3 FINANCING THE MDGs

Government Spending Watch also tracks how budgets are financed and the impact this has on how spending is implemented. This section examines how spending on the MDGs has been financed, and how this has affected the types of spending (investment and recurrent) and the degree to which planned spending has been implemented on schedule. Finally, it draws together lessons for financing the post-2015 agenda and the current Financing for Development negotiations.

FINANCING THE MDGs

The MDGs contained a promise to forge a global partnership for development, reflected in the eighth goal, and a set of related targets for high-income countries (HICs) to increase aid and cancel debt in order to increase funding available to spend on the MDGs.

In 2002, the Monterrey Financing for Development conference established a series of concrete commitments to finance the MDGs. These included:

- A commitment to mobilising government revenue through ‘effective, efficient, transparent and accountable systems for mobilizing public resources and managing their use by Governments’, including ‘equitable and efficient tax systems and administration’ (para 15);
- A commitment to provide more aid to support the MDGs, by urging developed countries to allocate 0.7% of their GNI to aid and 0.1–0.2% to aid to least developed countries (LDCs) (para 42);
- A commitment to increase the effectiveness and results of aid, notably by supporting ‘development frameworks that are owned and driven by developing countries’ (para 43);
- Exploring the use of ‘innovative finance’ to supplement ODA;
- Balancing the provision of new ‘sustainable debt financing’ and debt relief;
- Commitments to support national development efforts with ‘an enabling international economic environment’ (para 6), including ‘the use of ODA to leverage additional financing for development, such as foreign investment, trade and domestic resources’ (para 43).

What has been the progress on these commitments since 2000?

In terms of government revenue, there have been major steps forward. Overall, developing countries increased their tax revenue by 5.5% of GDP between 2000 and 2014,66 and low-income countries by 5%. For the GSW group of countries, as shown in Figure 2.2 (section 2), the revenue/GDP ratio has risen by almost 2% of GDP since 2008. This has occurred in spite of trade liberalisation, which cut revenue from trade, and the negative impact of the global crisis, which cut revenue by 1% of GDP. As a result of these efforts, LICs have managed to increase the proportion of their spending funded by government revenue from only 46% in 2000 to 71% in 2014. As Figure 3.1 shows, GSW countries were funding 78% of their spending...
from revenue by 2008. Due to the crisis, this fell to only 71% in 2009, but countries reached 77% again in 2012–13.

On the other hand, progress with aid has been mixed. By 2014, only six countries had met the 0.7% gross national income (GNI) target for official development assistance (ODA) (Denmark, Luxembourg, Netherlands, Norway, Sweden and the UK) and only five the target of 0.2% to LDCs (Denmark, Ireland, Luxembourg, Norway and Sweden). Many other OECD member countries managed to increase aid flows sharply during 2000–08 but since then aid flows have increased much more slowly, due initially to the impact of the global economic crisis on their budgets, but more recently due to anti-aid changes of policy in several major countries. Nevertheless, there has been a sharp and continuing increase in both ‘South–South cooperation’ (aid from non-OECD countries) and ‘private sector cooperation’ (aid via private foundations and non-governmental organisations (NGOs)). As a result, overall aid more than trebled after 2000, exceeding US$200 billion by 2013.67

However, only a relatively small amount of aid is allocated to sectors related to the MDGs. As Figure 3.2 shows, within aid tracked by the OECD the total allocated to the sectors discussed in this report more than quadrupled, from US$13 billion in 2002 to US$57 billion in 2013. In real terms (allowing for inflation) aid to these sectors doubled, and their share of total aid also rose from 24% to 34%. However, the share of MDG-related aid has stagnated since 2008, due in part to a 50% rise in aid for infrastructure, especially transport, energy and the financial sector. As Figure 3.3 shows, all individual sectors except agriculture saw an increase in their shares in 2002–08, with health gaining most. Yet since then only agriculture, the environment and health have increased their shares.68

