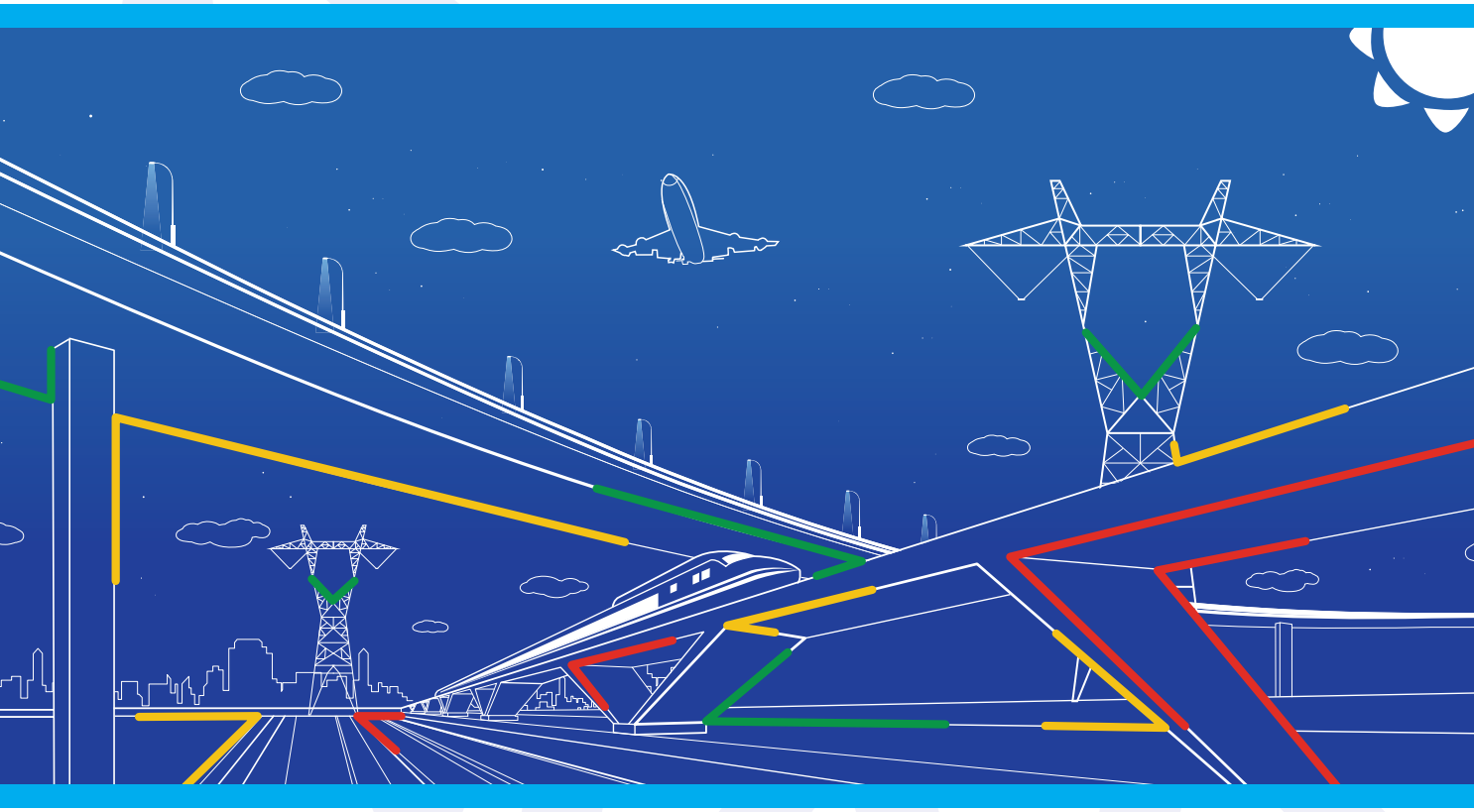
FINANCING FOR DEVELOPMENT: PROGRESS AND PROSPECTS

Report of the Inter-agency Task Force on Financing for Development 2017



United Nations

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Foreword

We live in challenging times. Despite the huge strides in the fight against poverty made possible by globalization and technological progress, inequality has increased markedly around the world. Conflicts are proliferating and other megatrends, such as climate change, food insecurity and water scarcity, are putting the progress of the last few decades at risk.

We must act decisively to address these challenges. The 2030 Agenda for Sustainable Development, the Paris Agreement on climate change and the Addis Ababa Action Agenda on Financing for Development lay out an ambitious set of commitments to create a more inclusive global economy that will provide opportunities for all people and ensure a healthier planet for future generations.

The Addis Ababa Action Agenda provides the financing framework for global cooperation on implementing the 2030 Agenda for Sustainable Development. Two years since its adoption, we can begin to take stock of how much has been achieved. This year's report of the Inter-Agency Task Force on Financing for Development finds numerous examples of progress – in mobilizing financial resources, in changes to business models and the operations of public and private actors, and in strengthened cooperation between countries for sustainable development. But significant existing and new challenges remain to be addressed, including humanitarian crises, cross-border financial risks and differing approaches as to how countries should engage in the global economy.

The policy recommendations put forward by the Task Force in this report provide Member States with a range of options to accelerate progress toward achieving the Sustainable Development Goals. I urge all actors to consider them carefully as they proceed in implementing the Addis Ababa Action Agenda.

António Guterres
Secretary-General

Preface

Implementation of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda on Financing for Development has begun in earnest. The 2017 report of the Inter-agency Task Force on Financing for Development, itself an outcome of the Addis Ababa Conference, provides a first assessment of progress in implementing the Financing for Development outcomes and in aligning our policies and institutions with the Sustainable Development Goals (SDGs).

The assessment draws on the expertise, analysis and data collected by over 50 United Nations agencies, programmes and offices, regional commissions and other relevant international institutions that make up the Task Force.

The inaugural report of the Task Force, published last year in time for the first ECOSOC Forum on Financing for Development follow-up, laid out the monitoring framework for the annual assessment of progress. This framework consists of an analysis of the global context and its implications for development finance, an overview of each chapter of the Addis Agenda, with the broader set of commitments and actions covered in an online annex, and analyses of thematic issues. This approach was endorsed by Member States and has guided the Task Force's work programme for the 2016/17 cycle.

Considerable effort went into building the online annex of the report (http://developmentfinance.un.org). The annex provides data and analysis for each of the more than 100 clusters of commitments and actions across the nine chapters of the Addis Agenda. It also incorporates data collected for the indicators of the SDGs and the means of implementation targets in particular. Putting together such a comprehensive platform was a significant undertaking, but one that should serve all stakeholders engaged in the financing for development follow-up process and implementation of the SDGs in accessing all relevant information in one place.

The online annex provides the basis for the chapters that report on progress in the seven action areas of the Addis Agenda (chapters III.A–III.G of this report). The report is by necessity much more concise and selective, and should thus be read in conjunction with the online annex. Reporting on the action areas is preceded by an analysis of the global macroeconomic context (chapter I), which provides the background for implementation efforts.

In 2016, the Task Force also set up a number of substantive work streams, in response to mandates contained in the Addis Agenda. They included infrastructure investments and public-private partnerships, illicit financial flows, financing social protection floors, aligning capital markets with sustainable development, and measurement issues on international public finance and the proposed measure of "total official support for sustainable development".[1] The Task Force has held expert meetings and carried out ana-

1 See http://www.un.org/esa/ffd/ffd-follow-up/inter-agency-task-force.html#5 for more information.

lytical work on each of these topics. Part of this work informed the thematic chapter of this year's report, which focuses on investment, social protection and other cross-cutting issues (chapter II).

We trust that the report of the Task Force and its broader work programme will provide the evidence and analysis for substantive and fruitful deliberations of Member States and all other stakeholders on financing for development follow-up and the means of implementation of the SDGs.

Wu Hongbo
Under-Secretary-General for Economic and Social Affairs
United Nations
Chair of the Inter-agency Task Force

Executive summary

In 2016, the first full year of implementation of the Addis Ababa Action Agenda, efforts have begun at all levels to mobilize resources and align financing flows and policies with economic, social and environmental priorities. Progress can be reported in all seven action areas of the Addis Agenda. Nonetheless, a difficult global environment has impeded individual and collective efforts, and many implementation gaps remain. The Addis Agenda offers a broad framework for individual actions and international cooperation to increase sustainable development investment, stimulate global growth and advance the world towards achieving the Sustainable Development Goals (SDGs). Its rapid implementation is therefore more important than ever.

The challenging global environment in 2016 had significant impacts on national efforts to implement the Addis Agenda. This includes not only economic factors, such as challenging macroeconomic conditions, low commodity prices, slow trade growth, and volatile capital flows, but also humanitarian crises. Despite improvements projected for 2017 and 2018, the current growth trajectory will not deliver the goal of eradicating extreme poverty by 2030. Least developed countries (LDCs) will fall short by large margins.

National actions and international cooperation can help change the trajectory of the global economy and support countries towards achieving the SDGs. The seven action areas of the Addis Agenda address the different sources of finance: domestic public resources; domestic and international private business and finance; international development cooperation (including official development assistance, South-South cooperation and development bank lending); international trade; debt sustainability; systemic issues; and science, technology, innovation and capacity building.[1] Each section of the report highlights key issues and puts forth policy options for consideration by Member States. These recommendations emanate from the assessment of progress and implementation gaps presented in the report and its online annex. Chapters also share lessons learned from the experience of taking action at the national and regional levels. Across the chapters, the Task Force has identified two elements in particular that respond to the challenges posed by the current environment—the need to increase long-term investments in sustainable development and the importance of addressing economic vulnerabilities.

Increases in long-term and high-quality investments will lead to a sustainable rise in economic growth. Additional public and private investment and financing will be required to meet the large investment needs associated with the SDGs, particularly in infrastructure and especially in the LDCs. Such investment will also help stimulate global

1 Those commitments and actions summarized in chapter I of the inaugural Task Force report (Cross-cutting issues), which includes issues such as social protection, infrastructure and gender, are covered partially in the respective action areas and partially in the thematic chapter of this report. All cross-cutting issues also have dedicated sections in the report's online annex at http://developmentfinance.un.org.

economic growth, creating a virtuous cycle. To achieve this, the report proposes measures that will address impediments to private investment and enhance public investments and the role of development banks. It raises the question of how to use such resources—including blended finance—most effectively, and identifies a number of principles for the use of blended instruments and public-private partnerships.

Increased long-term investments need to be complemented by measures to directly ameliorate the living conditions of the poor and vulnerable, such as social protection floors. Economic growth will not suffice to eradicate extreme poverty. The Addis Agenda responds to this challenge with a social compact, which includes a commitment to social protection floors for all, with a focus on the vulnerable, persons with disabilities, indigenous persons, children, youth and older persons. To address financing challenges associated with social protection floors, it proposes domestic measures and international support that respond to the countercyclical nature of financing needs. The Task Force also underlines that policies and actions on investment and vulnerabilities need not be just gender-sensitive, but should actively advance the goal of gender equality and women's empowerment.

Countries are taking actions on policy commitments across the Addis Agenda, and have started to bring them together into coherent implementation frameworks. Analysis by the Task Force shows that developing these financing frameworks is a central challenge for countries as they embark on implementing both the Addis Agenda and the 2030 Agenda for Sustainable Development. There are calls in all action areas for strategies and plans to guide implementation efforts, including medium-term revenue strategies, infrastructure plans, development cooperation strategies, and others. These strategies have to be coherent with the broader overall sustainable development strategy. The integrated national financing frameworks called for in the Addis Agenda, which take into consideration all financing sources and policies, can provide this coherence. Task Force members will continue analytical work in this area, with a view to sharing lessons and supporting Member States in building and strengthening these frameworks.

A steadfast commitment by the international community to multilateral cooperation for sustainable development should support national efforts. International cooperation is as vital as ever. Many of the challenges that countries face, including slow economic growth, climate change and humanitarian crises, have cross-border or even global repercussions, and cannot be addressed by any one actor alone. Rooted in the financing for development process, the Addis Agenda recognizes the complementary nature of national actions and a supportive international architecture for sustainable development.

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World Health Organisation (WHO)

World Intellectual Property Organization (WIPO)

Abbreviations

ADB	Asian Development Bank
AFD	Agence Française de Développement
AIIB	Asian Infrastructure Investment Bank
ATI	Addis Tax Initiative
BCBS	Basel Committee on Banking Supervision
BEPS	Base erosion and profit shifting
BIS	Bank for International Settlements
CCL	Countercyclical lending contract
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CIAT	Inter-American Center for Tax Administrations
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CPMI	Committee on Payments and Market Infrastructures
CRS	Creditor Reporting System
DAC	Development Assistance Committee
DCF	Development Cooperation Forum
DFA	Development finance assessment
ECOSOC	United Nations Economic and Social Council
ECOWAS	Economic Community of West African States
EIF	Enhanced Integrated Framework
ESCAP	Economic and Social Commission for Asia and the Pacific
ESCWA	Economic and Social Commission for Western Asia
FAO	Food and Agriculture Organization of the United Nations
FARI	Fiscal Analysis of Resource Industries
FATF	Financial Action Task Force
FDI	Foreign direct investment
FfD	Financing for Development
FSB	Financial Stability Board
G20	Group of Twenty
GAVI	The Global Alliance for Vaccines and Immunizations
GDP	Gross domestic product
GFSN	Global financial safety net
GIF	Global Infrastructure Facility
GNI	Gross national income
GPEDC	Global Partnership for Effective Development Cooperation
GRI	Global Reporting Initiative
G-SIBs	Global systemically important banks
GVCs	Global value chains
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
IATF	Inter-agency Task Force
IATT-STI	United Nations Inter-agency Task Team on Science, Technology and Innovation for the Sustainable Development Goals
ICT	Information and communications technology
IDA	International Development Association
IEA	International Energy Agency
IFC	International Finance Corporation
IFFs	Illicit financial flows
IFI	International financial institution
IISS	International Infrastructure Support System
ILO	International Labour Organization

IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IP	Intellectual property
IPR	Intellectual property rights
IPRA	Imposto Predial Autárquico
ISISA	Imposto Autárquico de Sisa
ITC	International Trade Centre
LDCs	Least developed countries
LIA	Lending into arrears
LIC DSF	Low-income country debt stability framework
LLDCs	Landlocked developing countries
MCAA	Multilateral Competent Authority Agreement
MDB	Multilateral development bank
MDG	Millennium Development Goal
MNEs	Multinational enterprises
MSMEs	Micro, small and medium enterprises
NDB	National development bank
NEPAD	The New Partnership for Africa's Development
NTMs	Non-tariff measures
OCHA	Office for the Coordination of Humanitarian Affairs
ODA	Official development assistance
OECD	Organization for Economic Cooperation and Development
PPI	Private Participation in Infrastructure
PPP	Public-private partnership
PRGT	Poverty Reduction and Growth Trust
QCPR	Quadrennial Comprehensive Policy Review
R&D	Research and development
RA-FIT	Revenue Administration's Fiscal Information Tool
RTAs	Regional trade agreements
SDG	Sustainable Development Goal
SDR	Special drawing right
SIDS	Small island developing States
SMEs	Small and middle-sized enterprises
SPF	Social protection floor
StAR	Stolen Asset Recovery Initiative
STI	Science technology and innovation
TADAT	Tax Administration Diagnostic Assessment Tool
TFM	Technology Facilitation Mechanism
TOSSD	Total Official Support for Sustainable Development
TRIPS	Trade-related Aspects of Intellectual Property Rights
UNCDF	United Nations Capital Development Fund
UNCTAD	United Nations Conference on Trade and Development
UN/DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNEP	United Nations Environment Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNFCCC	UN Framework Convention on Climate Change
UNODC	United Nations Office on Drugs and Crime
UNSC	United Nations Statistical Commission
UNSD	United Nations Statistics Division
WEO	World Economic Outlook
WFP	World Food Programme
WHO	World Health Organization
WoRLD	World Revenue Longitudinal Data
WTO	World Trade Organization

Introduction

2016 was the first full year of implementation of the Addis Ababa Action Agenda. This first substantive report of the Inter-agency Task Force on Financing for Development identifies the efforts that have begun at all levels to mobilize resources and align financing flows and policies with sustainable development. Progress can be reported in all seven action areas of the Addis Agenda. Nonetheless, a difficult global environment, sluggish growth and humanitarian crises have impeded individual and collective efforts. Success of the 2030 Agenda for Sustainable Development will rely on changing this trajectory. Rapid implementation of the Addis Agenda—which provides a broad framework for individual actions and cooperation to increase sustainable development investments while protecting the vulnerable—would stimulate global growth and advance the world towards achieving the Sustainable Development Goals (SDGs). It is thus more important than ever.

The Addis Agenda seeks to mobilize public finance, to set appropriate frameworks to unlock private finance, trade opportunities and technological development, to ensure debt sustainability and to align the international financial, monetary and trading system with economic, social and environmental priorities. Rooted in the financing for development process, this holistic approach entails both domestic actions and a commitment to create an enabling international environment that supports national efforts.

At the heart of the Addis Agenda are two main elements: integrated national financing frameworks to underpin coherent and nationally owned sustainable development strategies; and supportive global trade, monetary and financial systems. The national frameworks and strategies address country-specific needs and circumstances, and provide coherence to the many policy actions across the Addis Agenda action areas. Their implementation is what will drive progress towards the SDGs.

At the same time, national efforts need to be supported and complemented by international actions. The Addis Agenda includes commitments by Governments to take measures to improve and enhance global economic governance, and to arrive at a stronger, more coherent and more inclusive and representative international architecture for sustainable development. In addition, it commits to financial and capacity support to countries most in need, and to tackling social and environmental concerns with cross-border repercussions, such as climate change and humanitarian crises.

These two elements also underpinned successes in achieving the Millennium Development Goals. Poverty reduction relied to a significant degree on countries carefully managing their integration into a rapidly growing world economy. However, the context in which countries pursue their development goals has become more challenging in recent years. The 2008 world financial and economic crisis and its aftermath have brought to the fore some of the systemic risks to the real economy associated with financial market volatility. Disappointing investment and trade growth ever since has rendered export-oriented growth strategies a much more difficult endeavour for developing countries.

Reporting by the Task Force confirms the significant impact of this difficult global environment on national implementation efforts, including not only economic factors, such as challenging macroeconomic conditions, a large drop in commodity prices, decelerating trade growth, and volatile capital flows, but also natural disasters, environmental, humanitarian and security crises. These difficulties could be further exacerbated if the international community retreats from its commitment to multilateral cooperation for sustainable development. A

renewed commitment and concrete actions by Member States to create and preserve an enabling international economic environment therefore remain priorities.

At the national level, efforts are underway on many levels to develop and strengthen financing frameworks to support SDG implementation and sustainable development. Indeed, there are calls for national strategies and plans to guide implementation efforts in almost all action areas—including, for example, medium-term revenue strategies (chapter III.A), financial inclusion strategies and infrastructure plans (chapter III.B), development cooperation strategies (chapter III.C), science, technology and innovation strategies (chapter III.G), and many others. The Task Force recommends that these ultimately be brought together into a cohesive framework.

