Financing for Sustainable Development Report 2022:
Bridging the Finance Divide

KEY MESSAGES

- In the last two years, the world economy has been rocked by multiple shocks, including economic and financial impacts from the COVID-19 pandemic, climate shocks, and the war in Ukraine.
- These shocks do not impact all countries and peoples in the same way. A "great finance divide" has sharply curtailed the ability of developing countries to respond to and recover from the COVID-19 pandemic.
- Without international support and action, eradicating poverty and achieving the Sustainable Development Goals will be out of reach; the international community must work to bridge the finance divide.
- The report calls for urgent measures to address financing gaps, rising costs of borrowing and heightened debt risks.
- Second, all financing flows must be aligned with sustainable development. We must address climate change and inequalities head on to preserve economic prospects.
- Third, enhanced transparency and a more complete information ecosystem will strengthen the ability of countries to manage risks and use resources well and in line with sustainable development.

The Great Finance Divide

1. The pandemic has put more countries at risk of debt distress, constrained their fiscal space and hampered economic growth. The war in Ukraine is exacerbating these challenges. In this context, the 2022 Financing for Sustainable Development Report: *Bridging the Finance Divide* identifies a "great finance divide" – the inability of poorer countries to raise sufficient resources and borrow affordably for investment.

2. The great finance divide leaves developing countries unable to respond to crises and invest in sustainable development. Developed countries financed their response to the COVID-19 pandemic at historically low interest rates. Many developing countries had significantly higher borrowing costs. Globally, many developing countries were forced to cut budgets for education, infrastructure and other capital spending as a result of the pandemic.
    - On average developed countries spend 3.5 per cent of revenue on interest on their debt, versus 14 per cent of revenue for the least developed countries, despite much lower debt levels.
    - About 60 per cent of LDCs and other low-income countries are now assessed at a high risk of or in debt distress, double the 30 per cent in 2015.
    - The average interest cost of outstanding government debt is 1 per cent in developed countries, versus over 3 per cent in developing countries.
    - Some African countries are paying over 8 per cent on commercial borrowing.

    This translates into billions of dollars spent on servicing loans which are lost to development.

3. Many of the poorest countries are not expected to reach pre-pandemic income levels before the middle of the decade, with long-term scarring (i.e., countries remaining below the pre-pandemic output trend) likely.

- By the end of 2023, the size of the economies in **1 out of 5** developing countries will still be **below 2019 levels, even prior to the impacts from the war in Ukraine**.
- An additional 77 million people were newly plunged into extreme poverty in 2021. This number will likely grow due to the impact of the war in Ukraine, e.g. due to price spikes in food and energy prices.
- Vaccine inequity remains acute: Developing countries have only 24 COVID-19 vaccine doses per 100 people, versus almost 150 doses per 100 people for developed countries.
- In 2021 70 per cent of 10-year-olds in developing countries were unable to read a basic text, **17 per cent higher** than 2019. Meanwhile, two-thirds of low and lower-middle income countries have **cut education** budgets.
- The wealth of the world's 10 richest men **doubled** over the course of the pandemic, while in 2021, the average income of people in the bottom 40 per cent. of the global income distribution **went down 7 per cent** from 2019.

4. Debt, which had built up over the last decade, has now reached critical levels. Globally 3 in 5 of the poorest countries were at high risk or already in debt distress prior to the military conflict in Ukraine.

Effects of the military conflict in Ukraine

The economic impact of the military conflict in Ukraine is already reflected in higher energy and commodity prices, renewed supply chain disruptions, higher inflation, and increased volatility in financial markets. For many developing countries, this will likely lead to further increase in debt distress.

- Rising commodity prices worsen existing inflationary pressures and threaten global food security. Prior to the war, food prices had already reached their highest level in a decade. The Ukraine crisis has led to further rising of commodity prices and trade disruptions, particularly for food and fuel.
- African countries import twice as much wheat as they produce. The impact of the conflict on food prices in general, and wheat prices in particular, will worsen an already bad global situation with regards to reducing hunger.
- For net commodity importers, rising costs will negatively affect balance-of-payments and exchange rates against the US dollar.
- Worsening balance of payments will increase debt service burdens, and, in many cases, make already high debt levels unsustainable.

Bridging the Finance Divide

1. Developing countries will need international support and reliable and affordable finance to reverse the divergence in recovery and achieve the SDGs. This includes policy options in four areas:

    a) Governments effectively spending mobilized resources on the SDGs and productive investment;
    b) Increasing international support to those most in need as well as public finance for investment in public policy priorities;
    c) Global and national efforts to reduce borrowing cost and volatility from commercial sources; and

d) Addressing debt overhangs to reduce debt burdens.

2. Achieving efficiency and equity will depend on **effectively using resources and carefully managing associated risks.**
    - Transparency is a precondition for effective debt management and must be accompanied by efforts to improve governance more broadly.
    - Public investment decisions should be guided by a country's medium-term sustainable development strategies and plans.
3. **International public finance** must play a leading role in financing investments in recovery, the SDGs, and climate action.
    - ODA is at an all time high but cross-border ODA may need to increase to provide support to vulnerable people coping with elevated food prices.
    - Strengthen the system of public development banks. MDBs can expand their lending through capital increases and balance sheet optimization;
    - National and regional public development banks – which finance around 10 per cent of investment globally – should be strengthened. National banks can benefit from capacity and financial support from larger and more established development banks while contributing local knowledge.
4. To **reduce borrowing costs** and address fiscal pressures actions are needed at all levels:
    - Countries need a stronger enabling environments, good governance and the effective use of proceeds to reduce volatility and costs of borrowing from commercial sources
    - Monetary policies in systemically important countries can dampen volatility and mitigate global 'push factors'.
    - Better information can help reduce volatility in global markets, including by developing longer-term sovereign credit ratings and debt sustainability assessments
    - Focus on sustainability issues and shared priorities can translate into lower borrowing costs through targeted subsidies and capitalizing on green finance premiums, all of which should be in line with country priorities.
5. The international community must **address debt overhangs** to reduce debt burdens and free up resources for investment in climate action and the SDGs.