High-Level Peacebuilding Fund **Replenishment Conference - 2021**

SECRETARY-GENERAL'S PEACEBUILDING FUND **Replenishment** Conference

Background note on Financial Flows for Peacebuilding

Prepared by DPPA/PBSO/PSPB

JANUARY 2021

KEY MESSAGES

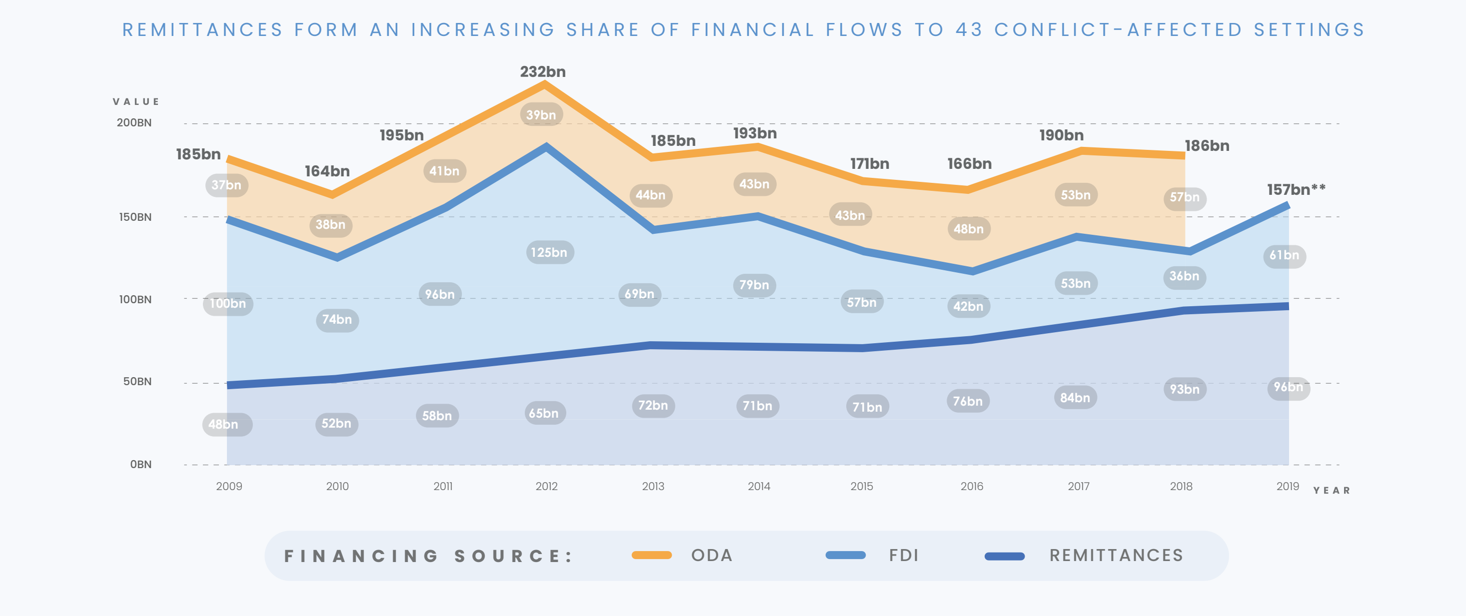
- Flows of remittances and ODA to 43 conflict-affected settings increased considerably between 2009 and 2019, but total financial flows stayed the same and showed notable variations because of FDI.
- Remittances form the largest share of financial flows to 43 conflict-affected settings, but ODA remains more important for low-income countries.
- ODA is very unevenly distributed among countries.
- Remittances as a share of GNI in conflict settings is larger than its share in non-conflict settings, for all income groups, and for FDI, the pattern is reversed: in all income groups, FDI as a share of GNI in conflict settings is smaller than its share in non-conflict settings.
- ODA can play an important role in stimulating FDI.
- While ODA to conflict-affected countries increased, the share of ODA that focuses on peacebuilding in those settings is declining.
- In 2020, ODA for peacebuilding, remittances and FDI probably all declined, which trends are forecast to continue in 2021.