In each case, stakeholders with diverse interests need to arrive at a common understanding, priorities have to be set within budget constraints, and technically complex policy issues have to be tackled, often despite limited capacities. As challenges invariably differ by country contexts and evolve over time, these strategies also have to be country-specific and responsive to changing circumstances. Finally, they must be coherent with the broader overall sustainable development strategy. Integrated national financing frameworks that take into consideration all financing sources and policies can provide this coherence. Indeed, the Addis Agenda notes that "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts".[1]

Such strategies and frameworks also serve as guideposts for national priorities and SDG-related opportunities to investors and development partners. Developing and implementing them is one of the central challenges that countries face as they embark on achieving the SDGs

The task is complex, but first steps have been taken. For example, the United Nations Development Programme has undertaken development finance assessments that comprehensively scan a country's financing landscape—both flows and policies—and is currently refining this methodology (box 1). Such assessments can be a baseline for integrated national financing frameworks. A number of building blocks of such frameworks have already emerged from this work, including leadership that facilitates institutional coherence; a clear vision for results; an overarching financing strategy; results-focused financing policies for specific flows; integrated monitoring, evaluation and learning; and an enabling environment for accountability and dialogue. Work is also ongoing on many of the action-area-specific plans and strategies, including, for example, on financial market development and how to incentivize long-term investment, alignment with sustainability, and inclusiveness. In the upcoming 2017/18 work cycle, Task Force members will continue analytical work in this area, with a view to sharing emerging lessons and support Member States' efforts to strengthen these frameworks.

Box 1

Development finance assessments and integrated national financing frameworks

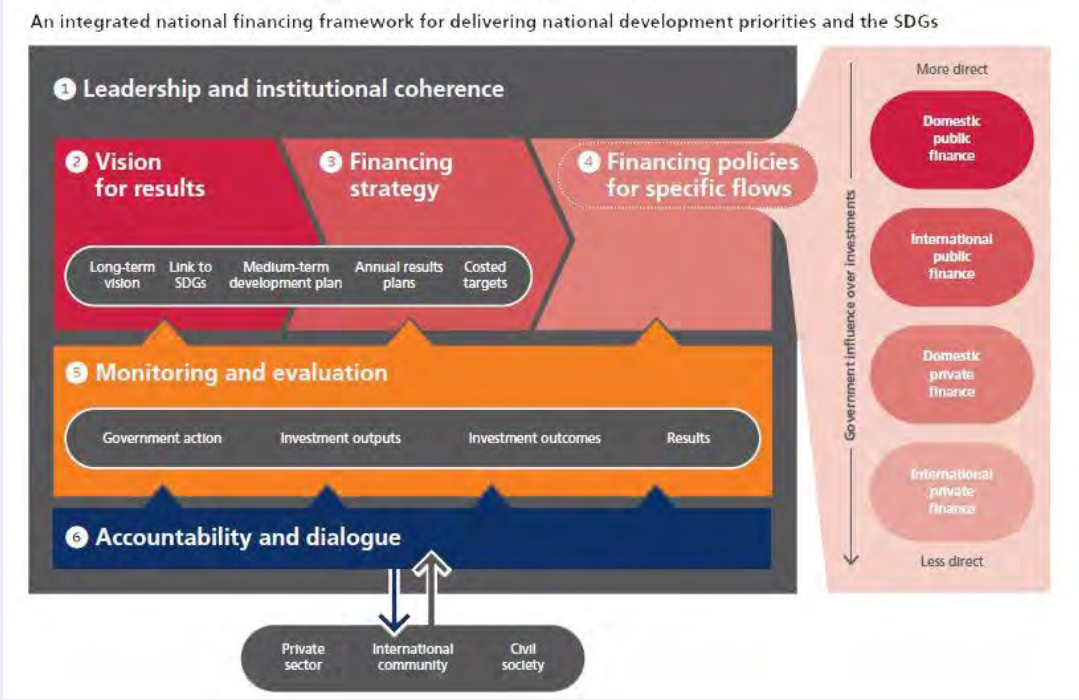
The Addis Ababa Action Agenda notes that "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts".[a] Such integrated national financing frameworks (INFFs) can be understood as the policies and institutional structures that help Governments develop and deliver a strategic, holistic approach towards managing policies and financing for nationally owned sustainable development strategies.[b]

Against this backdrop, and in response to growing demand from countries—first in the Asia-Pacific region and now globally—for support in managing the increasingly complex development finance landscape, the United Nations Development Programme has developed development finance assessments (DFAs), which can establish the baseline for an INFF in a specific country context.

1 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 9. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

DFAs shed light on a country's financing landscape by mapping finance flows — domestic and international, including those not primarily dedicated to addressing development challenges — and by examining the policies and institutions in place to ensure that finance supports national development priorities. They also help formulate recommendations for how institutions and systems might be adjusted to ensure that different sources of development finance are managed within a coherent framework to support implementation of the Sustainable Development Goals (SDGs).

Figure 1



Drawing on research and consultations in the Asia-Pacific region, a number of principles and building blocks for an effective, integrated and holistic financing framework have emerged. They include leadership that facilitates institutional coherence; a clear vision for results; an overarching financing strategy; results-focused financing policies for specific flows; integrated monitoring, evaluation and learning; and an enabling environment for accountability and dialogue.

Using the analysis, findings and recommendations from DFAs, several countries are taking steps towards establishing INFFs. Bangladesh's DFA provided clarity on finance flows in their country context, and provoked dialogue on the types of institutional and policy reforms needed to better align finance towards achieving Bangladesh's national development priorities. The findings and analysis of a DFA undertaken by the Philippines' National Economic and Development Authority have informed the formulation of the country's long-term vision and financing strategies, thereby ensuring a strong linkage between overall development goals and the financing landscape. In crafting AmBisyon Natin 2040 (Our Ambition 2040), the country's long-term vision document, critical findings from the DFA facilitated dialogue towards a more integrated management of complex finance flows towards achieving national priorities.

[a] Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 9. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

[b] The concept is explored in detail in the report published by the United Nations Development Programme and Asia-Pacific Development Effectiveness Facility (AP-DEF) Achieving the Sustainable Development Goals in the Era of the Addis Ababa Action Agenda. Available from: http://www.asia-pacific.undp.org/content/rbap/en/home/library/democratic_governance/achieving-the-sustainable-development-goals/.

About this report

Following the monitoring framework laid out in last year's inaugural report, the 2017 Task Force report begins its assessment of progress with an analysis of the global macroeconomic context (chapter I), which sets the economic framework for implementation efforts. Drawing on the findings from a number of substantive work streams set up in response to mandates in the Addis Agenda, the thematic chapter (chapter II) addresses how the Addis Agenda responds to the challenges presented in chapter I. Chapter II focuses on issues that cut across all chapters, including investment, social protection, gender and other cross-cutting issues, and provides policy options on each of them. The remainder of the report (chapters III.A to III.G and IV) discusses progress in the seven action areas of the Addis Agenda and data issues. Each chapter begins with a brief summary that highlights some key issues and presents policy options. The necessarily concise assessments in the report are complemented by and should be read in conjunction with the comprehensive online annex of the Task Force report (http://developmentfinance.un.org). The annex provides data and analysis for each of the more than 100 clusters of commitments and actions across the nine chapters of the Addis Agenda.

The production of the report and the online annex draws on the expertise, analysis and data of more than 50 United Nations agencies, programmes and offices, the regional economic commissions and other relevant international institutions such as the Organization for Economic Cooperation and Development and the Financial Stability Board that make up the Task Force. The major institutional stakeholders of the financing for development process, the World Bank Group, the International Monetary Fund, the World Trade Organization, the United Nations Conference on Trade and Development, and the United Nations Development Programme take a central role, jointly with the Financing for Development Office of the United Nations Department of Economic and Social Affairs, which also serves as the coordinator of the Task Force and substantive editor of the report.

By bringing them together, the Task Force itself represents a coherence exercise. Preparation of the report has helped to reveal data gaps, areas where additional analysis will need to be carried out, and issues where coherence and alignment with sustainable development within the United Nations system itself can be improved further. It has also led to a set of policy recommendations, specific to each of the action areas, which provide guidance to the efforts by the ECOSOC Forum on Financing for Development follow-up and all other stakeholders to accelerate implementation of the Addis Agenda.

Chapter I.

The challenge of the global economic situation[1]

In 2016, the first full year of implementation of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda, the world economy grew at its slowest rate since the 2008 world financial and economic crisis. Improvements are projected for 2017 and 2018, but remain insufficient to deliver the large increase in investment needed to achieve the Sustainable Development Goals (SDGs).

Since the crisis, global growth has been sluggish, trade and investment growth have decelerated and financial flows have remained volatile. The rapid decline in poverty over the last several decades relied on strong economic growth in developing countries, particularly in some large economies. The post-crisis growth trajectory in the context of current levels of inequality will not deliver poverty eradication by 2030, nor will current levels of mitigation investments suffice to keep global temperatures below agreed levels.

The success of the 2030 Agenda for Sustainable Development will rely on changing the current growth dynamic. International cooperation that supports policies to increase public and private investment in sustainable development and generate employment—while protecting the vulnerable against crises and shocks—would help achieve the SDGs and, at the same time, stimulate global growth and reduce the risk of future crises, thus creating a virtuous cycle. Implementation of the Addis Agenda, which provides a broad framework for such cooperation, is therefore more important than ever.

1. Inadequate growth of global demand and income

The United Nations Department of Economic and Social Affairs (UN/DESA) estimates that world gross product (WGP) expanded just 2.2 per cent in 2016, based on market exchanges rates. This is broadly in line with estimates by other Task Force members. The International Monetary Fund (IMF) and the World Bank both describe global growth as subdued; the United Nations Conference on Trade and Development (UNCTAD) characterizes the global economy as fragile; and UN/DESA notes that in 2016 the world economy had not yet emerged from the post-crisis period of slow economic growth, which is associated with weak growth of investment, trade and productivity. Nonetheless, some improvement in growth is forecast for 2017 and 2018, with UN/DESA projecting growth of 2.7 per cent in 2017 and 2.9 per cent in 2018.[2]

There is, however, a wide dispersion of possible outcomes around these projections, due to uncertainties over policy stances of major countries, potential impacts of unconventional monetary policies, capital flow reversals from developing countries, and geopolitical factors. While the balance of risks is on the downside, there are also upside factors to near-term growth. In particular, global activity

[1] This chapter draws from the following documents: United Nations (2017) *World Economic Situation and Prospects 2017*, IMF (2016) *World Economic Outlook,* IMF (2017) *World Economic Outlook Update,* UNCTAD (2016) *Trade and Development Report*, and World Bank (2017) *Global Economic Prospects.*

[2] See United Nations (2017); this is broadly in line with International Monetary Funds (IMF) estimates and projections. The IMF projects growth of 3.4 and 3.6 per cent respectively in 2017 and 2018, up from 3.1 per cent in 2016. The differences are due to exchange rate adjustments: IMF projections are based on purchasing power parity exchange rates, which give a greater weight to fast-growing developing economies.

could accelerate if policy stimulus turns out to be larger than projected in some countries.

2. Investment

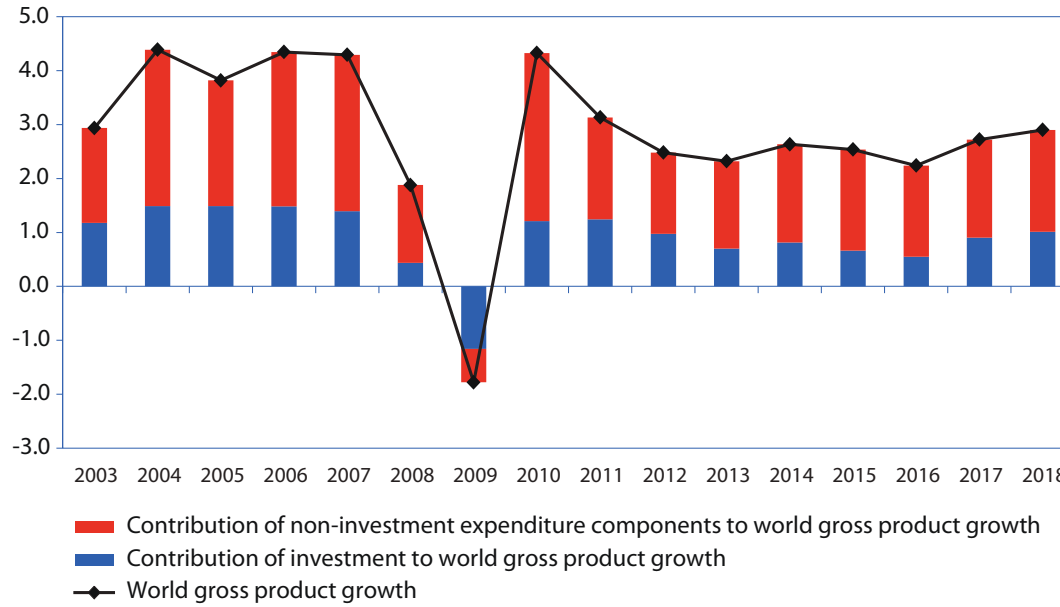
Weak investment has been central to the prolonged sluggishness in the global economy, through its linkages with aggregate demand, international trade, productivity and capital flows. Figure 1 shows that the levels of expenditure growth prior to the crisis—including, for example, debt-financed consumption by households in developed countries—could not be sustained. Deleveraging by banks will make it difficult to return to high levels of consumption in the near term. At the same time, the contribution of investment to global economic growth has declined from an average of 1.4 percentage points per annum during 2003-2007 to 0.7 percentage points per annum since 2012 (figure 1).

In developed economies, private non-residential investment growth has been exceptionally weak in recent years. Data shows that most major developed economies experienced a contraction in private non-residential investment in the first half of 2016. Despite some recovery in recent quarters, the public investment-to-gross-domestic-product (GDP) ratio also remains low in many developed economies. This reflects a continuation of fiscal adjustment policies adopted by Governments since 2010, following a bounce back in growth due to the coordinated monetary easing and temporary fiscal stimulus agreed by the Group of 20. The reluctance to increase public sector investment arose despite record-low and often negative government bond yields.

Investment growth also slowed in developing countries, largely owing to weak private investment, particularly in commodity sectors. In the case of China, weak investment growth reflects overcapacity in some industrial sectors, sluggish market demand, and higher corporate financing costs. In some developing countries, such as in East and South Asia and in some of the smaller economies in South-Eastern Europe and Central America, public investment growth picked up pace, which partially compensated for the deceleration in the growth of private investment.

The broad-based weakening of investment-to-GDP ratios can be attributed to a variety of global and country-specific factors. Protracted weak

Figure 1
Contributions to world gross product growth, 2003 – 2018 (*Percentage*)



Source: UN/DESA based on United Nations Statistics Division National Accounts Main Aggregates Database and UN/DESA forecasts.
Note: Data for 2016 are partially estimated; data for 2017–2018 are forecasts.

global demand has discouraged firms from investing — especially in export-oriented and commodity sectors once the period of high commodity prices ended. This has led to delays and cancellations of infrastructure investment and exploration activities. As a result, global energy investment declined by 8 per cent in 2015.[3]

Capital flows, especially to developing countries, reflect the weakening of investment. Cross-border bank loans to developing countries have been particularly volatile, as international banks have continued to deleverage. Portfolio investment (purchase of securities) has also been highly volatile; the net outflow was $413 billion in 2015 and $218 billion in 2016. Foreign direct investment, which tends to be more stable and longer term than the other types of cross-border private finance, fell to an estimated $209 billion in 2016 from $431 billion in 2015.

Other elements at play include long-term factors such as demographics and expectations of lower future productivity growth, and the weakening of the "profit-investment nexus" as reflected in the divergence of corporate profit growth and capital expenditure growth.[4] Across developed economies and increasingly in developing economies, the conventional corporate practice of reinvesting retained profits in production has been progressively replaced by strategies focused on meeting short-term earnings targets, especially for publicly listed firms. There is evidence[5] that the focus on short-term profitability horizons often comes at the expense of long-term-oriented, productive and sustainable investment.

The slowdown in private investment growth also raises some concerns over corporate debt, particularly in many developing economies, as it suggests that the significant increase in corporate debt burdens in emerging market economies has failed to translate into a commensurate increase in productive capital stock. Indeed, disaggregated sectoral data shows that 75 per cent of the increases in developing countries' corporate debt during 2010-2014 can be attributed to very few sectors, including oil and gas, electricity, and construction and materials, that are not at the technological frontier and do not have the greatest potential to contribute to overall productivity growth. As high debt burdens continue to accumulate, it could begin to restrain access to finance or prompt firms to deleverage and perpetuate the deceleration in investment growth.

3. International trade and trade policy

After a robust rebound from the global economic and financial crisis, international trade grew at a sluggish pace from 2011 to 2014—less than 2 per cent per year in value terms—before declining by 10 per cent in 2015.[6] Nominal factors such as the fall in commodity prices and the overall appreciation of the US dollar may have triggered the trade contraction in 2015. However, the contraction occurred not only in the commodity sector, where the fall was the largest, but also in the manufacturing, agricultural and services sectors. Moreover, it affected all geographic regions, including developing countries. A slowing down of the expansion of global value chains (GVC), which triggered weak import demand in emerging economies in East Asia, also played a role.

The downward trade trends appear to have continued into 2016. In September 2016, the World Trade Organization downgraded its forecasts for trade volume growth in 2016 from 2.8 per cent to 1.7 per cent. In February 2017, the World Bank[7] reported that world trade performance in 2016 was the weakest since the aftermath of the 2008 world financial and economic crisis, with overall growth of the volume of world trade almost stagnating.

3 IEA (2016). *World Energy Investment 2016*.

4 UNCTAD (2016). *Trade and Development Report* (TDR), 2016, Chapter V.

5 See for example, for the case of the United States, Sampson, Rachelle C. and Shi, Yuan (2016). Evidence and Implications of Short-Termism in US Public Capital Markets: 1980-2013. Available from: http://dx.doi.org/10.2139/ssrn.2837524

6 WTO (2106). *World Trade Statistical Review*. At publication of this report, the most recent year with comprehensive trade data is 2015.

7 World Bank (2017). Trade developments in 2016: Policy uncertainty weighs on world trade. Available from: http://documents.worldbank.org/curated/en/228941487594148537/pdf/112930-v1-revised-PUBLIC-1706109-Global-Trade-Watch-Report-Web.pdf.

The slowdown can be traced in part to the weakness in global economic activity and the slowdown in investment growth, especially in capital goods, which appears to have restrained trade growth since 2012. The IMF estimated that, for the world as a whole, up to three-fourths of the slowdown in the growth in the volume of goods imports between 2003-2007 and 2012-2015 was due to weaker economic activity, most notably subdued investment growth.[8] At the same time, weak trade is propagating and reinforcing the investment slump, particularly in export-oriented sectors. In other words, tepid international trade growth is both a symptom of and a contributing factor to low investment and the global economic slowdown.