Government Spending Watch aims to enhance the accountability of governments to their citizens, and to show how the quantity and quality of aid influence developing country governments’ efforts to meet the MDG spending targets. One way to make this easier would be for the international community to have clear evidence of how much of its aid goes through developing country budgets, and is therefore subject to accountability to their parliaments and citizens. However, it remains impossible to calculate this amount. All we know is that around half of Development Assistance Committee (DAC) member aid is actually programmed to be spent in a planned way in developing countries (i.e. excluding emergency aid, debt relief and spending in the donor countries): this is known by the OECD as ‘country programmable aid’ (CPA). Of this amount, only around two-thirds (i.e. a third of total DAC aid) is channelled via developing country budgets.69 A slightly higher proportion of South–South cooperation, and virtually no ‘private sector development cooperation’ is spent on-budget, implying that overall only around 30% of global aid can be held accountable by developing countries. To make spending on the SDGs more accountable, it is vital to increase the share of on-budget aid.

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In addition, there are no published global statistics on any breakdown of this ‘on-budget aid’ by sector or type of spending (recurrent/investment). It would be extremely easy for OECD DAC donors (at least) when reporting their aid to the OECD or the International Aid Transparency Initiative (IATI), to indicate whether each project is on-budget – thereby automatically allowing analysts to classify it by sector. It would be somewhat more difficult, but not impossible, for them to break down the spending in each project or programme depending on whether it is investment or recurrent.

Fortunately, GSW monitors the amounts of aid recorded in 66 developing country budgets – i.e. ‘on-budget’ aid – to track how much goes to each of the MDG-related sectors. This is the only global analysis of trends in on-budget aid and, given the very low share of aid which goes through country budgets, the trends in amounts and proportions going to MDG sectors via budgets can be very different from those reported within global aid as above.

Figures 3.4 and 3.5 show the difference between the two sets of data. According to DAC data (Figure 3.5), around 35% of ODA is spent on the MDG sectors, with health accounting for around 40% of this, education 21%, agriculture 14%, WASH 11%, the environment 8% and social protection only 6%. Comparing these allocations with governments’ own budget choices in Section 2, we can see that the proportion of government spending allocated to the MDGs is somewhat higher, at almost 38%.

According to GSW data for on-budget aid identified as going to the MDGs (Figure 3.4), WASH gets the largest amount, followed by education and health: this difference is because high proportions of health aid are spent off-budget, compared with much lower proportions for WASH. Agriculture also shows relatively lower shares on-budget, while environment and social protection have higher shares spent off-budget. The post-2015 agenda puts particular emphasis on integrated government planning in the three sectors with relatively low shares of on-budget aid – to reinforce integrated healthcare systems for universal health coverage, ensure fully ‘environmentally sustainable’ development plans and build comprehensive social protection floors. It is therefore a particular priority to make sure that more aid is brought on-budget for these three sectors.

GSW data also indicate that, since 2012, on-budget aid for the GSW countries has fallen substantially for agriculture, education (especially primary education) and (to a lesser extent) health. It has stagnated for the environment and social protection; only the WASH sector has seen increases in on-budget donor spending. This reinforces other analysis showing that donor aid overall is volatile, which reduces its effectiveness in producing results by 15–20%. In addition, this more detailed volatility for MDG sectors has worrying implications for donor commitment to key SDG sectors where much higher spending will be needed post-2015 – and, should revenue not continue to rise, for governments’ capacities to plan sustainably and make long-term progress with the SDGs by replacing declining donor funding.

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What does this mean for each sector’s budget? Figure 3.6 shows the percentage of budget spending in each sector that is funded by government and donors. There are wide variations across the different sectors. In education and social protection, government revenues are more than 85% of the funding; for health three-quarters, the environment two-thirds and agriculture over half. On the other hand, in WASH donors fund more than three-quarters of spending (and the donor share has gone up by 3% since 2012). This raises worrying concerns about government commitment to WASH spending and overdependence on donor aid – but also about low levels of donor on-budget spending on education. It also implies widely varying degrees to which donors are following government priorities and supporting national ownership.

IMPLEMENTING THE SPENDING

GSW also tracks two other breakdowns of data which allow us to analyse how spending is being implemented: the types of spending (split between capital and recurrent spending), and the degree to which planned spending is actually implemented. In both cases, we have conducted extensive analysis of what influences spending patterns – and donor aid emerges as the most important factor.