SECTION 1: Key trends in financial flows to conflict-affected settings

Financial flows, which include Official Development Assistance (ODA), Foreign Direct Investment (FDI) and remittances, to conflict-affected countries **were about the same in 2009 and 2018,** with significant fluctuations in between (see Figure 1). **Remittances steadily increased and doubled during this period and have become the largest source of external finance** for conflict-affected countries. ODA also increased between 2009 and 2018, but not continuously and not by as much as remittances – by 54 per cent. **FDI showed large fluctuations and an especially steep decline between 2012 and 2018 by 53 per cent.** In short, flows of remittances and ODA to conflict-affected settings increased considerably between 2009 and 2019, but total flows stayed the same and showed notable variations because of FDI.

These trends are in line with findings of the joint UN-World Bank publication *Pathways for Peace,* which states that aid to conflict-affected and fragile countries has been unevenly distributed and volatile – diverting from development and institutional support to humanitarian relief and back again – and has been infrequently directed to peacebuilding and state-building.

FIGURE 1: FINANCIAL FLOWS TO 43 CONFLICT-AFFECTED SETTINGS, 2009-2019 (IN BILLIONS OF CURRENT US$)[1]



Overall financial flows, however, are very unequally distributed among countries. From 2014 to 2018, overall **ODA steadily increased, but only for a small subset of conflict-affected settings.** The top six aid recipients (Chad, El Salvador, Gambia, Syria, Venezuela and Yemen) comprised 46 per cent of the total ODA increase between 2014 and 2018, with Yemen being the largest recipient (from US$1.6 billion in 2014 to US$7.9 billion in 2018). For the majority of the 43 conflict-affected settings, ODA declined, with Bosnia and Herzegovina, Kosovo,[2] Sierra Leone and Sri Lanka seeing the sharpest decreases.

For l**ow-income countries, ODA remains the main source of inflows, while lower middle and upper middle-income countries rely more on remittances** (see Figure 2). FDI inflows to conflict-affected countries is concentrated in a few upper middle- and high-income conflict affected-countries with 65 per cent of total FDI going to Colombia, Cyprus, Lebanon, Albania, Guatemala, Venezuela, Bosnia and Herzegovina and Kosovo.[3] Furthermore, FDI in low-income conflict-affected countries is typically concentrated in the extractive industries, which is capital intensive and provides generally only limited job opportunities.

FIGURE 2: AVERAGE SHARE OF GNI FOR ODA, FDI, AND REMITTANCES IN 43 CONFLICT-AFFECTED COUNTRIES IN 2018

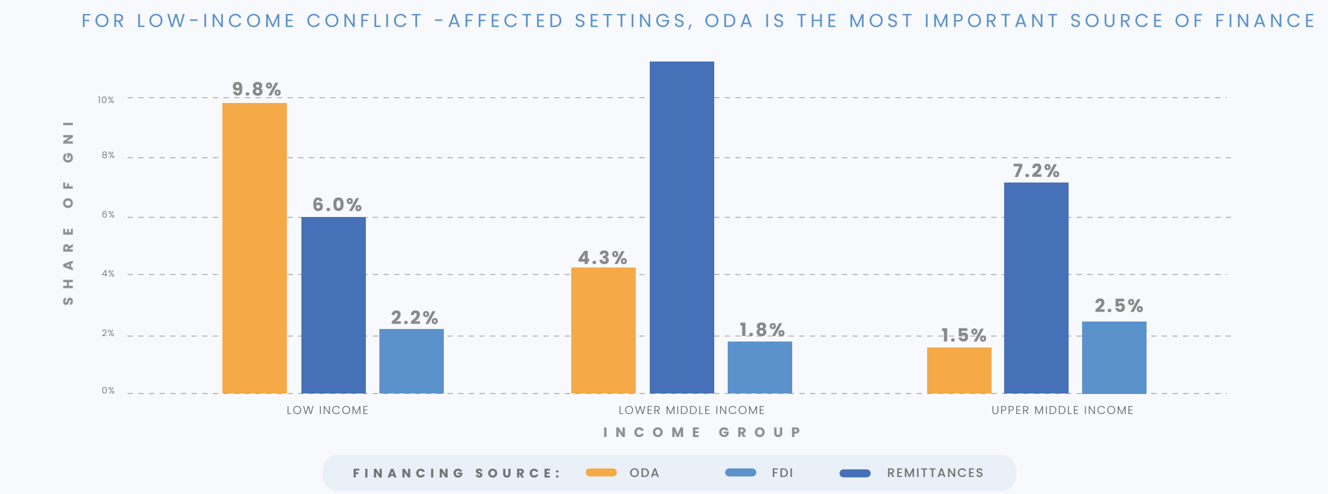
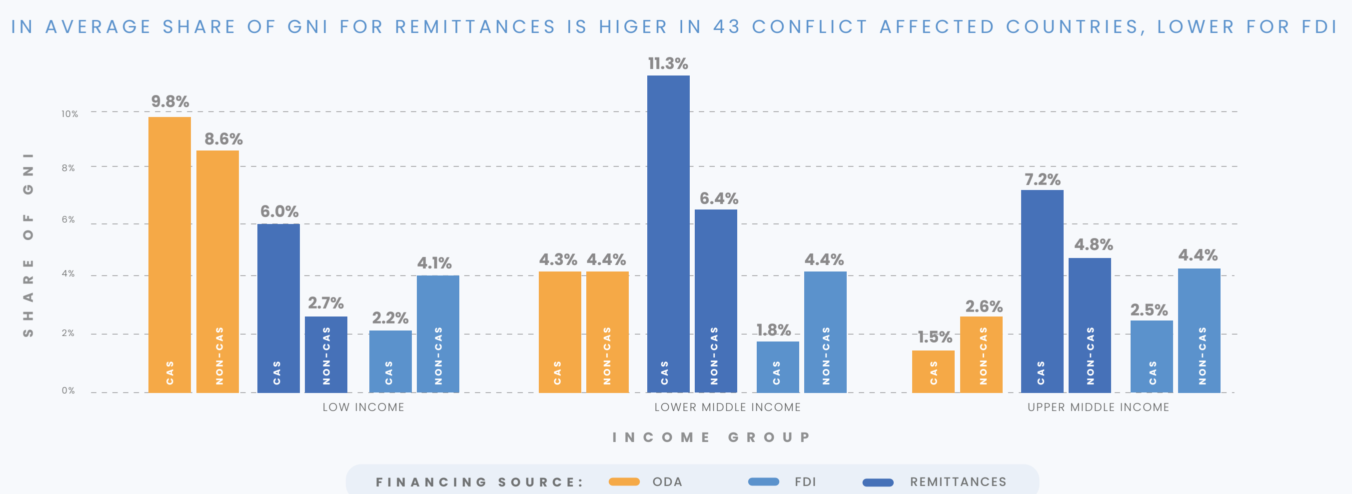