Services trade, in contrast, has been more resilient than trade in goods, a trend that has prevailed since the global financial crisis. Services exports from developing and transition countries grew faster than those of developed countries in almost every major sector during 2005-2015, including financial services, telecommunication, and computer and information services. Nevertheless, global trade in services remains barely one-fourth as large as trade in goods.

While it is unclear whether the current trade stagnation is temporary or reflects a "new normal", world trade growth is not likely to significantly outpace the growth of the world economy in at least the next several years. At the same time, the impact of trade on national economies and employment has become a central issue in the public discourse in a number of developed countries. Thus, although the Addis Agenda called for the promotion of a universal, rules-based, open, non-discriminatory and equitable multilateral trading system, there is a risk that domestic politics in some countries could take trade policy in a different direction.

4. Impacts on sustainable development prospects

Weak investment and trade have played a significant role in the decline of labour productivity growth since the 2008 crisis. In developed countries, the slowdown in productivity growth has been driven by the lacklustre rate of capital deepening. In fact, since 2011 some of the largest developed economies have experienced a period during which the volume of productive capital stock per hour of labour input has actually declined, reflecting the aforementioned low private and public investment growth.

The current deceleration of capital deepening could also lead to weaker total factor productivity growth over the medium-term, as the rate of innovation, labour force skills and the quality of infrastructure could all be negatively affected. This would in turn hamper technological change and efficiency gains that underpin total factor productivity growth. As it becomes more difficult for economies to specialize in production for which they have comparative advantage, the anaemic global trade environment also contributes to slow productivity growth.

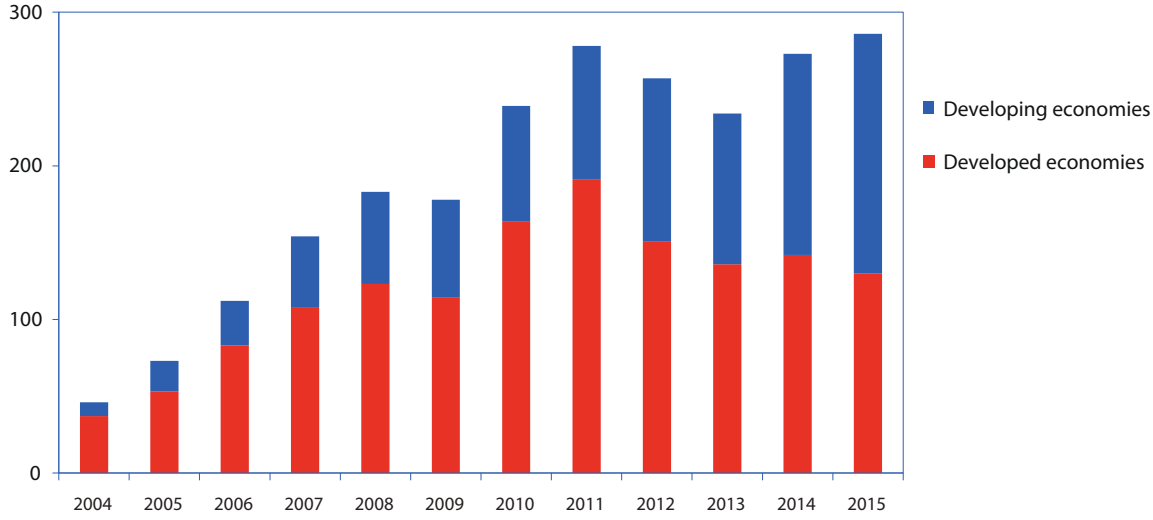
Lacklustre investment in low-carbon sectors also impedes carbon productivity growth. Achieving the SDGs will require both inclusive growth and a rapid decarbonization of the global economy, thus producing an ever-increasing amount of GDP per unit of carbon emitted. There had been some encouraging news regarding investment in renewable energy, which grew more than six fold from 2004 to 2011 (figure 2).[9] In 2015, renewables accounted for over 50 per cent of newly installed energy production capacity.[10] However, the absolute annual amount of such investment has not continued to grow measurably since 2011, meaning that it has been falling as a share of world output. Thus, while the earlier increase in renewable investment has helped hold back the growth of carbon emissions, strong and sustained further growth in investment will be needed to reach goals for mitigation of as well as adaptation to climate change.

5. Employment, inequality and social protection

The social consequences of the economic growth trend delineated here are profound. The International Labour Organization (ILO) estimates that over 200 million people are expected to be unem-

8 IMF (2016). *World Economic Outlook, October 2016*.
9 The data exclude large hydroelectric projects.
10 United Nations (2017), *World Economic Situation and Prospects, 2017*, p. 29.

Figure 2
Global new investment in renewable energy, 2004 – 2015 (*Billions of United States dollars*)



Source: Frankfurt School-UNEP Centre/BNEF, Global Trends in Renewable Energy Investment 2016.

ployed in 2017, 3.4 million more than in 2016, with further increases expected in 2018 as more and more people come of age and join the global labour force.[11] In addition, many jobs do not qualify as "decent work". About 42 per cent of employed persons globally (over 1 billion people) are estimated to work in vulnerable occupations—that is, the work is precarious and the workers do not enjoy sufficient access to social protection schemes. Indeed, despite growth in these schemes, the World Bank estimates that almost 60 per cent of the population of the developing world are served by no social protection system.[12]

There is reason for concern about below-target economic growth and its social impact in the least developed countries (LDCs) in particular. In the short run, low growth "poses a risk to critical public expenditure on healthcare, education, social protection and climate change".[13] In the long run, the current economic growth trajectory would leave the LDCs short by a large margin of the goal of eradicating extreme poverty by 2030 (figure 3).

A model simulation exercise to assess the magnitude of investment needed to reach an average GDP growth rate of 7.0 per cent per annum in LDCs suggests that investment growth in LDCs as a whole would need to average 11.3 per cent per annum through 2030, an increase of roughly 3.0 percentage points relative to baseline projections. While this exceeds the average rate of investment growth of 8.9 per cent recorded between 2010 and 2015, it is in line with the investment rate recorded during the period of rapid growth of 2000-2005, when GDP growth in the LDCs as a whole averaged 6.8 per cent per annum. However, the external environment is expected to be much less supportive to growth in the LDCs than it was at that time, when export growth for the group averaged 6.5 per cent per annum.

There is also reason for concern about reaching the poverty eradication goal in developing countries as a whole. Poverty reduction may be brought about through growth of the economy and by redistributive policies that bring more economic opportunities and income to the poor. Most of the reduction in global

11 ILO (2017), *World Employment and Social Outlook: Trends 2017,* Geneva.
12 Fiszbein, Kanbur and Yemtsov (2013). Social Protection, Poverty and the post-2015 Agenda. Policy Research Working Paper 6469. World Bank.
13 United Nations (2017). *World Economic Situation and Prospects, 2017*, p. 5.

poverty thus far has taken place through the economic growth effect. However, UN/DESA estimates that if the slow growth trend continues and no new redistributive policies are implemented, about 6.5 per cent of the world population will remain poor in 2030.[14]

It is also notable that the ILO global index of social unrest, which measures the expressed discontent with the socioeconomic situation in a given country, remains elevated. The ILO finds that, combined with the lack of decent job opportunities, this presages a likely further increase in the number of international migrants.[15]

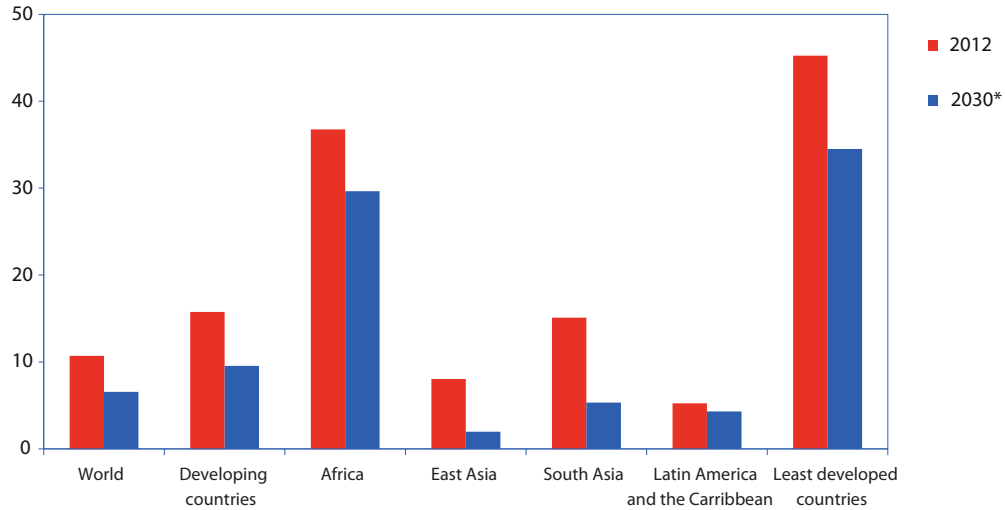
6. From a vicious to virtuous cycle

A more effective policy approach is needed to restore the global economy to a healthy, inclusive and resilient growth trajectory over the medium term. The Addis Agenda, which provides a comprehensive framework for achieving sustainable development, speaks to the challenges laid out above.

In the thematic chapter (chapter II), the Inter-agency Task Force on Financing for Development focuses on two issues in particular: increasing investments in sustainable development and enhancing social protection. On the one hand, it is imperative to increase the global rate of investment—in particular, sustainable medium- and long-term investment, including in infrastructure and combating climate change. Global savings are adequate to the task, but are not adequately focused on sustainable capital formation. The Addis Agenda specifies a range of policies at national and international levels aimed at increasing investment. On the other hand, the Addis Agenda social compact, and in particular its social protection floor, point towards concrete interventions that can address extreme poverty. They also provide income security to households and can thus smooth consumption cycles and support aggregate demand. The following chapter elaborates some of the thinking and proposals of the Task Force in this regard.

Figure 3

Extreme poverty headcount ratios in 2012 and projections for 2030, holding inequality constant (*Percentage*)



Source: UN/DESA.
Note: * Forecast; see Holland and Jayadev (2016) for detailed discussion of the forecast models.[16]

[14] Ibid., pp. 25-27.
[15] ILO (2017), op. cit., p. 9.
[16] Holland, Dawn and Arjun Jayadev (2016). Linking inequality and poverty in macroeconomic models. Presentation at Project LINK Meeting 2016, Toronto, October. Available from http://www.rotman.utoronto.ca/ FacultyAndResearch/ResearchCentres/ProjectLINK/LINKconferences/ LINK-2016-Agenda.

Chapter II.

Financing investment and social protection

1. Introduction

Chapter I on the global context laid out some of the factors that have contributed to low global growth: weaknesses in demand, investment, trade and productivity growth are closely linked and reinforce each other. The Addis Ababa Action Agenda provides a comprehensive framework to tackle these challenges through a wide range of commitments and actions.

Low levels of public and private investment have been a central component of disappointing growth since the 2008 world financial and economic crisis. Weak investment contributes to low levels of demand in the short run, and impedes productivity growth in the long run. Additional investments in the productive sector, as well as sustainable infrastructure, health, education, research and many other areas are needed to spur growth, achieve the energy transformation required to meet climate goals, and meet the Sustainable Development Goals (SDGs). Investment needs are largest in the area of sustainable infrastructure. The first part of this chapter explores ways to increase long-term public, private, and blended finance investments in sustainable infrastructure, including the role of development banks. It also address challenges specific to the least developed countries (LDCs), which face large investment gaps and will require specific support.

Increasing the time horizons of investors is a precondition for ensuring investments in sustainable infrastructure (also discussed in chapter III.B. on domestic and international private business and finance). Longer time horizons have the added benefit of reducing volatility and enhancing stability. Long-term and high-quality public and private investments sustainably increase productivity and economic growth, and enhance households' incomes and resilience to shocks. However, measures to directly ameliorate the living conditions of the poor are also needed, particularly in the light of their vulnerability to economic downturns, natural disasters and humanitarian crises.

The Addis Agenda responds to this challenge with a new social compact, which includes a commitment to social protection floors. This chapter presents options to finance such floors, focusing in particular on the challenges related to the start-up investments and cyclical nature of financing needs. Once implemented, social protection floors not only protect the vulnerable against downside risks, but also increase human capital and productivity, contribute to aggregate demand and growth, and promote political stability and social cohesion.

Measures to increase long-term investments and address short-term vulnerabilities are thus mutually reinforcing. They improve the economic system's capacity to deliver widespread rising incomes, end hunger and malnutrition, and provide decent work for all. Similarly, investment in gender equality and women's empowerment is essential to achieving sustained and inclusive economic growth and sustainable development.

This thematic chapter presents policy options and recommendations in these areas. Cutting across the seven action areas of the Addis Agenda, these recommendations relate to public and private resources and domestic and international policies, and complement the recommendations in the subsequent chapters on the specific action areas.[1]

1 Investments in infrastructure, social protection, ecosystem financing, gender equality, countries in special situations and other issues were addressed in a section on cross-cutting issues in the inaugural Task Force report last year. This

2. Long-term quality investment for infrastructure

The Addis Agenda recognizes that investing in sustainable and resilient infrastructure, including transport, energy, water and sanitation for all, is a prerequisite for achieving many of the SDGs. The Addis Agenda points to an infrastructure gap of $1 trillion to $1.5 trillion annually in developing countries. Estimates of the global gap generally range from $3 trillion to $5 trillion annually.[2] Infrastructure deficits are particularly deep in LDCs.[3]

Given the enormous investment needs, public, private, domestic and international investment and funding will be required. However, public and private sources are not necessarily substitutable; each has its own incentive structures, goals and mandates. This is reflected in the breakdown of public and private finance across sectors. Public investment typically accounts for more than half of all infrastructure investment globally.[4] In developing economies, three quarters of infrastructure is financed by the public sector (government, official development assistance and development banks), while in developed countries, this pattern is reversed, with about two thirds of investment coming from the private sector.

The proportions of public and private investment across countries reflect different institutional frameworks, policies and levels of development, as well as varying investment needs. In developed countries, for example, much infrastructure investment is in maintenance rather than new greenfield investment. Different sectors also have different capital structures. While ratios vary by country, private investment generally represents the majority of new investment in telecommunications, while public investment is generally greater in social infrastructure and/or when there are low financial returns. In the United States of America, for example, public investment represents about 90 per cent of the investment in transportation and water and sewage, while private investment represents 100 per cent of investment in telecommunications, and about 90 per cent in the power sector.[5] In Africa, transport and water have also been financed almost exclusively with public funds, but in contrast to developed countries, energy and communications are also majority publically funded, at 89 and 87 per cent, respectively.[6]

Table 1
Estimates of infrastructure investment in developing countries, by source (*Percentage*)

Source	Percentage
Domestic government budgets	67–72
Private sector	20–30
Aid and multilateral development bank financing	5–8
Other developing-country Governments	3

Source: Bhattacharya, A., M. Romania, and N. Stern. (2012). *Infrastructure for Development: Meeting the Challenge*. CCCEP, LSE, and G24.

thematic chapter covers several of those in more depth (infrastructure, social protection, and gender); additional analysis and data on these and other cross-cutting issues can be found at http://developmentfinance.un.org.

2 Estimates of global investment needs vary widely, depending on underlying assumptions about economic growth, policies and other issues, as well as the scope of the sectors included. McKinsey estimates a $3.3 trillion annual global gap (constant 2015 US dollars), which includes power, transport, communications and water. The World Economic Forum (2013) estimates a $5 trillion annual global gap, which includes power, transport, buildings and industrial, communication, agriculture, forestry, and water. See http://reports.weforum.org/green-investing-2013/required-infrastructure-needs/.

3 See, for example, UNCTAD (2014). *Least Developed Countries Report 2014*. Geneva.

4 Bhattacharya, Amar, Jeremy Oppenheim and Nicholas Stern (2015). *Driving sustainable development through better infrastructure: key elements of a transformation programme*. Brookings Global Economy and Development Working Paper 91, July 2015. Available from: http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2015/07/Bhattacharya-et-al.-2015.pdf

5 McKinsey (2016). *Sustaining sustainability: What institutional investors should do next on ESG*. Available from: http://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/sustaining-sustainability-what-institutional-investors-should-do-next-on-esg

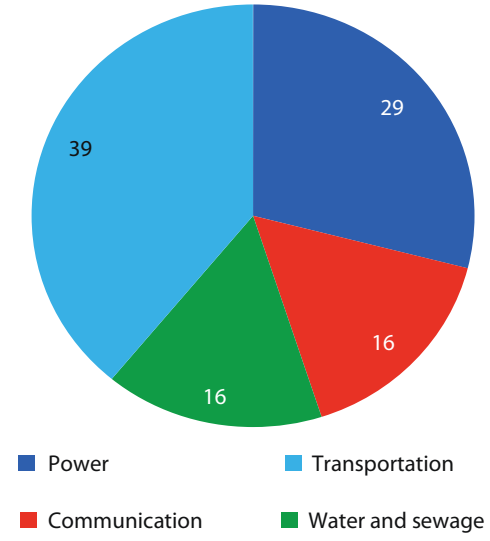
6 ICA (2014). *Infrastructure financing trends in Africa*. Available from: https://www.icafrica.org/fileadmin/documents/Annual_Reports/INFRASTRUCTURE_FINANCING_TRENDS_IN_AFRICA_%E2%80%93_2014.pdf

Historically high levels of public investment in infrastructure across many countries do not necessarily mean that its provision will remain a public endeavour going forward. They do imply, however, that the risk/return profile of such investments would generally not be sufficient to attract private finance on its own, absent guarantees or other incentives granted by the government. In general, investment is attractive to private actors when the expected return adjusted for risk is competitive with other investments. This is generally more likely to be the case when projects have strong positive cash flows, which can be used to repay the private investor, as is the case in the telecommunications and power sectors.

In most sectors, user fees can create cash flows to make the investments viable for private investors, but Governments also need to consider equity implications. User fees can make access to infrastructure and services unaffordable for the poor, though affordability can sometimes be achieved through other means, such as subsidies or differentiated tariffs. Governments also sometimes use guarantees or other incentives to change the risk/return profile for private investors. The regulatory frameworks and competition laws, particularly in sectors like telecommunications that can be subject to monopoly behaviour, are necessary components of an enabling environment for infrastructure investment. Nonetheless, the policy imperative for equitable, guaranteed and sustainable provision of certain services is a main reason for public funding of some forms of infrastructure, including in developed countries. ***Public policy may also be warranted in the presence of externalities, such as carbon emissions, which impose costs on society that are not reflected in private investors' returns and thus lead to misallocations of capital.*** This is particularly important in the power sector, as discussed later in this report.