Types of spending

The GSW database disaggregates spending according to its ‘type’ – either capital (investment in buildings, equipment, etc.) or recurrent (for wages, maintenance and other goods and services). Both are needed to ensure that new investment continues to improve the quality of equipment, extend coverage in marginalised regions and deliver buildings and equipment in new spending areas under the SDGs; and that recurrent spending is sufficient to ensure adequately motivated workforces, maintain investments and provide other supplies such as schoolbooks and drugs. Too much investment can lead to it not being maintained, and underinvestment can lead to reduced quality and insufficient coverage.

Donor funding distorts the types of spending in three ways:

- All donor project money is counted as capital spending in government budgets, regardless of whether it funds capital or recurrent items. This is largely because most donors do not provide governments with a breakdown of their spending between capital and recurrent items. This makes it hard to get a true picture of the capital/recurrent split, especially in aid-dependent sectors, and shows that interpreting spending trends would be much easier if donors did report an accurate capital/recurrent split to governments.
- Sectors with high donor funding have much higher percentages of investment spending (or appear to have given inaccurate classification). As Figure 3.6 shows, more than 83% of funding in the WASH sector is for capital investment. This may well be representative of actual spending in that sector: experts have for years complained that there is a lack of recurrent spending to maintain water and sanitation facilities once they are constructed; it also emphasises the need to ensure that adequate recurrent funding is included in sector plans.
- Sectors with lower donor funding appear to have much lower investment spending. This may also be accurate because they have genuinely high recurrent bills (salaries, drugs, books, social transfer grants) – and because most of the necessary capital investment in new schools and clinics took place earlier during the MDG period. However, this raises concerns about how recurrent spending will be maintained when the SDGs demand a massive new wave of investment spending in new areas.

Donor aid distorts relative shares of investment and recurrent spending.

One vital disaggregation by type of spending is missing from this analysis. GSW (as well as many sector specialists and labour unions) would love to be able to separate out wages to analyse trends in sector-specific wage bills. However, our work for UNESCO found that only 12% of the GSW countries publish separate and consistent data on wage levels for the education sector (one of the most transparent sectors), and therefore this has not been possible for the 2015 GSW report.
Implementation rates

GSW tracks not only planned spending but also actual spending implemented (though as will be discussed in Section 5, data on actual spending are less available). This is vital in order to assess and correct any implementation shortfalls in a particular sector. Many authors have raised questions about the capacity of developing country governments to absorb increased spending, or to execute budgets as planned, and it is true that some countries (especially conflict-affected states) regularly spend 20–30% less of their budget than planned. However, other analysts and developing country representatives have indicated that the fragmentation into small projects and volatility of donor aid, as well as the cumbersome and lengthy nature of donor procurement and disbursement procedures, are mainly responsible for implementation delays and that the ‘absorption’ problem is less significant for government-funded spending.

The evidence appears to support the latter position. Figure 3.7 shows two important facts:

- Shortfalls are considerably less of a problem than often implied. All sectors are keeping their underspends below 10%, and in 2013 agriculture, education and social protection were below 5%. So overall absorptive capacity is much less of an issue – indicating that countries could absorb increased spending on the SDGs. In particular, around one-third of countries have seen overspends in social protection, because needs have outstripped plans for spending.

- There has been a strong correlation between donor aid and shortfalls in implementation, most notably in the WASH sector. However, compared to the 2013 GSW report, implementation has improved considerably in donor-funded sectors, implying that procedures have become somewhat more flexible. This trend needs to continue, to improve SDG implementation rates.
HOW SHOULD THE SDGS BE FINANCED?

What lessons can we draw from the financing of the MDGs for how to fund the SDGs better?

Quantity of financing

First, this section has shown that government revenue is a more reliable funding source than aid, because it tends to be more aligned with government sectoral priorities; more likely to be stable; more able to fund investment/recurrent spending in a balanced way; and produces higher implementation rates. So the primary priority for financing public spending on the SDGs ought to be from increasing government revenue.