FIGURE 3: AVERAGE SHARE OF GNI FOR ODA, FDI, AND REMITTANCES IN 43 CONFLICT AFFECTED SETTINGS (CAS) VS. 92 NON-CONFLICT AFFECTED SETTINGS (NON-CAS) IN 2018

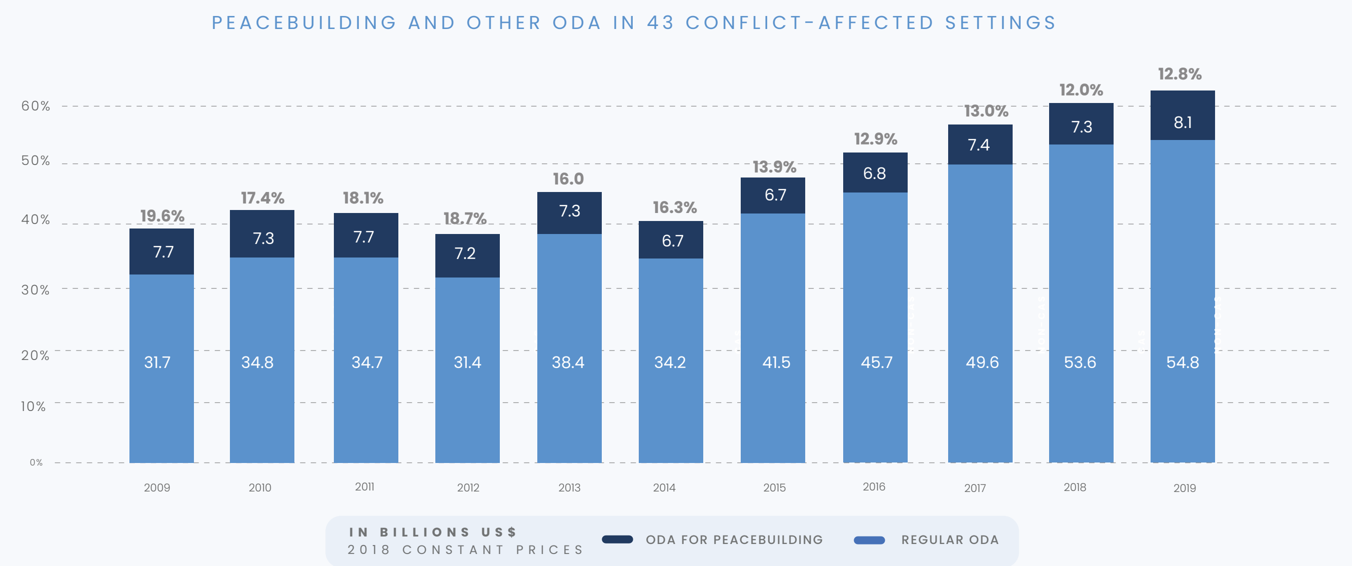


1. ODA is net ODA received. ** Indicates missing ODA data for 2019.
Data source for Figures 1-3: World Development Indicators, accessed 11/27/2020:
https://data.worldbank.org/indicator/DT.ODA.ODAT.CD https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT ;https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD.
Conflict-affected settings are defined as: (1) Agenda items of which the Security Council is currently seized and which have been considered by the Council at a formal meeting during the period from 1 January 2018 to 31 December 2018 (see S/2019/10); (2) Countries with a field-based or country-specific peacekeeping or special political mission in 2018 comprising 10 or more staff members; or (3) Countries that received programmatic funds from the Peacebuilding Fund in 2018.
2. All reference to Kosovo should be understood in full compliance with Security Council resolution 1244 (1999) and without prejudice to the status of Kosovo.
3. Countries list based on highest amounts of FDI in US$ in descending order.

Comparing conflict with non-conflict-affected settings, **ODA continues to remain the main source of inflow for low-income countries** (see Figure 3). In all income groups, remittances as a share of GNI in conflict settings is larger than its share in non-conflict settings. For FDI, the pattern is reversed: In all income groups, FDI as a share of GNI in conflict settings is smaller than its share in non-conflict settings. In middle-income countries, **the shares of FDI and remittances are more equally distributed and FDI plays a greater role,** due to the lower perceived risk in investing in emerging markets vs. in "high risk" conflict settings.

FDI inflows can be supported by ODA if it is used to improve the business infrastructure, strengthen the rule of law or de-risking investments in conflict-affected settings by offering currency and investment guarantees. The private sector often overestimates the risk of investing in conflict-affected countries because of the lack of information. Closer engagement between the private sector, development partners and the International Financial Institutions (IFIs) can provide more transparency about conflict dynamics and peacebuilding investments, which could reduce perceived risk. However, linking ODA to private sector development can result in overemphasis on countries with more effective governments and functioning markets – where private sector investments are more likely to yield returns – while overlooking countries most in need of support. Furthermore, certain key peacebuilding priorities, such as strengthening democratic processes, human rights and inclusion do not directly translate into business opportunities in the short term.

FIGURE 4: PEACEBUILDING CATEGORIES AS A PERCENTAGE OF TOTAL ODA IN 43 CONFLICT-AFFECTED COUNTRIES, 2009-2018 (IN BILLIONS OF CONSTANT US$)[4]



Although prevention works, saves lives and resources and is a cost-effective way to secure development gains, adequate, predictable and sustained financing remains a critical challenge. As Figure 1 already showed, total ODA to conflict-affected settings has increased in recent years.[5] **However, of all ODA to conflict-affected countries between 2009 and 2019, only 15.2 per cent was directed towards peacebuilding.** Moreover, the share of ODA that focuses on peacebuilding is declining, from 19.6 per cent in 2009 to 12.8 per cent in 2019. Peacebuilding expenditures vary significantly on a year-to-year basis and are highly unevenly distributed among countries, with Afghanistan, Colombia and Iraq receiving the bulk of the ODA-funded peacebuilding expenditures.

SECTION 2: Blending finance in conflict-affected contexts

Private finance can play an increasingly important role in bringing innovation, expertise and additional resources to help developing countries achieve the Sustainable Development Goals (SDGs). While the use of grants will remain critical to development and peacebuilding, particularly in conflict contexts, the growing volume of cross-border private capital flows cannot be overlooked.

4. The data represents gross disbursements of ODA – and reflects actual spending rather than commitments to spend money; while excluding debt repayments. Source: UN/DPPA/PBSO based on OECD Stat Creditor Reporting System (CRS) Database. Retrieved from *http://stats.oecd.org.*
5. ODA and percentages in Figures 1 and 4 are slightly different because Figure 1 is data in current US$ and Figure 4 in constant US$.