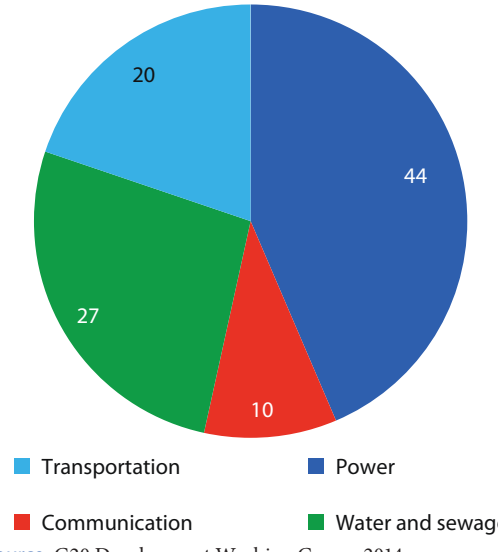
Figure 1.a breaks down the estimated global infrastructure financing needs noted above by sector. Areas traditionally financed by public spending (i.e., transportation (primarily roads) and sewage and water) make up more than half of total needs, although telecommunications and power, which tend to have a greater private component, are also significant. Figure 1.b shows estimated needs by sector for sub-Saharan Africa as an illustration of the breakdown in one developing region, where the greatest needs are estimated to be in the power sector.

Figure 1.a
Estimated infrastructure needs, globally
(Percentage of total)



Source: McKinsey (2016). Sustaining sustainability: What institutional investors should do next on ESG. Available from: http://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/sustaining-sustainability-what-institutional-investors-should-do-next-on-esg

Figure 1.b
Estimated infrastructure needs, sub-Saharan Africa
(Percentage of total)



Source: G20 Development Working Group, 2014.

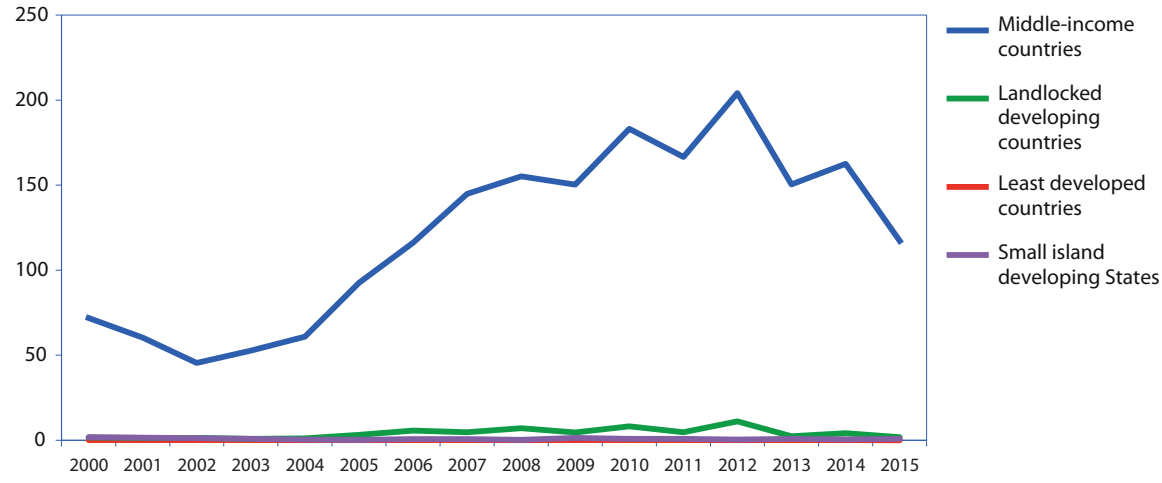
All projects, independently of how they are financed, should be considered as part of an overall infrastructure investment plan and prioritized accordingly, with cost-benefit analysis at the project level and debt sustainability at the macro level, as called for in the Addis Agenda. While the sectoral breakdowns indicate an important role for government in infrastructure investment going forward, whether through public private partnerships (PPPs), incentives, or direct investment, the breakdown of public and private finance across sectors and countries will ultimately depend on a host of factors, including government priorities expressed in the overall infrastructure investment plan, and policy frameworks. Nonetheless, the scope of financing needs makes it imperative to seek an increase in private and public SDG-related investment.

2.1 Private investment in infrastructure

Infrastructure projects with private participation include several financing structures, such as PPPs, lease and operation, and public divestitures. Infrastructure investments that include private participation have increased significantly since the turn of the century, with most of the growth in middle-income countries (figure 2). The nominal volume of investment in infrastructure with private participation in middle-income countries saw a sharp increase after 2002, which levelled off immediately following the world financial and economic crisis, and then declined after peaking in 2012. This trend was driven by electricity sector investment, with large investments announced in 2011 and 2012 before declining. Investment in infrastructure that includes private participation has remained at minimal levels in LDCs, landlocked developing countries (LLDCs) and small island developing States (SIDS).

The Addis Agenda includes commitments to tackle impediments to private investment in infrastructure on both the supply and demand sides. One common complaint by investors about investing in infrastructure in developing countries is the lack of investible projects. ***Rather than focussing on one-off projects, the Task Force emphasizes the need for infrastructure plans, which should then be translated into concrete project pipelines.*** Indeed, Governments committed to a package of policy actions in the Addis Agenda, including strengthening the domestic enabling environments (see chapter III.B) and embedding resilient and quality infrastructure investment plans in their national sustainable development strategies. There

Figure 2
Infrastructure investment with private participation, 2000 – 2015 (*Billions of United States dollars*)



Source: World Bank (2017). PPI Database. Available from https://ppi.worldbank.org/.
Note: Includes the total value of projects, not just the share attributable to the private sector, in current dollars. Infrastructure includes investments in energy, ICT, transport, water and sewerage.

are also commitments to provide technical support for countries in translating infrastructure plans into concrete project pipelines, to complete feasibility studies, to negotiate complex contracts, to expand project management, and to use investment promotion and other relevant agencies to strengthen project preparation.

Ongoing initiatives to strengthen project preparation and capacity-building, some of which also provide seed funding, include the World Bank's Global Infrastructure Facility (GIF), IFC InfraVentures, initiatives by regional development banks, and the United Nations Conference on Trade and Development's (UNCTAD) new partnership projects of inward and outward investment promotion agencies. Peer-to-peer learning could also be very useful in this regard, with the United Nations being a platform for sharing of experiences in regional and global forums.

At the same time, and as discussed in chapter III.B, the long-term investment available for infrastructure has been insufficient. Large international commercial banks, which had previously provided a significant portion of infrastructure financing, have been deleveraging since the global economic and financial crisis, affecting the availability of long-term financing (see chapters III.B and III.F). Additionally, institutional investors — some of which should be a source of longer-term finance for sustainable development due to their long-term liabilities, and which currently hold a total of $115 trillion in assets under management (with $78 trillion held by investors with longer-term liabilities (see chapter III.B)) — invest only a limited portion of their portfolios in infrastructure, in both developed and developing countries. For example, the largest pension funds hold 76 per cent of their portfolios in liquid assets, with direct investment in infrastructure at less than 3 per cent, and even lower in developing countries and for low-carbon infrastructure.[7]

In the Addis Agenda, Governments committed to "promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators".[8] The Task Force has identified several factors that shape these incentives, including institutional factors; short-term oriented compensation packages, particularly when long-term investors outsource management to asset managers with shorter-term horizons; a firm's culture; and regulatory and accounting standards. In this regard, some long-term investors are taking actions to better align incentives with long-term investing. ***To reorient more investment in support of the SDGs, additional steps will need to be taken, by long-term investors and by other private actors (e.g., rating agencies), Governments, civil society, norm-setting bodies and international organizations.*** (See also Chapter III.B for a discussion on institutional investors and aligning capital markets with sustainable development.)

Even with such additional steps, however, the risk/return profile of many investments that generate public benefits will not be sufficient to attract private investment. In these cases in particular***, there is an important role for public investment — including direct investment, co-investments, and risk and reward sharing with private investors — through guarantees, first-loss tranches and other mechanisms.***

2.2 Public investments for sustainable development: the role of development banks

As noted above, the public sector has played a significant role in financing infrastructure across developed and developing countries. Fiscal space is available in many (albeit not all) countries to expand public investments while maintaining debt sustainability. Beyond financing from current revenue or direct sovereign borrowing, development banks—national, regional and multilateral—have great potential to expand their activities and finance sustainable development investments.

Development banks can help finance infrastructure through four channels: (i) they can mobi-

7 Willis Towers Watson (2016). *The Global Pension Assets Study 2016*. Available from: https://www.willistowerswatson.com/en/insights/2016/02/global-pensions-asset-study-2016

8 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 38. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

lize finance by borrowing from financial markets at lower rates than granted to private investors; (ii) they can mobilize private capital for specific projects, through co-financing, providing risk guarantees and other instruments; (iii) their experience allows them to improve the quality of projects by providing technical assistance and sharing best practices; and (iv) they can promote practices for infrastructure investments that are aligned with sustainable development and ensure that the investment is in the wider public interest. Development banks also play a countercyclical role, by extending their balance sheets during economic downturns. For example, the multilateral development banks (MDBs) significantly expanded their lending during the 2008 world financial and economic crisis, as have many national and regional development banks.

Over the last 70 years, MDBs have channelled large amounts of long-term development finance to developing countries, and infrastructure financing has been a key focus of their activities. Nonetheless, in recent decades, their overall contribution to infrastructure financing in developing countries has become relatively minor: the eight major MDBs (excluding the European Investment Bank) invest about $35 billion to $40 billion annually in infrastructure in developing countries, compared to total infrastructure investment of about $2 trillion.[9] This is at least partly due to a refocusing of their activities towards programme and policy lending and social sectors in the 1990s and 2000s. Infrastructure lending has rebounded in recent years, but remains a smaller share of overall operations than in earlier years.[10]

It is widely agreed that the MDB system has the potential to significantly expand its contributions to financing the 2030 Agenda for Sustainable Development. Indeed, the Addis Agenda pointedly recognizes this potential and calls on MDBs to take responsive steps. Among measures discussed is an expansion of their capital base and its more effective use to increase lending, while also aligning practices and policies with sustainable development. MDBs have also been encouraged to better leverage their existing capital by the Group of Twenty (G20), and have already taken steps in this regard. Nonetheless, ***significant scope remains to optimize MDB balance sheets***.[11] The recent establishment of the Asian Infrastructure Investment Bank and the New Development Bank has also expanded overall available resources.

National development banks (NDBs) are widespread across the globe. A global survey of development banks carried out by the World Bank in 2012[12] found that NDBs are an important source of long-term credit in many emerging market economies, and also play an active role in strategic sectors in some advanced economies. Most institutions are small in size relative to their domestic market: 80 per cent of the development banks surveyed hold less than 3 per cent of assets of their national banking systems. However, some NDBs play a significant role, either in their local markets (such as some NDBs in SIDS) or at the regional or global level (such as the Brazilian Development Bank, China Development Bank, and Germany's Kreditanstalt fuer Wiederaufbau (KfW)). Overall, it is estimated that NDBs hold about $5 trillion in assets, more than half of which are held by the three institutions mentioned above. This considerably exceeds the combined assets held by the MDBs.[13]

9 Bhattacharya, Amar, Jeremy Oppenheim and Nicholas Stern (2015). *Driving sustainable development through better infrastructure: key elements of a transformation programme*. Brookings Global Economy and Development Working Paper 91, July 2015. Available from: http://www.lse.ac.uk/GranthamInstitute/wp-content/uploads/2015/07/Bhattacharya-et-al.-2015.pdf

10 Humphrey, Chris (2015). *Infrastructure finance in the developing world. Challenges and opportunities for multilateral development banks in 21st century infrastructure finance*. G-24 Working Paper Series.

11 Ahluwalia, Montek Singh, Lawrence Summers, Velasco, Andres, Birdsall, Nancy and Scott Morris (2016). *Multilateral development banking for this century's development challenges. Five recommendations to shareholders of old and new multilateral development banks*. Center for Global Development.

12 de Luna-Martínez, José, and Carlos Leonardo Vicente (2012). *Global Survey of Development Banks*. World Bank Policy Research Working Paper 5969; the study defined development banks as having at least 30 per cent state-ownership and a legal mandate to reach socioeconomic goals.

13 Studart, Rogerio and Kevin Gallagher (2016). I*nfrastructure for sustainable development: the role of national development banks*. Global Economic Governance Initiative Policy Brief 7, October 2016.

Many of the large NDBs prioritize infrastructure, providing both financing and technical expertise, which ranges from needs assessment and planning to project feasibility studies. Some have also been pioneers in incorporating sustainability considerations in their operations. In India, NDBs play a central role in financing the transition to sustainable infrastructure and to renewable power sources that is laid out in the country's intended nationally determined contribution (INDCs) submitted to the United Nations Framework Convention on Climate Change (UNFCCC).[14] KfW has similarly been central to financing Germany's energy transformation.

NDBs have also been able, in many countries, to finance small and medium-sized enterprises (SMEs), support financial sector development, and have played a countercyclical role. However, ***experience also shows that a precise mandate ideally stipulated in law and embedded in a broader national development strategy, and sound governance structures with representative supervisory bodies and executive management with banking experience are critical for the success of NDBs***. In many developing countries, NDBs also lack the scale to fully address the vast infrastructure financing needs, and will remain constrained for the foreseeable future by challenging macrofinancial conditions in their home markets. In such cases, regional banks and MDBs can help fill the gap.

2.3 Public-private partnerships and blended finance

The Addis Agenda notes that "both public and private investment have key roles to play in infrastructure financing, including through … mechanisms such as public-private partnerships [and] blended finance."[15] It defines blended finance as combining "concessional public finance and non-concessional private finance and expertise from the public and private sector." The discussion below thus focusses on blending with non-concessional or for-profit private finance.[16]

Blended finance and PPPs are fairly controversial in debates on implementation of the SDGs, with views ranging from the essential need for PPPs in meeting large financing needs, to concerns that PPPs will be used to privatize public services, subsidize the profits of the private sector, and keep investment and contingent liabilities "off balance sheet". Nonetheless, such mechanisms have become increasingly looked to as a method of using official resources to leverage private financing. The use of such instruments in official development assistance (ODA) is still quite limited, but it has increased steadily over the last several years. According to a survey from the Organization for Economic Cooperation and Development (OECD), $27 billion was mobilized from the private sector in 2015 by official development finance interventions, and new platforms have been established to further expand blended finance (see chapter III.C).

While blended finance and PPPs have most often been used for infrastructure investment, there is also consideration of these mechanisms to help finance SMEs and other entities, aligned with the discussion on inclusive finance measures in chapter III.B. In terms of infrastructure investment, PPPs account for about 3 per cent on average of infrastructure investment in developed countries (although their share is significantly higher, at about 10-15 per cent, in countries that make the greatest use of PPPs), 7.5 per cent on average in some large middle-income countries, and minimal amounts in LDCs.[17]

The goal of using PPPs should be to improve the coverage, access and quality of a given service in a cost-efficient manner that commands the confidence of all stakeholders, and to provide greater "value-for-money" than the alternative of public procurement.

14 Kumar, Nagesh, Pradeep Keshoari and Rohan Ray (2016). *National development banks and sustainable infrastructure in South Asia*. Global Economic Governance Initiative.

15 Public-private partnerships are referred to as a specific type of blended finance (see paragraph 48 of the Addis Ababa Action Agenda).

16 For a discussion of blending of international public finance with philanthropy see chapter III.C on international development cooperation.

17 McKinsey (2016). *Sustaining sustainability: What institutional investors should do next on ESG*. Available from: http://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/sustaining-sustainability-what-institutional-investors-should-do-next-on-esg

While assessing financial risks and rewards determines the viability of PPPs for the private partner, non-financial costs and benefits, including long-term fiscal liabilities and social, environmental and development impacts throughout the life of the project, are integral to assessing value-for-money from the public perspective.

The appropriate capital structure of a project ultimately depends on national circumstances and preferences, as well as levels of expertise and capacity constraints. However, in general, PPPs can be considered as a financing modality when (i) the public benefit of the project is greater than the financial return,[18] and the project is a high priority as part of an overall public investment strategy and (ii) the procurement mechanism adds value, such as through increased efficiency of public assets and private financial resources, lower costs, or higher quality than traditional public procurement. The viability of PPPs also varies across sectors. As noted above, PPPs may be better suited in sectors that have positive cash flows to repay the private sector (such as power) and more difficult to structure in sectors without clear positive financial returns (such as social sectors.)

Nonetheless, evidence to date suggests that many PPPs have been less efficient than the alternative of public procurement, across both developed and developing countries and across sectors, while in a number of instances they have failed to deliver the envisaged gains.[19] ***There is a need for more in-depth analysis and guidance on the conditions under which PPPs can best bring benefits, avoid adverse societal and environmental impacts and advance sustainable development.***

The Addis Agenda recognizes both the potential and the challenges associated with PPPs. It notes that "careful consideration should be given to the appropriate structure and use of… blended finance, including PPPs, [and that projects] should share risks and reward fairly, include clear accountability mechanisms and meet social and environmental standards".[20] ***To facilitate effective use of PPPs, the Addis Agenda identifies a number of principles, spelled out in box 1, which should guide PPP activity.***

These principles range from ensuring effective and fair use of PPPs, to calls for transparency, accountability, and inclusiveness. Many PPP projects have had weak accountability and transparency. Those PPPs involving publicly owned development finance institutions could, for example, publish relevant contracts and establish mechanisms for greater stakeholder input and public feedback. ***More broadly, a framework for disclosure on PPPs throughout the asset's life cycle, including at the time when the choice of financing instrument is made, could be an important agenda item for future work.*** To ensure effective management, accounting, and budgeting for contingent liabilities, debt incurred through PPPs needs to be effectively tracked and managed***. Task Force members believe that Governments should account for PPPs on balance sheets, to avoid non-transparent contingent liabilities and the misuse of PPPs as a tool to evade fiscal controls.*** In this vein, Task Force members have developed tools to help countries manage fiscal risks associated with PPPs. The PPP Fiscal Risk Assessment Model — or P-FRAM — developed by the International Monetary Fund (IMF) and World Bank, provides a framework to estimate fiscal costs and identify the main fiscal risks arising from PPP contracts.

As infrastructure projects often profoundly impact local communities, ***stakeholder participation in decision-making on PPPs is critical to ensuring accountability and project effectiveness.*** The Addis Agenda also calls for PPPs to meet social and environmental standards, and ***for all investment flows to be aligned with sustainable development.*** This represents a shift in thinking, from "doing no harm" through safeguards, to

18 Additionally, the financial risk-adjusted returns would generally not be sufficient to attract private investment on its own.

19 KS Jomo, Anis Chowdhury, Krishnan Sharma and Daniel Platz (2016). *PPPs and the 2030 Agenda for Sustainable Development: Fit for Purpose?* UN DESA Working Paper 148.

