. Green bonds to finance green investments are also increasingly being introduced in capital markets worldwide, where it reached US$ 40 billion in 2014 (ESCWA, 2015). Ethical finance based on the religious beliefs that are very much in line with sustainable development provide another untapped source of funding in the Arab region. Promoting green bonds and Ethical funding in Arab countries should therefore provide a reliable source of funding green and sustainable development activities. This should be supported by efforts by Arab countries to green their financial systems thus directing more funds towards sustainable development activities.