Widely seen as a powerful way to help mobilize larger pools of capital, ideally from the private sector, blended finance is a type of innovative financing mechanism aimed to bridge the investment gap for the achievement of public good objectives.[6] Blended finance refers to the blending of concessional funds, including grants and financing that does not seek commercial levels of return, with private finance that requires a higher level of return.

In the context of conflict-affected settings, the importance of blended finance is often recognized, in terms of catalyzing private capital through public resources, for development as well as peacebuilding. Yet, **national strategies addressing conflict-affected settings rarely reflect the role of private investors.** Currently, there is more focus on capacity building of local businesses and enabling environments, increasing access to financing, and private sector development, and very few strategies explicitly identify the private sector as a potential source of additional funding in fragile contexts.

Certain multilateral development banks, including a few international and national financial institutions, have emphasized the priority of mobilizing additional private finance in conflict situations. Interventions in the form of country-level investments, however, are limited as they have only recently adopted new strategies (e.g. World Bank's first Fragility, Conflict and Violence Strategy launched in March 2020) that have formalized a commitment to conflict-affected contexts and considering the full range of tools available to address the challenges presented, expanding private sector's role.

Yet, blended finance remains small in conflict settings and their potential is limited as long as conflict risks are prevalent and business environment and infrastructure are weak – although the potential is clearly far from reached. Transaction costs in particular are rather high as the blended finance facility in Colombia funded by the Peacebuilding Fund has shown.

In practice, **blending finance in conflict contexts is led by multilaterals and a few donors.**[7] In absolute terms, the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group has mobilized the largest volume of private finance to fragile and conflict contexts, reporting US$5.8 billion over the 2012-2017 period. The World Bank Group, which includes MIGA, the International Development Association (US$1.8 billion), the International Finance Corporation (US$1.6 billion) and the International Bank for Reconstruction and Development (US$ 0.6 billion), is the largest multilateral player, accounting for over a third of all private finance mobilized in conflict-affected settings. Bilateral blending is driven by a few donors – namely France and the United States, which together claimed 30 per cent of all private finance mobilized in fragile areas in 2012-2017, through AFD and OPIC, respectively.

Understanding the relationship between ODA and private financing

Based on current trends, private finance mobilization can by no means be considered a replacement of ODA. Instead they work in a complementary manner. Not only do they follow different patterns based on country-specific context and type of conflict, private investors tend to focus on infrastructure development whereas development assistance tends to be more appropriate for social sectors – such as health, education, water and sanitation.

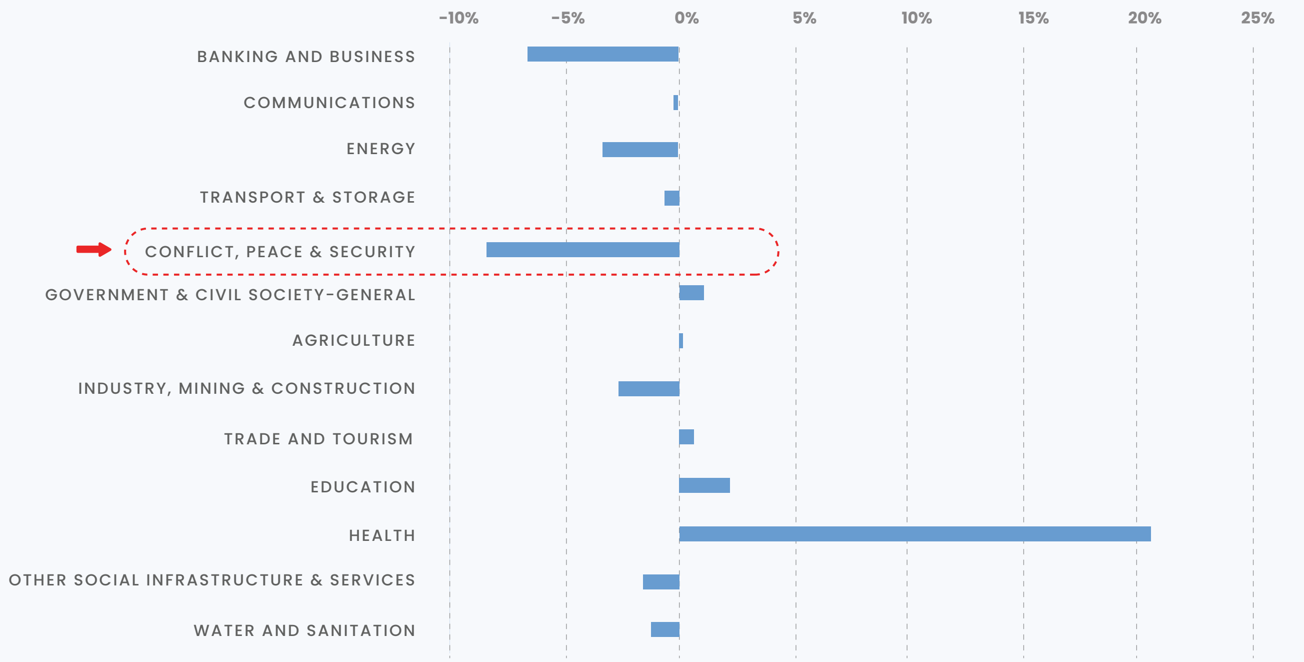
Although development aid has a catalyst role to play for blending and FDI, even in conflict-affected areas, this is not (and should not be) its primary aim. The diffusion of blending for profit-generating sectors and in stable, middle-income countries might progressively free up concessional resources for peacebuilding in conflict contexts, not necessarily alleviate the SDG financing gaps.