20 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 48. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

Box 1

Principles for blended finance and public-private partnerships extracted from the Addis Ababa Action Agenda

1. Careful consideration given to the structure and use of blended finance instruments (para. 48)
2. Sharing risks and reward fairly (para. 48)
3. Meeting social and environmental standards (para. 48)
4. Alignment with sustainable development, to ensure sustainable, accessible, affordable and resilient quality infrastructure (para. 48)
5. Ensuring clear accountability mechanisms (para 48)
6. Ensuring transparency, including in public procurement frameworks and contracts (paras. 30, 25 and 26)
7. Ensuring participation, particularly of local communities in decisions affecting their communities (para. 34)
8. Ensuring effective management, accounting, and budgeting for contingent liabilities, and debt sustainability (paras. 95 and 48)
9. Alignment with national priorities and relevant principles of effective development cooperation (para. 58)

addressing adverse impacts and generating positive impacts in all three dimensions of sustainable development (similar to impact investing, discussed in chapter III.B).

The Addis Agenda calls for sharing risk and return fairly, to avoid undue subsidies to the private sector and undue risk for the public sector. Valuing risks and rewards in complex projects is notably difficult, even for Governments with strong capacities, and climate risk makes this task more difficult. While analysis inevitably needs to be carried out on a case-by-case basis***, the Task Force could be a platform for bringing together work on analytical parameters to guide the use of instruments, such as when subsidies might or might not be appropriate, and what types of structures could be most effective.***

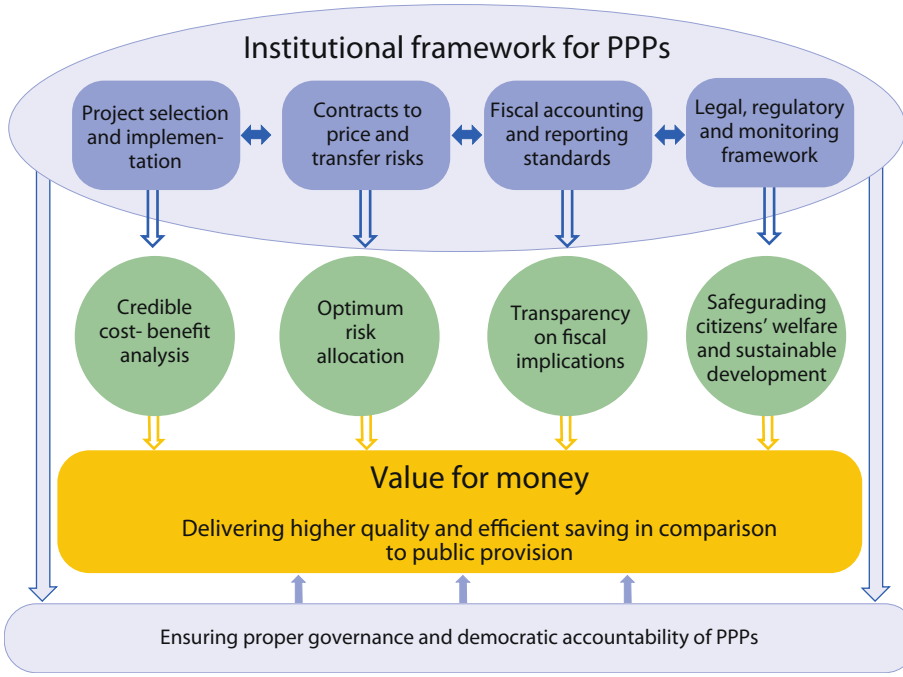
The Addis Agenda also calls on all financing flows to adhere to principles of development cooperation. In the context of using official funds to leverage private finance, the principle of country ownership implies that developing countries should play a central role in the decision to prioritize the use of ODA for blending and in the planning, design and management of specific blended finance projects.

For successful use of PPPs, countries need the institutional capacity to create, manage and evaluate them, including for project selection, transparent fiscal accounting and reporting, and legal and regulatory frameworks (figure 3). Indeed, there is a growing recognition that the quality of public governance is correlated with the efficiency and quality of infrastructure delivery. ***Considerable efficiency gains can be realized by focusing on the management of public investment throughout its life cycle, by standardizing procedures along the project cycle, and by improving coordination and collaboration across levels of government.*** For many countries, setting these capacities in place requires assistance from the international community in the form of technical support and capacity-building. The International Infrastructure Support System (IISS), a digital platform dedicated to speeding up the delivery of infrastructure, is a case in point.

Finally, in the Addis Agenda, Member States made the commitment to "build a knowledge base and share lessons learned through regional and global forums".[21] A number of knowledge-sharing initiatives have been developed by multilateral organizations, including the World Bank's PPP knowledge lab, which provides an online platform for knowledge-sharing among some actors. The Global Infrastructure Forum provides a space for MDBs, United Nations agencies, development

21 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 48. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

Figure 3
Institutional frameworks for PPPs



Source: KS Jomo, Anis Chowdhury, Krishnan Sharma and Daniel Platz (2016). *PPPs and the 2030 Agenda for Sustainable Development: Fit for Purpose?* UN DESA Working Paper 148.

partners and national entities to share knowledge on PPPs for infrastructure investment. ***The United Nations, with its universal membership, can be a platform for further discussion through regional forums and the Financing for Development Forum — discussions that could further explore how to ensure access to finance for all, and how mechanisms discussed above could be used effectively in countries often bypassed by such investment (LDCs in particular).***

3. Investment promotion for the LDCs

In the Addis Agenda, Governments "resolve to adopt and implement investment promotion regimes for least developed countries … [and to] offer financial and technical support for project preparation and contract negotiation, advisory support in investment-related dispute resolution, access to information on investment facilities and risk insurance and guarantees such as through the Multilateral Investment Guarantee Agency, as requested by the least developed countries".[22]

FDI flows to developing countries have been on an upward trend since 2000, but have registered lower levels in recent years (see chapters I and III.B). In LDCs, the bulk of FDI is associated with capital-intensive extractive industries. While FDI to LDCs as a group increased in 2015 to $35 billion on a gross basis (or 5 per cent of gross FDI to developing countries), this upturn was largely due to investment in one country — Angola, where over three-quarters of FDI was in the form of loans provided by foreign parent firms to their Angolan affiliates.[23] Structural change in global production processes through the rise of global value chains (GVCs) has also impacted these trends. GVC participation requires specialized production capabilities at a demanding level of quality and quantity, and within tight timelines. These demands largely confine LDC participation in value

22 Ibid., para. 46.
23 UNCTAD (2016). *World Investment Report 2016*. Geneva.

chains to upstream activities such as raw material provision. Nonetheless, GVCs have spawned strong growth in investment into LDCs in Southeast Asia and some South Asian LDCs. East and Southern Africa have also enjoyed increased FDI flows through GVC integration.

3.1 Obstacles to FDI in LDCs

Several obstacles need to be overcome if LDCs are to benefit more concretely from FDI (see the UNCTAD *World Investment Reports*, various years), including on infrastructure, linkages between foreign-owned and local enterprises, employment creation and skills transfer. Poor or limited physical infrastructure is one of the most fundamental constraints facing LDCs, not just to attract diversified types of FDI, but more generally to develop productive capacities, reduce poverty and reap the benefits of economic globalization.

Interactions between the formal and informal parts of the economy are limited in most LDCs, which tend to be characterized by a dual economy where a relatively small formal private sector coexists with a large informal segment. Foreign-owned companies, which in some countries make up the bulk of the formal economy, account for a significant share of formal private sector employment in LDCs and rank among the largest individual employers. However, export-oriented companies frequently operate as enclaves. ***Deliberate policy efforts are required for linkages to take root. This includes FDI promotion and facilitation focused on achieving an optimal match between the type of investments targeted and the structure of the national economy targeted by national development strategies.*** This extends to the need to nurture local entrepreneurial capabilities to ensure the availability of linkages partners. Dedicated matchmaking efforts, such as the UNCTAD business linkages programme, can also be a useful tool.

Despite being important employers, the foreign affiliates of multinational enterprises have frequently not met expectations about job creation related to FDI. On average, the labour intensity of FDI projects in LDCs is low compared to that in other developing countries. Promoting quality investment, as called for in the Addis Agenda, requires a strategic approach by policymakers. The relatively small number of jobs generated has also limited the transfer of skills and know-how through FDI.[24] This highlights the need to strengthen the development of homegrown skills. ***Policies to strengthen financial inclusion and nourish entrepreneurship (see chapter III.B) could help develop domestic SMEs.***

3.2 Investment promotion

Efforts to facilitate and promote FDI in LDCs have been made at all levels—in LDCs themselves, in home countries and by other development partners, and international organizations. But more needs to be done to increase the volume and quality of FDI to LDCs; its alignment with the SDGs is of particular importance.

LDCs themselves have made efforts to attract more FDI through improvements in the investment climate (see chapter III.B), and most of them possess promotion schemes to attract and facilitate foreign investment. Measures often include the granting of fiscal or financial incentives and the establishment of special economic zones or one-stop shops. Between 2010 and 2015, LDCs introduced at least 29 new investment promotion and facilitation policies. The preferred policy instrument of LDCs has been investment incentives, which account for just under half of all policies. While fiscal incentives should be geared towards aligning investment with sustainable development, countries should exercise care with fiscal incentives, as there is a risk that poorly designed incentives can be abused or may be considered harmful tax practices. (See chapter III.A on domestic resource mobilization for a discussion on some of the benefits and risks of tax incentives.)

Many countries have also set up special investment promotion agencies to attract foreign investors through investor targeting, investment facilitation, aftercare and policy advocacy. At present, 39 of the 48 LDCs have an investment promotion agency in place and some of these agencies are actively promoting investment in the SDGs. Investment promotion agencies should aim to align investment with all dimensions of sustainable development. ***Additional policy options to tackle obstacles to investment***

24 See UNCTAD (2013). *Least Developed Countries Report 2013*. Geneva.

include improvements in transparency and information available to investors; more predictability and consistency in the application of investment policies; efficient administrative procedures; consultation procedures with investment stakeholders; enhanced accountability and effectiveness of government officials; mechanisms to mitigate investment disputes; cross-border coordination and collaboration; and technical cooperation and other support mechanisms to strengthen investment facilitation (UNCTAD Global Investment Facilitation Action Menu).

Many LDCs have entered bilateral investment treaties, and are part of interregional and multilateral agreements with FDI-relevant provisions. Such treaties aim to facilitate FDI by providing guarantees to investors, including fair and equitable treatment, but have also raised concerns over constraining policy space of host countries to pursue sustainable development strategies. Globally, the bulk of treaties were concluded in the 1990s and early 2000s, but new treaties are still being established. Currently, 41 out of the 48 LDCs have at least one bilateral investment treaty in force.[25] The pace of new agreements slowed, as the focus shifted from a bilateral to a regional level. As bilateral agreements are left in force, this further increases the complexity of the landscape (see chapter III.D on international trade, and its online annex). Past experiences with investor-state dispute settlement also have made clear that the international investment agreement regime needs to be better aligned with sustainable development, and reforms are under way. A review of 25 new bilateral investment treaties concluded in 2015—6 of which involve LDCs—finds that all have included a clause to safeguard the right to regulate and have at least one sustainable development-friendly clause, such as provisions that promote responsible investment.[26] More broadly, the UNCTAD Investment Policy Framework for Sustainable Development helps countries, in particular LDCs, to formulate investment policy and investment agreements to enhance the sustainable development dimension of both local and foreign investment. ***It is critical that investment policy is embedded in a broader industrial and sustainable development strategy so that investment contributes to SDGs.***

Many developed and some developing countries have policies, programmes and measures in place to encourage outward FDI flows, including outward investment agencies that promote and service investment abroad. They provide information services on the business environment and opportunities in host countries; financial support for pre-investment activities (such as support for feasibility studies, loans and guarantees); fiscal measures (tax exemptions or tax credits); and political risk insurance. ***Outward investment agencies could support investment promotion agencies in LDCs, including through information exchange on project standards and guidelines, technical cooperation and joint promotion campaigns.***[27] Some developed countries also have specialized agencies to provide long-term financing for private sector development by providing loan and equity financing for FDI projects. For example, the Overseas Private Investment Corporation of the United States of America provides medium- to long-term financing and political risk insurance. However, in 2015, only 12 of the 140 projects were in LDCs.

Overall, blended finance and other mechanisms that aim to incentivize private investments in developing countries have so far largely bypassed LDCs. An OECD survey found that only 7 per cent of private finance mobilized by official development finance through guarantees and other private sector instruments targeted LDCs between 2012 and 2015 (see chapter III.C). However, steps have been taken to focus more of these activities on LDCs, where investors face the largest risks, and where the need for public support is arguably greatest. The European Union (EU) has recently launched its External Investment Plan to mobilize additional private finance and investments in Africa and the EU neighbourhood, including LDCs in particular. In

25 As of March 2017, see: http://investmentpolicyhub.unctad.org/IIA/IiasByCountry#iiaInnerMenu

26 UNCTAD (2016). *World Investment Report 2016*. Geneva.

27 See UNCTAD (2015) *Investment Promotion Observer,* No. 4. Available from: http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d4_en.pdf

addition to technical assistance and measures aimed at improving the investment climate, the plan will use EU grants to mobilize investments, including through guarantees to support private sector projects in risky environments. MDBs and development finance institutions also provide a range of blending instruments, political risk guarantees and technical assistance to promote private sector investments.

In addition, the World Bank Group's International Development Association (IDA) has created a Private Sector Window to support direct private investment in IDA countries, many of which are LDCs. It will include a risk mitigation facility to provide project-based guarantees, a local currency facility and a blended finance facility that blends IDA funds with investments by the International Finance Corporation to support SMEs. Nonetheless, high risks in many LDCs will make it extremely challenging to entice private investment. Mechanisms need to be designed with the vulnerabilities and capacities of LDCs firmly in mind. To make such mechanisms most effective, ***the Task Force recommends continued work on understanding how such structures should be adapted to LDCs.***

4. Addressing vulnerabilities

As noted in chapter I, the world is not yet on a path to end extreme poverty by 2030, let alone to eradicate poverty in all its forms and dimensions. Extreme poverty is still suffered by 13 per cent of the world's population,[28] including women, persons with disabilities, indigenous persons, children and youth and older persons. Increasing investments and other measures can help put the global economy back on a sustainable growth path and provide the employment and income opportunities required to make that growth more inclusive. But such measures will not suffice on their own to protect the most vulnerable and eradicate extreme poverty, at least in the short and medium run. In the Addis Agenda, the world's Governments agreed to address this challenge, at least in part, through a new social compact. Under that compact, Governments agreed to provide "fiscally sustainable and nationally appropriate social protection systems and measures for all, including floors"; Member States also committed to "strong international support for these efforts" and to explore "coherent funding modalities to mobilize additional resources, building on country-led experiences".[29]

The provision of universal social protection floors (SPFs) is included in the 2030 Agenda for Sustainable Development and was also adopted by the member countries of the International Labour Organization (ILO) in 2012.[30] SPFs are meant to convey at least minimum benefits to all people at every stage in their life cycle (children, mothers with newborns, support for those without jobs, persons with disabilities, older persons) through nationally designed and owned social protection systems.[31] Social protection systems are essential elements of a policy response to address poverty and vulnerability, with a successful track record of quickly reducing poverty in countries across all regions.

SPFs also have important economic consequences. They expand nations' "production possibility frontiers" as SPFs enlarge the stock of healthy, educated and productive citizens who might otherwise be excluded from the main economy. They also economically empower poor people and thereby enlarge their potential contributions to the economy, raising productivity and growth along with their incomes. This ultimately expands tax revenues and the fiscal sustainability of public services. Some components of SPFs act as "automatic stabilizers" that lessen the contraction phase of macroeconomic cycles. Further, SPFs can help prevent social conflict, and support political stability and social cohesion.

28 United Nations (2016) *Sustainable Development Goals Report*. New York.

29 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 12. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

30 R202 - Social Protection Floors Recommendation, 2012 (No. 202), adopted by 187 countries.

31 ILO Recommendation 202 defines SPFs as comprising basic social security guarantees which ensure that all in need have access to essential health care and to basic income security which together secure effective access to goods and services defined as necessary at the national level. The recommendation focuses on income security and access to social services.

4.1 Financing requirements for SPFs

Countries need to plan the implementation and financing of SPFs well, to ensure that financing is available in both the booms and slowdowns of the economic cycle. Financing social protection generally comes from the budget; thus, tax revenues are first and foremost the basis of financing. Increasing domestic public finance is critical to the financing of SPFs (see chapter III.A). Nonetheless, SPFs also have some unique features. In particular, necessary expenditures tend to rise during economic slowdowns when the available resources are falling, so that financing needs to be countercyclical.

Member States can build on the many case studies and successes of their peers as they choose a financing mix that matches their needs, capacities and national circumstances. There is a variety of options to finance SPFs at country level.[32] Reallocation of some inefficient expenditure, such as some harmful fossil fuel subsidies, could also provide a viable source of funds for social protection finance. Many countries have experimented with reallocation of pre-tax fossil fuel subsidies (see chapter III.A) towards social protection systems, and these efforts could be extended to efforts to reduce post-tax subsidies. This is in line with the commitment in the Addis Agenda to rationalize inefficient fossil-fuel subsidies that encourage wasteful consumption by removing market distortions, while minimizing the possible adverse impacts on their development in a manner that protects the poor.

Employer and worker contributions to social insurance systems have played an important role in many countries, expanding social protection in the formal sector in those countries where this is significant. Some countries have earmarked revenues from a particular source, such as commodity-related revenue for social protection. Creating dedicated fiscal reserve funds has been a successful strategy of some countries to create countercyclical financing. This has been a particularly popular choice for commodity-exporting countries, though these systems have to be designed well to deal with commodity price fluctuations. Given low commodity prices, building a reserve fund through this mechanism today would be difficult.

Another possibility for countercyclical financing, which applies to the entire budget, not just SPF finance, is the use of state-contingent debt instruments, including gross domestic product (GDP)- or commodity-linked financing, or clauses in sovereign loan or bond contracts (e.g., "bisque clauses" to allow borrowers to postpone interest payments when needed, such as "sovereign cocos"). Such instruments allow a government to reduce payments on debt during economic slowdowns, freeing up resources for other needs such as social protection. State-contingent debt instruments are discussed in more depth in chapter III.E on debt and debt sustainability.

One good practice that is relevant to all countries is the linking of social protection contributions and payments to tax compliance and enforcement. ***Building synergies between the social protection and tax systems can strengthen the social contract between citizen and state, as expansion of the tax base coincides with provision of benefits.*** Efficient operation of a social protection system also helps maintain public confidence in the effectiveness of the programme.