Many developing countries have achieved large revenue increases in recent years, with the average increase across LICs and LMICs during the MDG period reaching 5% of GDP. As a result, the countries analysed in this report have already been funding 77% of MDG spending themselves – the main exceptions being countries which have had protracted internal conflict and where taxpayers have little faith in government.

How has this been achieved? There have been three main types of country strategy:

- Strong improvements in administration and the introduction of new taxes such as value-added tax (VAT) (for example in Ghana, Rwanda and Senegal);
- Changing policy to cut tax exemptions dramatically (for example Mauritius); and
- Renegotiating key contracts with mining companies (for example Guinea, Liberia and Niger).

The first two of these methods have produced increases of 4–5% of GDP, and the third has gone as high as 10% of GDP. But in all three types of country these strategies have been stagnating in recent years: the LIC average has stagnated at about 22–23% since 2011, and the IMF forecasts no significant increase between 2015 and 2020. The only countries which still have scope to increase revenue through these ‘traditional’ strategies are post-conflict countries with revenue/GDP ratios well below 20%.
Yet the scale of extra spending needed for the SDGs requires a proportionate increase in revenue mobilisation – a massive step change – increasing revenues by up to 10% of GDP during the SDG period, and thereby (together with the effect of growth on the revenue base) doubling budget revenues on average over the same period. Efforts to improve tax administration and squeeze more revenue out of existing (largely domestic) taxpayers will not suffice. How can this increase be delivered?

As many have analysed, it is essential that the international community delivers on its Monterrey commitment to support revenue mobilisation with an ‘enabling international environment’. One component of this involves increasing aid which helps to ‘catalyse budget revenue’ from its current pathetically low level of only 0.2% of total aid. However, without more fundamental changes to the global tax system and rules, developing countries will not be able to fund the SDGs.

These changes include ensuring that the G20/OECD initiatives on base erosion and profit shifting (BEPS) and exchange of information among tax authorities are implemented in ways which maximise the increase of tax revenues for developing countries. This means focusing on tracking practices and exchanging information that will increase taxpaying in the source countries of the raw materials which are the basis for company profits, rather than in the headquarters country of the multinational investor. However, even if these are oriented to the maximum to help developing countries, and they receive all the technical assistance needed to implement these complex initiatives, this is likely to increase tax/GDP ratios by only around 2%.

Much more far-reaching measures are needed, including:

- Revising tax and investment treaties in the same way, to ensure that they give fair emphasis to paying tax in source countries, using the ‘UN model’ of tax treaties. This could mobilise up to 3% of GDP;
- Dramatically reducing tax exemptions, which, as a forthcoming IMF/World Bank report to the G20 will say, have mostly been proven not to influence investment flows. This could increase revenue by a further 3% of GDP but requires commitments by OECD governments (through their aid agencies and development financing institutions), as well as international organisations and major enterprises, that they will not request such exemptions for private sector enterprises;
- Clamping down on tax evasion and avoidance and illicit financial flows (IFFs) by individuals, by providing information urgently to developing countries (without obliging them to reciprocate, given that virtually no tax evading or IFFs go to developing countries which are not tax havens), dramatically increasing developing country capacity to exchange, analyse and audit information and to prosecute evaders, and guaranteeing non-intervention by OECD governments or international organisations on behalf of companies accused of evasion. This could raise a further 2.5% of GDP;
- Increasing tax collections from large enterprises (especially multinationals in the natural resources sector but also those in other high-profit sectors such as finance, telecoms, fishing, tourism and real estate) by providing impartial technical and legal assistance to countries to renegotiate contracts and tax agreements with these companies.

The current G20/OECD discussions on tax issues cover only a portion of these issues, and largely from a G20/OECD member government perspective. It is therefore essential that the role of the UN – which gives a louder voice to developing country governments and other stakeholders, and is already dealing with the wider issues raised above – be expanded by upgrading the ECOSOC UN Committee of Experts into a full intergovernmental ECOSOC commission which – in cooperation with the OECD, IMF and other organisations – would make regular annual decisions on global tax rules. All of these tax issues therefore need to be strongly debated in the FfD process and reflected in the Addis Ababa conference through a special roundtable discussion and in the final outcome communiqué.