SECTION 3: Financial flows trends in 2020 and 2021 in the COVID-19 era

Data on financial flows for 2020 are not yet available but they are doubtless influenced by the COVID-19 pandemic. The economic and social impact of the pandemic has been huge – and has, therefore, also consequences for fiscal space and global financial flows, through various channels, some of which were already evident in 2020 and the effects are likely to be felt for years to come. GNI declined significantly in 2020, extreme poverty is projected to rise dramatically, and financing gaps and debt service problems have started to arise. ODA is projected to decrease, not in the least because several donors have tied ODA levels to GNI. Moreover, countries are focusing on health and humanitarian needs and are already de-prioritizing peacebuilding.

6. https://www.oecd-ilibrary.org/docserver/f5e557b2-en.pdf?expires=1608065779&id=id&accname=guest&checksum=3EC1DA5C84B0D0641A494D211DBDD197
7. Data Source: OECD-DAC Statistics on amounts mobilized from the private sector by official development finance interventions, http://www.oecd.org/development/stats/mobilisation.htm. Database accessed on 10 July 2019.

FIGURE 5: SECTOR PERCENTAGE CHANGES IN SHARE OF TOTAL BILATERAL ODA, JANUARY–SEPTEMBER 2020 COMPARED TO 2019



Source: CDG Report "Strategic Reset: How Bilateral Development Agencies are Changing in the Covid-19 Era," 8 December 2020.

Based on Figure 5 above, aid commitments to health from bilateral donors increased by over 20 per cent in 2020 compared to 2019 due to the COVID-19 response and recovery. This increase in spending on health has been associated with a **fall in other sectors, largely for conflict, peace and security,** as well as banking and business, energy, and industry, mining, and construction.

These trends are also apparent in the latest IATI data,[8] which shows that bilateral donor commitments to health have increased by 73 per cent (equal to US$3.3 billion) in 2020 compared to the same period in 2019, driven primarily by the US. This increase has come at the cost of other economic, governance, and productive sectors, where commitments are falling in volume and percentage terms.