Building consensus around reforms, including across government ministries and among different stakeholders is an important consideration. In countries where SPFs have been agreed through tripartite national dialogue, they have covered not only SPF benefits but also the costs and financing, which has led to increased buy-in and stronger consensus on the implementation of SPFs. ***Design and financing options should be reviewed through national social dialogues to ensure that SPFs are well designed, efficiently operated and sustainable in the long term.***

4.2 International cooperation for strong and reliable social protection floors

As noted above, the Addis Agenda includes a commitment of strong international support for social

32 See Ortiz, Isabel, Matthew Cummins and Kalaivani Karunanethy (2015), *Fiscal Space for Social Protection Options to Expand Social Investments in 187 Countries.* ESS Working Paper, No. 48, International Labour Organization. Geneva.

protection.[33] Additionally, while national SPFs should generally be financed by national resources, there are times and circumstances—for example, after an economic shock—when it will be difficult for countries to fully meet all the costs of their SPFs and other entitlements and obligations out of their own resources. Some international steps have been taken to assist in such situations. More are under consideration and should be advanced.

While the recurrent costs of SPFs are affordable in the majority of developing countries,[34] many need support to start up a national SPF system. The design and implementation of SPFs requires initial start-up investments towards the formulation of policies and strategies, the development of legal frameworks, the identification of sustainable financing mechanisms, and the building of technological, administrative, actuarial and statistical capacities, including training of government officials. Countries that require capacity-building may be hesitant to make initial investments, instead opting for small-scale, fragmented or unsustainable programmes. In general, there is very little ODA provided for social protection systems (averaging $1.1 billion a year over the last 10 years), especially compared to ODA directed to social services, such as health and education (averaging $5.6 billion and $9.2 billion a year, respectively).[35] Donor resources have sometimes contributed to the costs for the set-up and design of the systems. At the same time, development cooperation partners are showing increasing interest in capacity development for tax systems and administrations. As noted in chapter III.A, the efficacy of spending is equally important as the efficacy of revenue generation, underscoring the need for assistance for the entire budgeting process. In this regard, ***further resources for capacity-building to help countries design and implement effective SPFs would be warranted.***

While technical assistance and start-up costs are the main areas in need of greater international support, some countries may also need external financial support for their SPFs, as for other non-discretionary spending, during temporary and relatively short crisis periods. Official international financing remains crucial for addressing such temporary financing needs, especially for the LDCs. The IMF has a leading role in this regard on behalf of the international community, lending resources when countries face balance-of-payments constraints, providing an important financial buffer. The IMF and the World Bank have created several facilities in recent years to more quickly disburse financial resources.[36] The IMF has also created much larger credit lines for countries pre-qualifying with "strong" domestic policies, although they are regularly used by only a few countries[37] (see also chapter III.F on addressing systemic issues). Overall, while it is accepted that countries may require substantial quick-disbursing international financial assistance to address various crisis situations, the international system's availability of resources to finance entitlement spending is uncertain and opportunities to improve the international architecture should be further explored. ***To shed light on this question, an inventory of instruments, including existing quick-disbursing international facilities, and requirements for accessing them seems warranted at this time.***

33 ILO Recommendation 202 states "National SPFs should be financed by national resources. Members whose economic and fiscal capacities are insufficient to implement the guarantees may seek international cooperation and support that complement their own efforts." (para. 12)

34 ILO estimates in 90 developing countries that recurrent resources needed to operate cash transfers and administrative costs amount to 2.9 per cent of GDP, on average.

35 Figures are based on project-level data for members of the OECD Development Assistance Committee in constant 2014 US dollars. Social security systems are covered under code 16010 for social/welfare services.

36 The IMF funds are provided through the Rapid Credit Facility at concessional interest rates for low-income countries and the Rapid Financing Instrument at normal interest rates for all IMF members. The World Bank created the Crisis Response Window, the Immediate Response Mechanism and most recently the Pandemic Emergency Financing Facility, in partnership with the World Health Organization.

37 Birdsall, Nancy, Liliana Rojas-Suarez and Anna Diofasi (2017), "Expanding Global Liquidity Insurance: Myths and Realities of the IMF's Precautionary Credit Lines," Working Paper 449, Center for Global Development, Washington, D.C. (February).

Box 2

Investing in gender equality and women's empowerment

The Addis Ababa Action Agenda clearly states that achieving gender equality, empowering all women and girls, and the full realization of their human rights are essential to achieving sustained, inclusive and equitable economic growth and sustainable development. Women's empowerment and participation in the labour market can strengthen economic growth; the International Monetary Fund estimates gross domestic product losses per capita due to gender gaps of 5 per cent to over 30 per cent across a wide range of developed and developing countries.[a]

The Addis Agenda includes specific language on the need to provide financing to achieve these aims. A corresponding Addis Ababa Action Plan on Transformative Financing[b] for gender equality and women's empowerment calls on all actors to adopt policies at the domestic and international level to mobilize the resources needed to implement gender equality commitments. As United Nations Member States address the long-term investment challenges and the vulnerabilities facing households and countries, ***it is critical that the policies and actions of Member States are not just gender-sensitive, but actively seek to advance the goal of gender equality and women's empowerment***.

The lack of adequate and sustainable infrastructure limits the opportunities of women and girls. Often there is an assumption that investment in infrastructure is gender neutral because women and men both have the ability to access infrastructure assets — meaning Governments may not develop the capacity to incorporate gender analysis into infrastructure planning. Implicit bias and social norms, such as the traditional roles assigned to women, shape the incidence of public expenditure on infrastructure. For example, if women are more likely than men to do unpaid care work, then increases in expenditure on social infrastructure (for example, on schools, health clinics, roads or water) would have a greater positive impact on women.[c] ***It is thus critically important that the institutions, both domestic and international, that influence infrastructure investment choices consider the gendered impact of their investments***. Inclusive decision-making and dialogue with stakeholders, including women's organizations, is essential; at the national level, this can be fostered by gender-responsive budgeting, thereby strengthening transparency and equal participation in the revenue and expenditure decisions of Member States. UN Women has supported more than 80 countries over the last 15 years to design and implement gender-responsive budgeting, demonstrating the massive potential for fiscal policy to be designed, implemented and monitored to respond to women's and girls' needs. For development banks, processes for mainstreaming gender equality in investment decisions are critical.

It is no less important that the design, financing and implementation of public policies to address vulnerabilities are also aimed at achieving gender equality.[d] Many social programmes around the world have incorporated gender analysis and sought to increase women's and girls' empowerment. Yet not all social protection systems do this, and ***in some countries' social insurance programmes, women are treated unfairly, given that they disproportionately have lower pay, lower status and more insecure jobs, meaning the existing inequality in employment and income is replicated in pensions and social security benefits. This can and should be redressed by reforming those social protection systems.*** Furthermore, unpaid care work, which contributes to individual and household well-being, is primarily provided by women and girls but is rarely equally recognized. Empirical evidence shows that women are particularly vulnerable to income shocks and frequently face higher impacts from fiscal consolidation programmes enacted in response to economic downtowns since they are usually more dependent on social expenditure and bear responsibility for unpaid care work. ***As countries build up their social protection floors, it is important that they are sufficiently robust and carefully designed to reduce women's and men's vulnerability to economic fluctuations. The design of those systems should also recognize and value unpaid care and domestic work, and can even help reduce and redistribute some of this work.*** Appropriately designed and financed floors can lift households out of poverty, but they can also economically empower women, allowing them to be more productive and contribute to more inclusive and socially sustainable societies.

a International Monetary Fund (2013). *Women, Work, and the Economy: Macroeconomic Gains from Gender Equity*; IMF Staff Discussion Note; http://www.imf.org/external/pubs/ft/sdn/2013/sdn1310.pdf

b http://www.unwomen.org/-/media/headquarters/attachments/sections/news/action%20plan%20on%20transformative%20financing%20for%20gewe.pdf?vs=5346

c Report of the UN Secretary-General's High-Level Panel on Women's Economic Empowerment (2016). *Leave No One Behind a Call to Action for Gender Equality and Women's Economic Empowerment*.

d For a more in-depth discussion please see the Report of the Secretary-General on Women in development, A/68/271.

Members of the Task Force are already increasing cooperation on SPFs. The ILO and the World Bank bring together the relevant global, regional and bilateral development institutions though a Global Partnership on Universal Social Protection launched in September 2016.[38] "Working as One" to promote SPFs is an important initiative of the United Nations Development Group and the ILO, launched in 2014. It mobilizes "One UN" national teams, under the Social Protection Floor Initiative, to design and implement social protection systems and floors through national dialogue. In addition, some developing countries have bilateral cooperation initiatives on social protection, and the ILO and the United Nations Special Unit for South-South Cooperation have facilitated peer-to-peer learning,[39] including through events like the China High-level South-South event to achieve the SDGs on Universal Social Protection in September 2016.[40] In sum, many countries are working on enhancing their SPFs and the international community is supporting such efforts; however, more needs to be done to speed implementation of this crucial component of the Addis Agenda.

38 See http://www.social-protection.org/gimi/gess/NewYork.action?id=34. Additionally the Social Protection Inter-Agency Cooperation Board (SPIAC-B), co-chaired by the ILO and the World Bank Group, was created by the G-20. See http://www.ilo.org/newyork/issues-at-work/social-protection/social-protection-inter-agency-cooperation-board/lang--en/index.htm.

39 Information at http://ssc.undp.org/content/ssc/un_entities_space/ILO/programmes.html).

40 http://www.social-protection.org/gimi/gess/Beijing.action?id=33

Chapter III.A

Domestic public resources

1. Key messages and recommendations

Domestic public finance is essential to providing public goods and services, increasing equity, and supporting macroeconomic stability. Effective mobilization, budgeting and use of resources are critical to achieving sustainable development. Both quantity and quality are important, along with accountability and alignment with the Sustainable Development Goals (SDGs).

As noted in the Addis Ababa Action Agenda, additional domestic resources will be, first and foremost, generated by economic growth. At the same time, improved policies and administration will help realize more efficient and effective resource mobilization. Tax administration and public financial management capacities have dramatically improved in many countries, and there is strengthened awareness of the link between taxation, expenditure, accountability and the legitimacy of the state. ***To improve revenue collection, Governments should take whole-of-government approaches that emphasize the development of medium-term revenue strategies and stronger enforcement. Greater use of tools to assess tax policy and administration capacity can assist countries in developing strategies.***

Donor countries have historically provided only small amounts of resources for revenue capacity, although in the Addis Agenda they committed to increasing external support to build tax capacity. ***International organizations have put forward recommendations on enhancing the effectiveness of external support in building tax capacity in developing countries. Recommendations include better donor coordination and greater sharing of expertise (box 3).***

Peer-to-peer learning and regional cooperation are key elements of capacity-building and the Addis Agenda supports the strengthening of regional networks of tax administrators. ***Development cooperation actors should work in close partnership with regional tax organizations, where they exist, to increase their strength and coverage; where they do not exist, they should be developed expeditiously.***

As noted in the Addis Agenda, in a world of cross-border trade, investment and finance, there are limits to what can be done by domestic policy alone, necessitating strengthened international cooperation. ***Additional analytical work to analyze spillovers from national tax policies and propose possible mitigating measures is recommended.*** The United Nations Committee of Experts on International Cooperation in Tax Matters is an important mechanism for the development of international tax norms with special emphasis on guidance by and for developing countries. ***Member States should consider nominating qualified tax experts for the Committee's new term, which begins in the second half of 2017.***

International tax norms have important distributional implications, both between the private sector and Governments as well as among Governments, and thus impact sustainable development and investment. ***The Task Force recommends thorough analysis on the implications for sustainable development of reforms to international tax frameworks. Such analysis will be facilitated by greater availability of national data related to the reforms.***

Increasing revenue mobilization ability is not enough if countries' resources are simultaneously drained as a result of illicit activity. The Addis Agenda calls for the strengthening of the rule of law and the combatting of corruption at all levels, as well as the elimination of illicit financial flows (IFFs). However, measuring and tracking IFFs is extremely

challenging, in part because of a lack of an intergovernmental agreement on the conceptual framework defining IFFs. Given the multiple motivations for IFFs, the Task Force has provided a mapping of some of the components of IFFs. ***The Task Force recommends component-by-component and channel-by-channel analysis and estimation of IFFs, allowing further methodological work and proposals for relevant policy tools and options.***

It is important for countries to strengthen existing institutions and enforcement of the law. To more strategically tackle this problem, the Task Force recommends conducting risk and vulnerability assessments to help countries focus their monitoring, implementation, policy and enforcement efforts to the channels most relevant to their country contexts.

On top of prevention and enforcement, the Addis Agenda calls for the confiscation and recovery of the proceeds of crime and stolen assets to be made more effective. ***The Task Force recommends that Member States speed up international cooperation on the return of stolen assets to the maximum extent allowable by law and, recognizing that asset return is unconditional, make efforts to ensure that returned assets are not stolen again.***

To further strengthen the link between taxation, expenditure and the accountability of the state including any relevant subnational authorities, fiscal transparency is critical. ***The Task Force recommends better disaggregation of budget data, including by sex and geography, to improve tracking of revenue raising and spending related to the SDGs and to speed up efforts to improve transparency, with increased capacity-building for countries that need assistance.***

2. Domestic resource mobilization and taxation

A defining feature of the last decade of public policy has been the strengthening of domestic resource mobilization. While domestic resources are first and foremost generated by economic growth, domestic policy frameworks and institutions can have important impacts on revenue mobilization. An increase in tax collection may be achieved through several channels, including strengthened institutions, administration and legal frameworks; higher compliance and increased trust; stronger enforcement; improved tax policies, including the broadening of the tax base; the creation of new taxes; and the reduction of tax incentives. All of these measures must be carefully considered, as the incentives generated may affect income distribution and inequality, consumption and investment. At the same time, in a world of cross-border trade, investment and finance, there are limits to what can be done by domestic policy alone, necessitating strengthened international cooperation, as discussed in the next section.

Figure 1 shows the recent trend in tax revenue collection across groups of countries. Despite declines in revenue mobilization following the 2008 world financial and economic crisis, all country groupings experienced growth in median tax revenue since 2000, with the gap between countries in developed regions and developing countries narrowing over this period. Least developed countries (LDCs) generated particularly strong growth in median tax revenue, from under 10 per cent of gross domestic product (GDP) in 2001 to 14.8 per cent in 2015. Nonetheless a gap still remains, underscoring the potential for developing countries to raise more revenue through taxation.

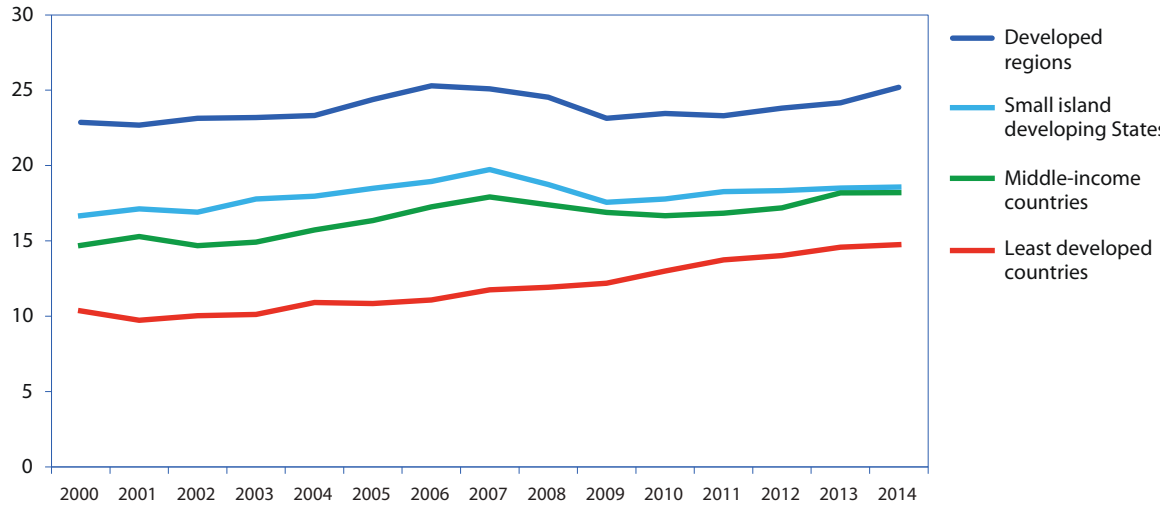
Although every country is different and there is no one-size-fits-all formula, there is increasing evidence that countries with tax revenues below 15 per cent of GDP have difficultly funding basic state functions.[1] Yet, taxes in half of LDCs remain below that threshold, especially in countries that are experiencing or have recently experienced conflict.

2.1 Revenue targets

The Addis Agenda welcomes efforts by countries to set nationally defined targets for enhancing domestic revenue as part of their national sustainable development strategies, with international support to those in need to reach these targets. While targets can be oversimplified, in that establishing a target might not be enough to motivate reform, such targets can demonstrate political will and help strengthen tax administration practices. Indeed, targets help create

1 Gaspar, Vitor, Laura Jaramillo and Philippe Wingender, (2016). *Political Institutions, State Building, and Tax Capacity: Crossing the Tipping Point*, IMF Working Paper WP/16/233.

Figure 1
Median tax revenue, 2000 – 2014 (*Percentage of GDP*)



Source: IMF World Revenue Longitudinal Database.

the urgency needed for reform. A number of countries, particularly in Africa and South East Asia, have set regional targets for revenue mobilization at levels higher than 15 per cent of GDP. The East African Community's convergence criteria for their single currency sets 25 per cent as the target tax-to-GDP ratio for member countries.[2] Similarly, the West African Economic and Monetary Union and the Economic Community of West African States (ECOWAS) have set 17 per cent and 20 per cent of GDP, respectively, as reasonable convergence targets. Many national development strategies that cite tax targets indicate a level of 15 per cent or higher (e.g., Egypt, Ethiopia, Indonesia, Uganda, the United Republic of Tanzania and Viet Nam).

2.2 Tax administration

Many countries have taken important steps to strengthen the institutional framework necessary to increase their potential tax revenue over the last five years. The Tax Administration Diagnostic Assessment Tool (TADAT) is one important tool, which can help identify options for strengthening tax administration. TADAT aims to identify strengths and weaknesses and assess performance in tax administrations on a country-by-country basis. More than 30 TADAT assessments were conducted through October 2016. The International Survey on Revenue Administration (ISORA), a joint endeavor between The Inter-American Center of Tax Administrations (CIAT), the International Monetary Fund (IMF), the Intra-European Organisation of Tax Administrations and the Organization for Economic Cooperation and Development (OECD), will build upon the IMF Revenue Administration Fiscal Information Tool (RA-FIT). The first round of ISORA data collection covering 132 countries is expected by June 2017, which will provide new benchmarks countries may use.

A number of developments offer opportunities for countries to increase revenues, but may also put new resource pressures on tax administrations. New international norms in the sphere of tax information exchange (discussed below) will provide benefits in deterring and detecting tax fraud, evasion, and aggressive tax planning; these also mean that more capacity will potentially be needed to deal with the large volumes of information countries will receive and send. Countries that choose to implement new and sometimes more complex norms on transfer pricing, controlled foreign company rules, permanent establishment status and other areas will likely

2 East African Community (2013). *Protocol on the Establishment of the East African Community Monetary Union*.

need more human resources with greater levels of training to fully realize the benefits. Investments in new technologies are likely to be needed. Countries should weigh the cost of adhering to the new standards against the potential for revenue generation those standards are likely to bring.