However, it is also clear from the estimates of additional financing needs presented in Section 2 that government revenue itself would not be remotely adequate to finance the SDGs. The Overseas Development Institute (ODI) has recently come to this conclusion especially for LICs, based on the

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theoretical maximum capacity of countries to raise revenue given their income levels and economic structures (as assessed by the IMF and World Bank).\textsuperscript{73} However, it is also true for most LMICs, given that attaining their maximum tax capacity will be very difficult and that ODI looked at spending needs for only three SDG sectors – education, health and social protection. The SDSN has also found, especially in the social sectors (education, health, social protection and WASH) but also for broadening access to energy, and smallholder agriculture and nutrition, that the degree to which private financing can replace public financing is very low; and that even in environmental, climate change and infrastructure interventions, the public sector will need to spend a lot more (see also Table 2.2 in Section 2). Equally, as shown in Section 2 via growing debt burdens, non-concessional public finance and extremely expensive public-private blended financing arrangements, cannot fill the financing gap.

Concessional international public finance will remain vital to funding the SDGs – with as much as US$1 trillion being needed. To mobilise and channel this money, the FfD agreement needs four clear targets:

- All DAC donors recommitting to reach the goal of 0.7% of ODA/GNI, by 2025, and halving the current gap between the levels of GNI they provide and 0.7% by 2020. These steps could mobilise an additional US$250 billion a year, bringing ODA to around US$400 billion;
- South–South cooperation providers committing to rapid increases in concessional flows. These rose by 300% during 2000–15, and a similar increase for the SDGs would bring them to US$80 billion;\textsuperscript{74}
- Innovative financing of US$450–550 billion a year, including taxes on carbon emissions, bunker fuels and air travel (which could easily raise US$250–300 billion a year), on financial and currency transactions (US$100–150 billion) and regular annual issuance of IMF Special Drawing Rights targeted to supplementing developing country reserves and fiscal space (at least US$100 billion);
- Focusing 90% of concessional flows on lower-middle-income and low-income countries, and 50% on countries in ‘special situations’ (fragile and conflict-affected, least developed, landlocked and small island states) – countries which can least afford to fund the SDGs from their own revenues.

Taken together, these measures could double the availability of international concessional public financing to support the SDGs and, when matched with a doubling of budget revenues, would therefore represent a genuine commitment to an equal partnership between developing countries and developed countries in financing SDG progress across LICs and LMICs.

Even with higher public financing, private financing will have a key role to play in supporting the SDGs, as will ‘catalytic’ use of concessional funding to mobilise private financing. However, to maximise its positive contribution to the SDGs, it is vital to set and monitor standards for the quality and effectiveness of catalytic and public-private finance, and of private financing intended for the SDGs.\textsuperscript{76}

**Sectoral issues and allocations**

This section has also shown that in terms of sectoral allocation of concessional flows to support the MDGs – and the future SDGs – donors are falling short. Figure 3.8 shows that for the three sectors where African governments are setting themselves targets to allocate a percentage of government spending, lower shares of ODA (and only half as much in education) are being allocated to these sectors by donors than overall in government budgets, and ODA is falling even further behind sectoral targets.

As we approach the period when new money will be needed to fund the SDGs, many different groups are arguing for more funds for their sector without thinking about the negative impact this could have on funding for other sectors (especially as all of the SDGs are inter-related and spending on one impacts on many others). The post-2015 period needs a more rational accountability and decision-making process on sectoral allocation. This should involve:

- Setting an overall target for allocation of aid to SDG sectors, at least to match the 60% targeted for government spending by developing country governments in Section 2;
- Setting broad targets for global sector allocations of concessional funding, comparable to those agreed by developing country governments (currently 20% education, 15% health, 10% agriculture – but revised to reflect the relative funding needs of the SDGs);

\textsuperscript{39} Financing the Sustainable Development Goals: Lessons from Government Spending on the MDGs
Inserting ‘markers’ for SDG spending in each sector and overall into the OECD Creditor Reporting System (CRS) and IATI databases, as well as all national aid databases, to make providers accountable for progress;

Screening all aid projects for their compliance with the three pillars of the SDG agenda, as reflected for example in positive impacts on reducing income inequality, increasing gender equality and fighting environmental degradation and climate change (by expanding and tightening the definitions of the current DAC ‘screening marker’ systems for gender and Rio).