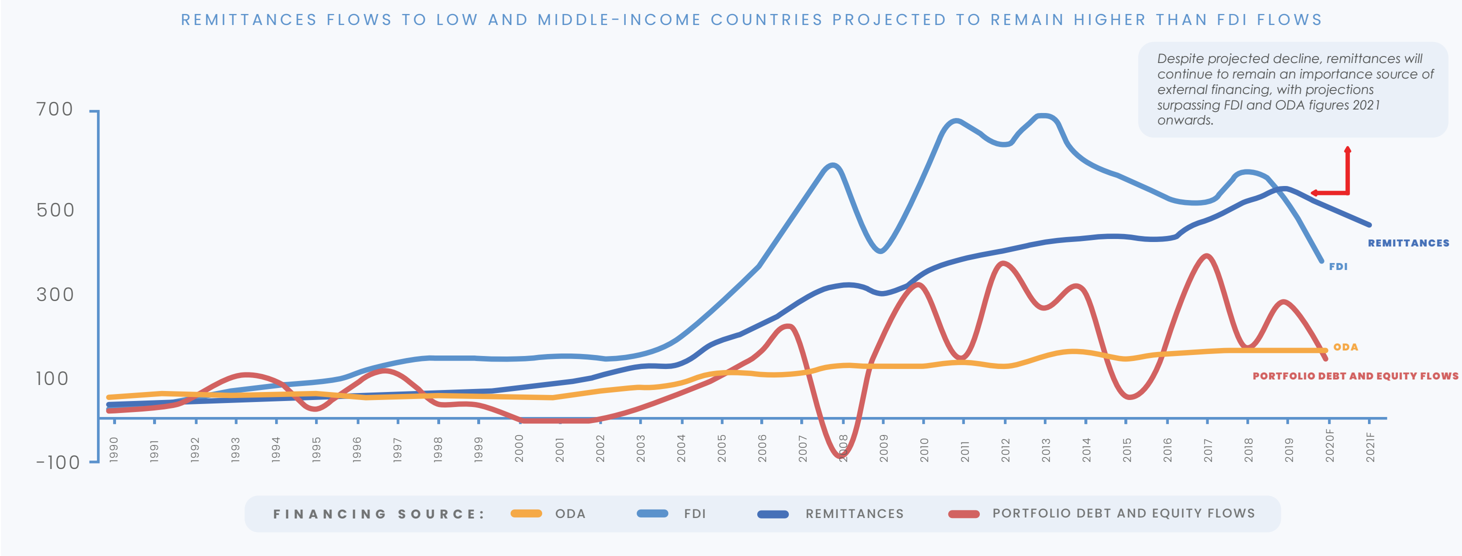
While bilateral donors are decreasing aid commitments, **IFIs have increased their aid commitments by 31 per cent in 2020,** driven by a more than doubling (139 per cent growth) in grants and loans that qualify as ODA. As a result, ODA makes up over half (52 per cent) of IFI commitments in the first seven months of 2020, up from 28 per cent in 2019.

In the context of conflict-affected settings, **neither bilateral donors nor IFIs are increasing the share of aid to low-income countries (LICs),** which make up the majority of the settings where peacekeeping and programmatic funds from PBF are active.

As described above, remittances have become the largest external financial flow in conflict countries. In Haiti and South Sudan, the share of remittances in Gross Domestic Product (GDP) is more than 35 per cent.[9] Remittances end up being economic saviors for millions of households of international migrants and refugees – which are among the most vulnerable populations hit by the COVID-19 pandemic. Typically, remittances are responding to disasters and crises on countries of origin, and showing significant increases, but because the pandemic is global and employment of migrants and refugees in host countries is severely affected, remittances are expected to decline.For 2020-2021, the pandemic is forecasted to cause a decline in remittance flows by 7 per cent globally – with the drop expected to be even sharper (approximately 9 percent) in countries impacted by medium-intensity conflict (World Bank classification).[10]

8. https://devinit.org/resources/how-aid-changing-covid-19-pandemic/
9. Data Source: Migration and Development Brief 33, World Bank-Knomad Report, October 2020
10. Countries in medium-intensity conflict are defined as (i) countries with lower intensity conflict, as measured by (a) an absolute number of conflict deaths above 250 according to ACLED and 150 according to UCDP vii; and (b) between 2 and 10 per 100,000 population according to ACLED and between 1 and 10 according to UCDP; or (ii) countries with a rapid deterioration of the security situation, as measured by (a) an absolute number of conflict deaths above 250 according to ACLED and 150 according to UCDP; (b) a lower number of conflict deaths relative to the population between 1 and 2 (ACLED) and 0.5 and 1 (UCDP) and (c) more than a doubling of the number of casualties in the last year.

FIGURE 6: ESTIMATES AND PROJECTIONS OF REMITTANCES TO LOW- AND MIDDLE-INCOME COUNTRIES [11]