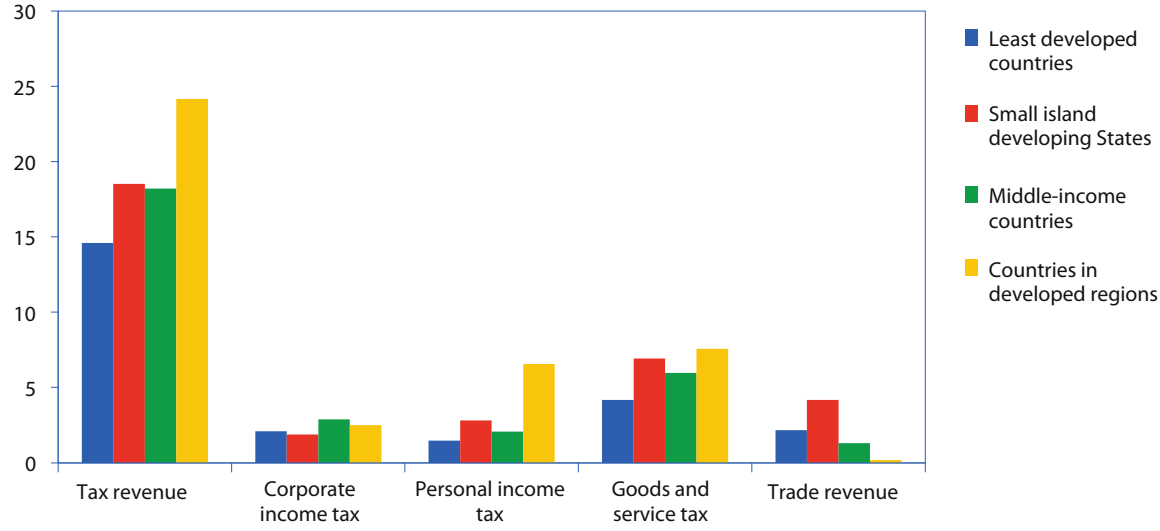
2.3 Improving tax policies

The Addis Agenda emphasises that Member States should improve the fairness, transparency, efficiency and effectiveness of tax systems, including by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy.

Tax reforms may broaden the tax base or increase rates of direct taxes (corporate and personal income) and/or of indirect taxes. The balance between the two can be altered as well, although that can be difficult. Reforms may also consider whether national or subnational authorities should be responsible for rates and collection. In general, as shown in figure 2, while countries in developed regions rely more on direct taxation, middle-income countries rely more heavily on indirect taxes (general goods and services taxes) and corporate income taxes, while LDCs and small island developing States (SIDS) rely more on indirect taxes and trade revenue. An increase in indirect taxation — for example, through increasing value-added taxes or reducing exemptions — can provide scope to easily increase the revenue collected. However, indirect taxation can be regressive by taxing lower-income consumers proportionally more. In general, analysis of the distributional impact of tax reforms, including disaggregating the impacts by sex, is important. A balanced approach should also take into account a country's circumstances, the distributional impact of planned expenditure and the existing economic and institutional framework.

It is also possible to develop new taxes, which may be needed to respond to shifts in consumption resulting from technological change, particularly digital activity where the service provider often does not have a fixed place of business in the country where the final sale takes place. Several countries have now introduced taxes on digital activities, such as taxation on the provision of internet advertising, consumption taxes on digital transactions, and diverted profits taxes. Anti-avoidance regulations have been used to cover digital transactions as well as levies outside the tax system to avoid conflicts with bilateral tax

Figure 2
Median tax revenue by type of tax, 2013 (*Percentage of GDP*)



Source: International Monetary Fund World Revenue Longitudinal Data (WoRLD), 13 July 2015 and UN/DESA calculations.
Note: Tax revenue as a percentage of GDP, middle-income countries according to World Bank Group country income groups 2015 and United Nations country groupings for SIDS and LDCs. Countries in developed regions as per the United Nations Statistical Division's M49 statistical classification.

treaties. The unilateral application of some of these taxes could lead to tax disputes and double taxation.

Taxes to combat negative externalities can be efficiently used to raise revenue as well. Environmental taxes, such as carbon taxes, are important. Excise taxes — taxes applied to domestic consumption of specific, often damaging, products such as tobacco and alcohol — are another good example. As noted in the Addis Agenda, countries can take price and tax measures on tobacco to raise revenue, improve health, and decrease health-care costs, as demonstrated by the experience of the Philippines (box 1).

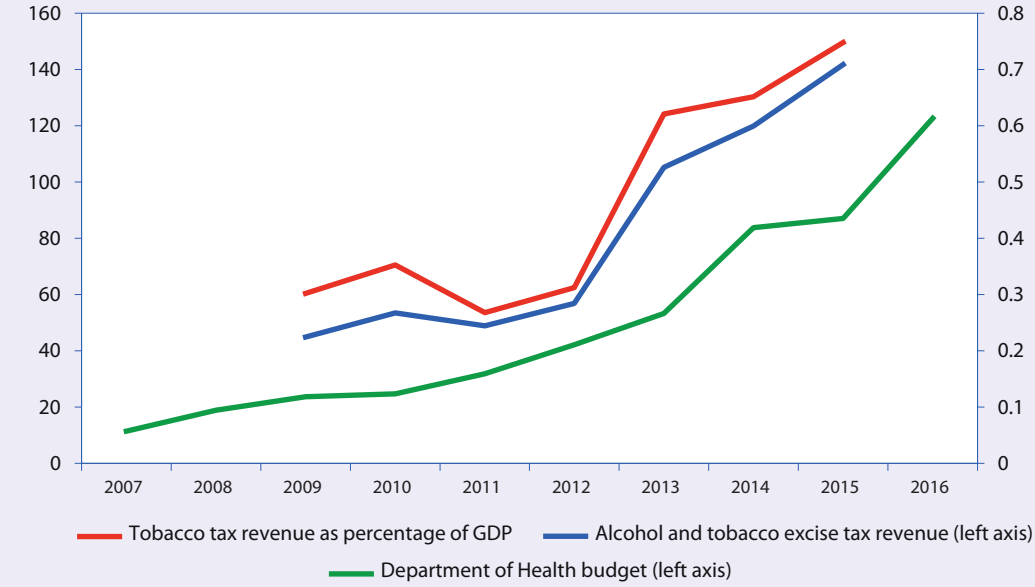
Box 1

"Sin tax" reform in the Philippines

The Addis Ababa Action Agenda recognizes that "price and tax measures on tobacco can be an effective and important means to reduce tobacco consumption, and represent a revenue stream for financing for development in many countries".[a] A recent study has shown that if all countries were to raise their cigarette excises by the equivalent of $0.80 per pack, an additional $141 billion in excise tax from cigarettes would be generated globally.[b] In developing countries, this increase in revenue could help create the fiscal space for investment in development priorities. For example, the 2012 "sin tax" reform law (Republic Act No. 10351) in the Philippines that, among others, simplified the tobacco tax structure and raised taxes significantly, resulted in revenues doubling as a share of gross domestic product and increased budgets for the health sector dramatically. The increased fiscal space allowed the Philippines to provide fully subsidized health insurance to the poorest 40 per cent of the population.

Figure 1.1.

"Sin tax" revenues and Department of Health budget, 2007–2016 (*Billions of Philippines pesos, percentage*)



Source: Kaiser, Bredenkamp, and Iglesias (2016). Sin Tax Reform in the Philippines: Transforming Public Finance, Health, and Governance for More Inclusive Development. Directions in Development. Washington, DC: World Bank. Doi: 10.1596/978-1-4648-0806-7.

a Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 32. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

b Goodchild, Mark, Anne-Marie Perucic and Nigar Nargis (2016). Modelling the impact of raising tobacco taxes on public health and finance. Bulletin of the World Health Organization, Vol. 94, pp. 250-257.

Governments may also choose to introduce a property tax if they do not already have one, or improve the effectiveness of existing property tax systems, although development of property taxation systems yield relatively little revenue in developing countries and would need significant time and efforts to build up. Some revenue streams, such as property taxes, are often devolved to or administered by subnational or municipal authorities, and governments should pay attention to the capacity of such authorities and the possible synergies of revenue initiatives with other areas of administrative reform (box 2).

The Addis Agenda recognizes that tax incentives can be an appropriate policy tool, but it also warns that incentives can be excessive and some tax practices can be harmful. According to an October 2015 joint report[3] by the IMF, OECD, United Nations and World Bank, tax incentives are often found to be redundant in attracting investment in developing countries; that is, the same investments would have been undertaken even if no incentives had been provided. The paper argues that tax incentives should not be overly complex or discretionary, and countries should make sure incentives are transparent and that the aggregate benefits generated by incentives outweigh the costs, while being mindful of the potential distributional implications and the impact on inequality. In addition, tax incentives should be weighed against other uses of the funds, such as for improved infrastructure and strengthened institutions, which could stimulate both domestic economic activity and foreign investment. The Addis Agenda notes that countries can also "engage in voluntary discussions on tax incentives in regional and international forums"[4] to avoid countries competing on lowering tax rates and diminishing the tax base.

2.4 Improving tax legislation

Improved administration and better tax policies might not be sufficient where domestic legal frameworks lack clarity or provide loopholes. Reducing loopholes in tax legislation can be complemented by efforts to introduce general anti-avoidance legislation which helps deter and respond to aggressive tax planning. Governments may also want to update legislative frameworks to keep pace with developments in international tax norms, such as on transfer pricing, as not all countries have transfer pricing legislation.

3. International tax cooperation

The Addis Agenda notes that international tax cooperation should be scaled up, universal in approach and scope, and fully take into account the different needs and capacities of all countries. For many years international tax cooperation focussed on the conclusion of bilateral tax treaties, which had the principle aim of reducing double taxation. More recently international tax cooperation has increasingly looked at setting tax norms to close loopholes, and to increase the exchange of information between tax authorities to help limit tax avoidance by all types of taxpayers. International tax cooperation can also help build capacity in the countries that need support.

As shown in figure 3, the institutional environment for international tax cooperation is complex. The United Nations and the OECD are the two principle venues for the development of international tax norms, particularly through the maintenance of model conventions and commentaries as well as codes of conduct and guidance to countries. Certain standards are agreed elsewhere, such as the Financial Action Task Force on beneficial ownership information, and may be drawn upon by United Nations and OECD forums. The OECD, while not a universal membership body, has worked extensively with the Group of Twenty (G20) countries and has established forums open for interested countries to participate, such as the Global Forum on Transparency and Exchange of Information for Tax Purposes, currently with 139 members, and the Inclusive Framework on BEPS, currently with 94 members.

3 IMF, OECD, United Nations, and World Bank (2015), *Options for low income countries' effective and efficient use of tax incentives for investment, October 2015*. Available from http://www.oecd.org/tax/tax-global/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf.

4 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 27. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

Box 2

Strengthening local taxation in Mozambique

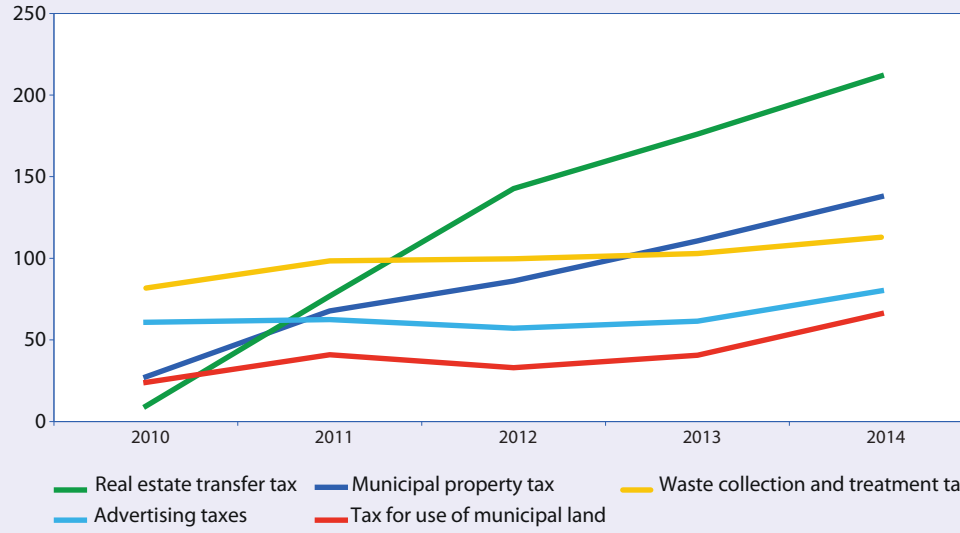
The Addis Ababa Action Agenda highlights the need to support local governments in mobilizing revenues where appropriate. Expenditures and investments for sustainable development can be made at the subnational level. In the case of Maputo, Mozambique, the city has raised additional resources for investment through reforms of property and real estate transfer taxes. The success of their efforts relied on the devolution of authority to the municipal level and well-sequenced and comprehensive reforms involving tax rates, land registries and the greater sharing of information.

In 2008, the Government of Mozambique enacted legislation confirming that the property tax, known as Imposto Predial Autárquico (IPRA), is part of the municipal tax base. IPRA is levied on the resale value of an urban building that is regarded as infrastructure and built on a municipality's urban land. The city of Maputo increased the nominal tax rate and expanded the scope of its application. To improve the performance of IPRA, Maputo faced a wide range of challenges: The territorial areas covered by local offices responsible for property registration often did not match the jurisdiction of its local councils. Some of Maputo's local councils did not have a property registration office where transactions could be recorded. In some cases, both the local branch of the national tax authority and a local tax authority collected the IPRA. Through well-sequenced and comprehensive reform efforts, Maputo overcame the many challenges, improved communication and coordination between local and national tax authorities to avoid double taxation, and ensured that property registration corresponded to local jurisdictions. IPRA revenues grew fourfold from 2010 to 2014.

At the same time, the reforms contributed to the success of a real estate transfer tax, known as Imposto Autárquico de Sisa (ISISA), whose collection was devolved to the local level in 2008. ISISA is levied on the transfer of ownership of urban property in a municipal territorial area. The tax relies on many of the same prerequisites that are necessary for successful property taxation, including reliable property registration. By 2014, ISISA revenues represented 20 per cent of Maputo's own-source municipal revenue, and now the IPRA and ISISA taxes are the two largest sources of local revenue in the city.

Figure 2.1.

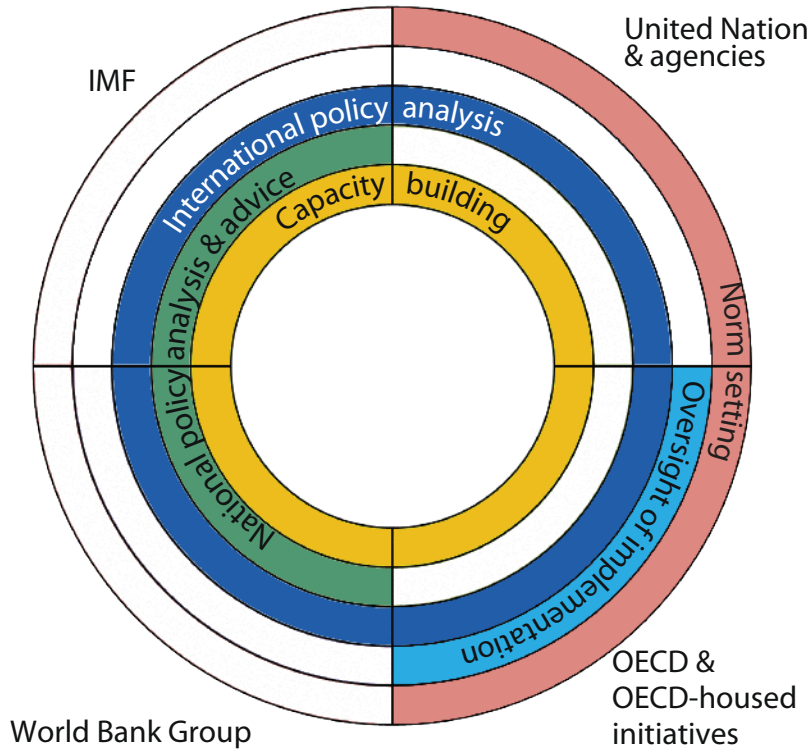
Top five own-source revenues in Maputo, 2010 – 2014 (*Millions of Mozambican metacais*)



Source: UNCDF and FfDO (2017). *Financing sustainable urban development in the Least Developed Countries.*

The OECD also serves as a coordinator and overseer of implementation of its agreements and has also designed a number of multilateral conventions and instruments. The United Nations Model Double Taxation Convention between Developed and Developing Countries is developed and updated by the Committee of Experts on International Cooperation in Tax Matters, which draws its member-

Figure 3
Schematic representation of international organization roles in international tax cooperation



Source: Inter-agency Task Force on Financing for Development.
Notes: Size of diagram does not reflect the volume or importance of work. Examples of norm setting include model conventions, multilateral treaties and some types of recommendations derived from international tax forums. Oversight of implementation includes peer reviews and the assessment of compliance with international standards. International policy analysis examples are research papers, and handbooks. National policy analysis and advice includes surveillance, assessment of tax administrations, and policy proposals. Examples of work on capacity-building are IMF technical assistance, the Global Tax Program of the World Bank, the United Nation Department of Economic and Social Affairs Capacity Development Unit, and the OECD Global Relations programme.

ship from United Nations Member State nominations. The Committee of Experts is drawn from the fields of tax policy and tax administration, and is composed of a balance between developed and developing countries reflecting an adequate equitable geographical distribution, representing different tax systems. It submits its report and conclusions to be considered by the United Nations Economic and Social Council (ECOSOC).

The United Nations and its agencies conduct international policy analysis, as does the OECD and the IMF. The IMF and World Bank also work at the national level on policy analysis and recommendations. Capacity-building is a priority for all the actors. In April 2016, in response to the call in the Addis Agenda for more coherence in tax work, the IMF, OECD, United Nations and World Bank launched The Platform for Collaboration on Tax, which is designed to strengthen cooperation between these organizations on tax issues.

Many of the most recent developments in international transparency, cooperation and taxation will require a heightened standard for the countries who implement them. Dealing with these standards is particularly difficult for developing countries, some of whom have limited resources and capacity to efficiently administer and enforce domestic tax compliance. For the countries facing those limitations, capacity-building is of utmost importance, especially as proportionally developing countries have the most potential to gain from improved revenue collection.

3.1 Estimates of volume of international tax avoidance and evasion

Tax evasion is an illegal action that is, in most countries, characterized as a crime, whereas tax avoidance is a legal practice, which involves tax planning and arbitrage across borders. Measurements of tax gaps are not made in most countries.[5] Table 1 outlines some global tax avoidance estimates. The diversity of estimates points to the lack of a uniform methodological approach.