There are also crucial implications for potential SDG funding for each sector:

- Agriculture has seen a marginal decrease in the proportion of donor/total spending in the last few years, from 47% to 43%, with a 20% reduction in on-budget aid. A temporary rise in on-budget aid to agriculture after the 2008 food crisis has been followed by a decrease since 2011. Much more aid funding will be needed for agriculture, with higher recurrent spending on agricultural extension, purchase of food stocks and recurrent supplies for nutrition, and investment in sustainable agriculture if SDG progress is to be achieved.

- Education has also seen a fall in the share funded by donors, from 18% to 14%. This matches overall DAC data showing falls in aid to education.77 Even more alarmingly, aid to primary education has fallen more sharply, leaving governments to pick up 90% of the bill (up from 80% in 2012). These trends need to be dramatically reversed, with much higher aid commitments to education. Very high levels of recurrent spending raise concerns about long-term sustainability for teachers’ salaries and other maintenance/materials costs and low levels of capital spend currently, against the need to dramatically increase both spending for implementing lifelong learning under the SDGs.

- Environmental aid (and its share in total environmental spending) has been stagnant. In the context of the needs to address environmental challenges in the SDGs, this demonstrates that donors have not really begun to scale up on-budget interventions to make development environmentally sustainable. Huge commitments will be needed in this sector.

- Health on-budget aid has fallen by around 20% from an all-time high in 2012, requiring governments to spend much more from their own revenues to maintain the relatively slow MDG progress in this sector. This is a worrying trend given the massive need to scale up budget funding for the SDG of universal health coverage discussed in Section 2.

- Social protection has the lowest amount of on-budget donor support of any sector, and among the lowest donor-funded proportions of total spending. Both have been stagnating since 2008. This is concerning given the massive increase in social protection spending that will be required post-2015 for comprehensive social protection floors to eliminate poverty and reduce inequality.

- WASH has been the only sector to register large increases in donor funding since 2012, but this has left the sector highly dependent (75%) on donor funds, spending too much on investment and with larger spending shortfalls. A series of collaborative projects between GSW and WaterAid have pointed to high donor funding as reducing recurrent spending and hampering absorption.78 Governments will need to commit more of their own resources to this sector – especially to recurrent maintenance spending – if progress is to be sustained and expanded under the life of the SDGs.
Aid quality and effectiveness

Finally, the GSW analysis of donor performance also brings lessons for quality and effectiveness:

- A much higher share of aid (at least 80%) needs to be reaching developing countries, and at least 85% of this amount needs to be recorded and implemented ‘on-budget’ (the target set in the 2011 Busan agreement on effective development cooperation), to enhance accountability between governments and their citizens and improve budget planning and implementation.
- DAC and IATI recording systems need automatically to track these trends by introducing markers for each project.
- Donors and governments need to monitor carefully the balance between investment and recurrent spending, and how their aid may be distorting such priorities, especially in the likely context of a new capital spending boom which could accompany the SDGs. To facilitate this, they need to report their aid spending to developing country governments in ways which separate investment and recurrent components.
- Donors need to put a much higher share of aid through developing country government procurement and disbursement systems, again in line with their Busan commitments, and to simplify and accelerate their procurement and disbursement procedures for remaining aid.

The post-2015 SDGs require much greater amounts of financing than the MDGs. This means much stronger efforts at domestic resource mobilisation, which can occur only if international tax rules change; much greater efforts to mobilise international public finance (through South–South ODA cooperation and innovative finance) and improve its allocation; clear standards for private and blended finance; monitoring and implementation of better sectoral allocation and spending practices; and dramatic improvements in the quality and effectiveness of development cooperation. A business as usual approach – or an attempt to rely excessively on private or non-concessional financing – will not suffice. If these measures are not taken, then many of the SDGs will be dead at birth.