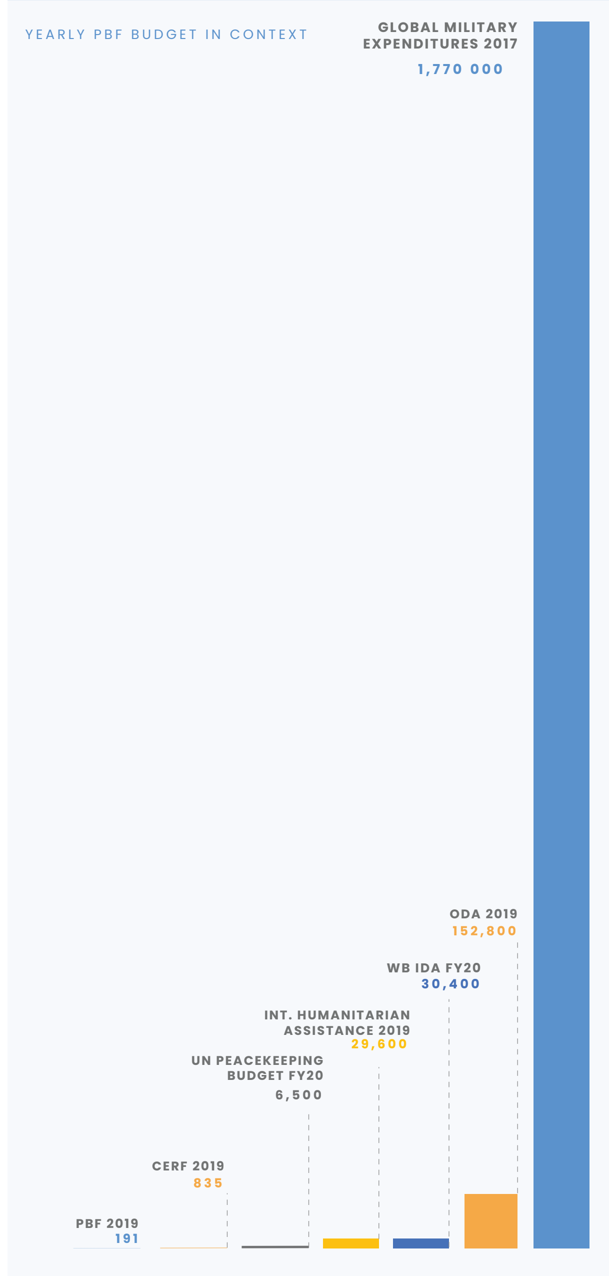


FDI flows to low- and middle-income countries are projected to decrease by nearly 32 percent in 2020 in the wake of the global pandemic, from $534 billion in 2019. The global lockdown measures in 2020 and 2021 have and will continue to affect the implementation of existing investment projects. Also, the severe global recession caused by the COVID-19 pandemic is likely to prompt multinational companies to reassess new projects, with even more scrutiny in conflict-affected situations.

SECTION 4: Conclusion

Financial flows to conflict-affected countries have been under severe pressure, particularly ODA devoted to peacebuilding, for over a decade. This trend is likely to worsen because of the COVID-19 pandemic. This is very worrisome given the continued need for peacebuilding – even, or especially, in response to the pandemic. As the Secretary-General states: "Adequate, predictable and sustained financing for peacebuilding remains a critical challenge. It is necessary to strive to secure the resources needed to support peacebuilding and sustaining peace" (A/74/976–S/2020/773, para. 8). Peacebuilding expenditures are rather low – US$ 173.8 million in terms of the PBF – and are outpaced by peacebuilding needs. They are also dwarfed by various other expenditures, not in the least compared to global military expenditures, which amounted to US$ 1.77 trillion in 2017 (see Figure 7). Prevention saves lives and resources, works and is cost-effective.[12] But, a fundamental shift from crisis response to investing in prevention has not yet taken place.

FIGURE 7: PBF ALLOCATIONS IN PERSPECTIVE [13]
IN MILLION OF US$



11. Sources: World Bank¬–KNOMAD staff estimates. See appendix in World Bank, Migration and Development Brief 32 (2020) for forecast methods. Note: e = estimate; f = forecast; IDA = International Development Association
12. United Nations-World Bank, Pathways for Peace: Inclusive Approaches to Preventing Violent Conflict (Washington, D.C., 2018).
13. Sources: PBF: A/74/976–S/2020/773; CERF: *https://cerf.un.org/our-donors/contributions;* UN Peacekeeping Budget: *https://undocs.org/A/C.5/73/21; Int.* humanitarian assistance: *https://devinit.org/resources/global-humanitarian-assistance-report-2020/executive-summary/*; World Bank IDA: *https://www.worldbank.org/en/news/press-release/2020/07/10/amid-multiple-crises-world-bank-group-refocuses-programs-and-increases-financing-to-74-billion-in-fiscal-year-2020;* ODA: *https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2019-detailed-summary.pdf*; World Military Expenditures: *https://www.state.gov/world-military-expenditures-and-arms-transfers-2019/*