3.2. Tax treaties and voluntary agreements

To address tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations, the OECD and G20 launched a base erosion and profit shifting (BEPS) project in 2013. In November 2016, more than 100 countries concluded negotiations, held under the auspices of the OECD, on a multilateral instrument (MLI) to facilitate implementation of the aspects of the BEPS Action Plan requiring modification of treaties (e.g., introduction of anti-abuse provisions). The MLI will open for signature by interested countries in June 2017, and may be adopted in total or in part.

In the Addis Agenda, Governments commit to making sure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created. However, a revision of the division of taxation rights between source countries and residence countries has not been effectively addressed in any of the existing forums and, so far, there has been no revision of the standards that grant countries the right to tax profits from activities occurring within their countries.[6] While the UN and the OECD Model Conventions and the MLI does include provisions to prevent treaty abuse, no aggregate information is yet available on the extent to which countries are inserting anti-abuse clauses in bilateral tax treaties, as suggested in the Addis Agenda.

Bilateral treaties are generally based on either the United Nations Model Convention or the OECD Model Convention. Both of these model conventions are under revision, and will adopt new preambles that will expand the aims of the conventions. The revisions aim to eliminate double taxation without creating opportunities for tax avoidance or evasion, such as through treaty shopping. The revisions will not automatically change the existing base of more than 3,000 treaties.[7]

3.3. United Nations Committee of Experts on International Cooperation in Tax Matters

The Addis Agenda includes a commitment to strengthen the effectiveness and operational capacity of the United Nations Committee of Experts on

Table 1
Corporate tax avoidance estimates, 2014 and 2015

Estimate provider	Date of estimates	Volume	Underlying data
G20/OECD BEPS Action 11 Report	2015	$100 billion – 240 billion annual revenue loss	Corporate financial information databases
UNCTAD	2015	$100 billion annual revenue loss	Locational data on FDI flows and MNE profitability reporting
IMF staff	2014	$123 billion in short-run revenue loss	Macro-level differences in statutory corporate income tax rates and effective tax rates

Source: Inter-agency Task Force on Financing for Development.

5 OECD (2015). *Tax Administration 2015*, OECD Publications, available from https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/comparative/tax-administration-23077727.htm.

6 The so-called permanent establishment concept.

7 Provided the country does not adopt the ambulatory approach for interpretation of tax treaties. The ambulatory approach allows treaties to accommodate changes in domestic law without the need to renegotiate the treaty, by allowing countries to interpret the terms of the treaty according to the most recent amendment/interpretation conveyed by the intergovernmental institutions (OECD or the United Nations).

International Cooperation in Tax Matters, which has a special role in producing guidance by and for developing countries. In 2016, the Committee held two meetings, implementing the commitment in the Addis Agenda for increasing the Committee's official workdays. The engagement between the committee members and ECOSOC was strengthened by the holding of ECOSOC special meetings on tax back-to-back with the December 2016 and April 2017 meetings of the Committee in New York.

The Committee has been working on a number of products to further clarify the application of tax treaties, transfer pricing legislation, and how resource-rich countries should address the taxation of extractive industries. The Committee has approved, and in 2017 will be issuing, the following new products: (i) a new revised United Nations Model Convention and Commentaries (for launch in June) with a new provision on technical services; (ii) a revised version of the Transfer Pricing Manual (for launch in April), reflecting and giving guidance on transfer pricing practices of developing countries; and (iii) a new handbook on selected issues in the taxation of extractive industries by developing countries (for launch in October). The draft versions of these documents can be found on the web page for the Committee.[8] The last year of the four-year mandate of the fourth composition of the Committee of Experts is 2017; the United Nations Secretary-General will appoint a new group of tax experts as members of the Committee, in consultation with the Member States, for a new term starting in July 2017. Member States, in particular developing countries, should consider nominating qualified tax experts, with nominations of female experts particularly encouraged.

3.4 Tax information availability

Increasing the availability of information to tax administrations has been at the core of the recent initiatives in international tax cooperation, as this can assist in reducing tax avoidance and evasion. Progress has been made in the areas where the Addis Agenda called for action: exchange of tax information, country-by-country reporting for multinational enterprises (MNEs), availability of beneficial ownership information, and transparency in the extractive industries.

Exchange of tax information

Exchange of information has long been included in tax treaty models as a feature. By agreeing to exchange information with respect to taxpayers, countries can become more aware of taxpayers' global activities to be able to impose taxes that should be due. Information can be exchanged using a variety of tools, and under automatic or on-request frameworks. While exchange of information on request has been the predominant standard to date, most forums are currently progressing towards automatic exchange.

The upcoming 2017 revision of the OECD Model Convention and commentaries is expected to broaden the scope of the exchange-of-information article to allow triangular, or multiparty exchange-of-information requests. The United Nations Committee agreed in 2016 to a proposal for a United Nations Code of Conduct on Cooperation in Combating International Tax Evasion, which supports the automatic exchange of information for tax purposes as the way forward for countries generally, and recognizes that it is vital for developing countries to exchange information, even if they are not ready for automatic exchange. The draft Code has been approved by the Committee of Experts in 2016, and will be incorporated in the United Nations Model Convention and forwarded for possible adoption as an ECOSOC resolution.

Exchange of financial account information

The 139 members of the OECD-housed Global Forum on Transparency and Exchange of Information for Tax Purposes have committed to implementing an international standard on exchange of information on request. In order to put an end to bank secrecy and to tackle tax evasion, it has targeted the exchange of financial account information through the Common Reporting Standard (CRS). The CRS, agreed by the OECD with the G20 in 2014, calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions

8 Available from http://www.un.org/esa/ffd/ffd-follow-up/tax-committee.html.

on an annual basis. Through the Global Forum, 100 countries have agreed to implement the CRS.

These international standards may require Governments to build tax information databases, reorganize tax administrations or invest in new technologies to fully comply with and benefit from exchange of information. The G20 has asked the OECD to prepare a list of jurisdictions that have not yet sufficiently progressed towards a satisfactory level of implementation of the agreed international standards on tax transparency. The G20 has already stated that it will consider taking defensive measures against listed jurisdictions.

Exchange of corporate information: country-by-country reporting

Country-by-country reporting refers to an annual report by MNEs to the authorities in the jurisdiction where they are headquartered, showing a range of financial and other relevant data for the MNEs activities in each tax jurisdiction in which they do business. These reports enable revenue authorities to undertake high-level risk assessments.[9] Country-by-country reports can be exchanged automatically between tax administrations, provided the country enters into an agreement to exchange country-by-country reports such as the Multilateral Competent Authority Agreement (MCAA). This new reporting standard is set to enter into effect in most of the jurisdictions that have agreed to it in 2017. The MCAA has so far been signed by 57 countries.

Exchange of beneficial ownership information

To discourage hiding of income and wealth, countries are implementing stronger rules on the disclosure and exchange of beneficial ownership[10] information. The Financial Action Task Force (FATF) first agreed on a standard on beneficial ownership in 2012, and the G20 and OECD countries agreed to the principle that all countries must have beneficial ownership information available to competent authorities. All 139 Global Forum members will be assessed to evaluate the implementation of this requirement in the second round of peer reviews. Some countries, particularly in Europe, have gone beyond the basic international standard and pioneered the development of centralized, public beneficial ownership registries on certain types of entities.

Information on the extractive industries

The Addis Agenda highlights the particular importance of corporate transparency in the extractive sector to assist populations of resource-rich countries to hold their Governments accountable for the proceeds of these activities. In 2013, the European Union made it mandatory for businesses in the extractive and logging industries to publish their government payments relating to the exploitation of natural resources, on a project-by-project basis. The United Nations Committee of Experts in Tax Cooperation's forthcoming publication, Handbook on Extractive Industries, provides guidance for countries wishing to reform their tax systems in order to capture the full revenue generation potential of extraction projects.

The IMF is revising its Natural Resource Fiscal Transparency Code and accompanying Guide on Resource Revenue Transparency, and in May 2016 launched the second consultation on revisions to the Code. Both should be finalized in 2017 after pilot implementation and consultation. In late 2015, the IMF publicly released a tool called Fiscal Analysis of Resource Industries (FARI)[11] to evaluate fiscal regimes for extractive industries through financial and economic analysis of projects. FARI methodologies have been used in developing new policies for the extractive industries, and to estimate and manage a project's revenue raising ability.

3.5. Capacity-building

Intergovernmental organizations such as the United Nations, IMF, the World Bank Group and the OECD hold a variety of training programs in different areas, to build capacity for countries that need

9 Country-by-country reports are one of three key pieces of transfer pricing documentation. The others are the local file, where separate reports providing detailed transactional transfer pricing documentation specific to each country are provided; and the master file, provided to all jurisdictions in which the multinational enterprise does business, outlining the global business operations and transfer pricing policies.

10 Beneficial owner is the corporate entity or natural person that ultimately controls or profits from that entity.

11 See http://www.imf.org/external/np/fad/fari/.

assistance. In 2016, the OECD Development Assistance Committee (DAC) adopted a new monitoring code for its Creditor Reporting System, to better track the provision of official development assistance for domestic resource mobilization. It shows that in 2015, $189 million was committed to this work.[12]

The Addis Tax Initiative was launched in July 2015, and commits donor countries to doubling the resources they provide for capacity-building on tax. In 2016, a monitoring framework was put in place and in spring 2017, the first Monitoring Report, using data from the OECD DAC, will be released, setting the baseline against which the commitment to doubling support to domestic resource mobilization will be measured. The IMF provides technical assistance to approximately 100 countries every year. In 2017, this revenue mobilization advice has been further integrated into regular IMF economic surveillance in approximately three dozen countries. The United Nations capacity-development programme on international tax cooperation focuses on training developing-country tax administrators in the application of international tax standards, including the outputs of the United Nations Committee of Experts, and in 2016 it held six regional and national training events that reached almost 200 officials. The Tax Inspectors Without Borders initiative, which is jointly operated by the OECD and the United Nations Development Programme (UNDP) and supports countries in building tax audit capacity, estimates that its programmes have increased tax collection by more than $260 million.

In 2016, the Platform for Collaboration on Tax produced a report on the effectiveness of capacity-building (box 3) and has been working on the development of toolkits to assist developing countries with addressing BEPS issues.

4. Illicit financial flows

Increasing a country's revenue mobilization ability is not enough if countries' resources are simultaneously drained as a result of illicit activity. Many Task Force members convene policymaking forums and provide policy guidance and capacity-building assistance to Member States related to illicit financial flows (IFFs). Although there is currently no firm intergovernmental agreement on the conceptual framework defining the term, combatting IFFs generally has several elements, including estimation of the volume of IFFs, improvement of policies and enforcement capacity and return of stolen assets.

4.1 Estimates of IFF volumes

Measuring and tracking IFFs is extremely challenging because of the clandestine nature of the underlying activity, as well as the lack of an agreed definition. There is also no single tool or process capable of effectively measuring or estimating IFFs. In September 2016, members of the Task Force held a technical experts meeting to map a way forward. Despite the lack of a firm definition, there are some parameters for identifying IFFs that are frequently agreed upon. First, IFFs are often defined as constituting money that is illegally earned, transferred or used and that crosses borders.[13] Second, there are generally three categories of IFFs, although these are not mutually exclusive or comprehensive: IFFs originating from transnational criminal activity; corruption-related IFFs; and tax-related IFFs.

Even within the above parameters, controversies remain, particularly on how to treat tax-related IFFs. Tax practices such as base erosion and profit shifting are sometimes in grey areas because of differences in legal standards across countries, the absence of legal frameworks in some countries, and different interpretations and acceptance of norms on international taxation. In general, only illegal components are considered to be illicit flows.

Figure 4 shows a schematic representation of components and channels of IFFs. At the Task Force meeting, experts debated whether it is constructive to aggregate different types of flows and activities into a single measure called IFFs. There was strong support from a majority of the participants to keep efforts disaggregated and to work on improving measurement of the separate components or channels of flows, keeping in mind that the different

12 Includes only commitments from Australia, Germany, Ireland, Portugal and European Union institutions.

13 Chowla, Peter and Tatiana Falcão (2016). *Illicit Financial Flows: Concept and Scope,* December, available from World Bank Group (2017). "Equitable Growth, Finance, and Institutions (EFI): Board Update," February.

Box 3

Enhancing the effectiveness of external support in building tax capacity in developing countries

The Platform for Collaboration on Tax is a joint initiative of the International Monetary Fund, Organization for Economic Cooperation and Development, United Nations and World Bank Group aimed at strengthening cooperation on tax issues. Its July 2016 report analysed how support for developing tax capacity can be improved and provided the following recommendations, excerpted from a longer list of proposals:

- **Recommendation 2a.** International organizations involved at the country level should facilitate explicit collaboration among providers and other stakeholders as a central part of the pilot medium-term revenue strategies and, more broadly, facilitate the development of in-country coordination, by both donor groups and developing coordinating country counterparts
- **Recommendation 2b.** To support country-level cooperation, Platform partners to develop a manual for good practices, building on the Principles for International Engagement in Supporting Developing Countries in Tax Matters and a voluntary peer-review mechanism among development partners. This would include how to facilitate coordination among providers and different in-country stakeholders, such as business and civil society organizations
- **Recommendation 2c.** The Platform to develop mechanisms to support the development of coordinated plans for all development providers' work in relation to base erosion and profit shifting implementation and wider international tax issues
- **Recommendation 2d.** Providers and recipients of capacity-building support on tax matters should be well coordinated, including: effective coordination across different agencies active in tax reform in recipient countries, fully supported by providers of capacity-building support (whole-of-government approach); while international organizations should ensure internal coordination where they are active in the different areas affecting the tax system, and across their different entry points into taxation (whole-of-institutions approach)
- **Recommendation 2e.** Group of Twenty (G20) and development partners should more effectively facilitate the participation of their serving tax officials in capacity-building, including through the timely and efficient release of such officials to participate in capacity-building efforts
- **Recommendation 2f.** The Platform will review the range of results indicators currently used with a view to establishing sound-practice results frameworks and guidance to track progress in ongoing reforms of the tax system (policies and administration) against a broad range of indicators, taking account of the need to ensure a proper balance between the needs of development partners and reporting burdens, and the appropriateness of fit within the country context

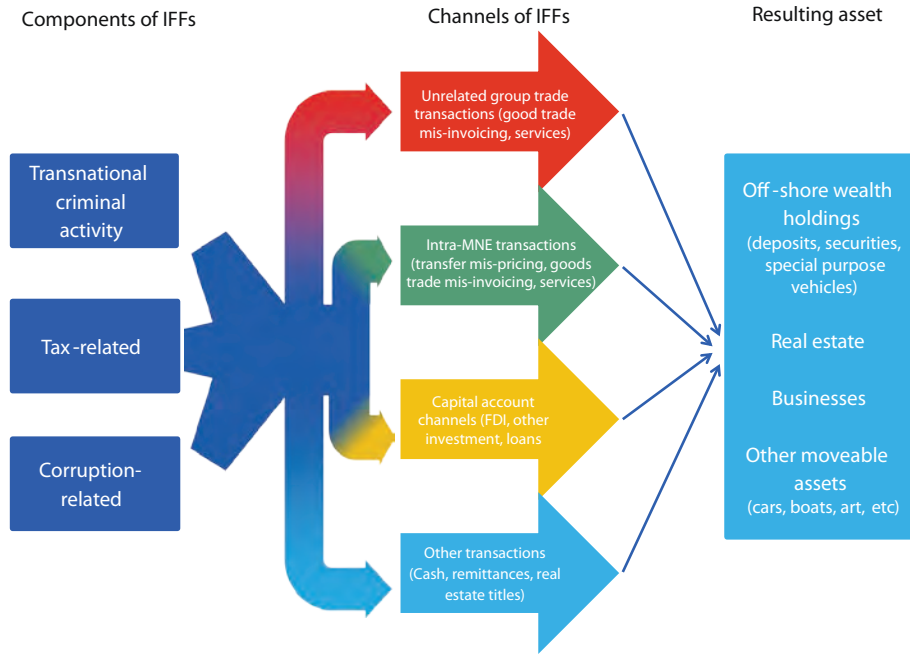
Source: IMF, OECD, United Nations and World Bank (2016), available from http://www.oecd.org/tax/enhancing-the-effectiveness-of-external-support-in-building-tax-capacity-in-developing-countries.pdf.

components of IFFs are not comparable, aggregation across channels and components could result in double-counting, and analysis of channels or components separately is more beneficial in designing policy responses to prevent illicit flows.

Estimates have been made in the following areas: proceeds of crime, stolen assets, goods trade mis-invoicing, transfer mis-pricing, and undeclared offshore wealth. There are a few methods that are currently used to attempt to estimate some of these components or channels of flows, although they do not provide a global picture of the full scope of IFFs. There is little to no measurement of IFFs through some channels because of a lack of data or methodology to make estimations. In addition, measurement of the flows in other channels sometimes overstates the domestic public resource impact, as the full amount of the flow is included in the estimate, while the Government would only accrue the assessed taxes, if channelled legally. The data sources are generally not robust enough for measuring changes or determining trends across years, and the methods also are not comparable or aggregable. The current status of some of the most cited estimates is included in table 2. Figure 5 shows the regional estimates of goods trade mis-invoicing that have been made to date, in response to the call in the Addis Agenda for such exercises to be carried out.

The United Nations Office on Drugs and Crime (UNODC) is the custodian agency for the SDG indicator to monitor progress on target 16.4. UNODC is therefore leading the work to develop

Figure 4
Schematic representation of components and channels of illicit financial flows



Source: Inter-agency Task Force on Financing for Development.
Notes: Resulting asset will be considered a 'stolen asset' if it is the product of corruption-related IFFs.
Components of IFFs include both source of funds and motivations of IFFs and may not be mutually exclusive. Individual transactions from different channels may be combined by actors to try to obscure the source, motivation and/or use of funds. Arrows do not represent estimates of the magnitude of flows, and are illustrative rather than comprehensive.

a methodology to produce an estimate of "total value of inward and outward illicit financial flows". In 2017, UNODC, the United Nations Commission on Trade and Development (UNCTAD), and other institutions will organize an expert group meeting to begin the methodological work on the development of the indicator in coordination with the Inter-agency Expert Group on SDG indicators. This Task Force will continue analysis on a component-by-component basis to complement the SDG indicator work.

4.2 Improvement of policies and enforcement

While data and estimation can be helpful in designing policies and interventions to tackle this issue, it is critically important for countries to work on strengthening existing institutions and enforcing related laws in both source and destination countries. Task Force members recommend the development of policy tools and options relevant to specific channels of IFFs. Efforts can be directed at both the ultimate owners of the resources as well as at the enablers of transactions, including financial institutions. Policy options that will assist in addressing these components are found throughout the Addis Agenda, including transparency standards and beneficial ownership information, addressed above. The development of new standards for regional or international exchange of financial information will also assist in enforcement. Fighting corruption and crime are also addressed in the systemic issues action area.

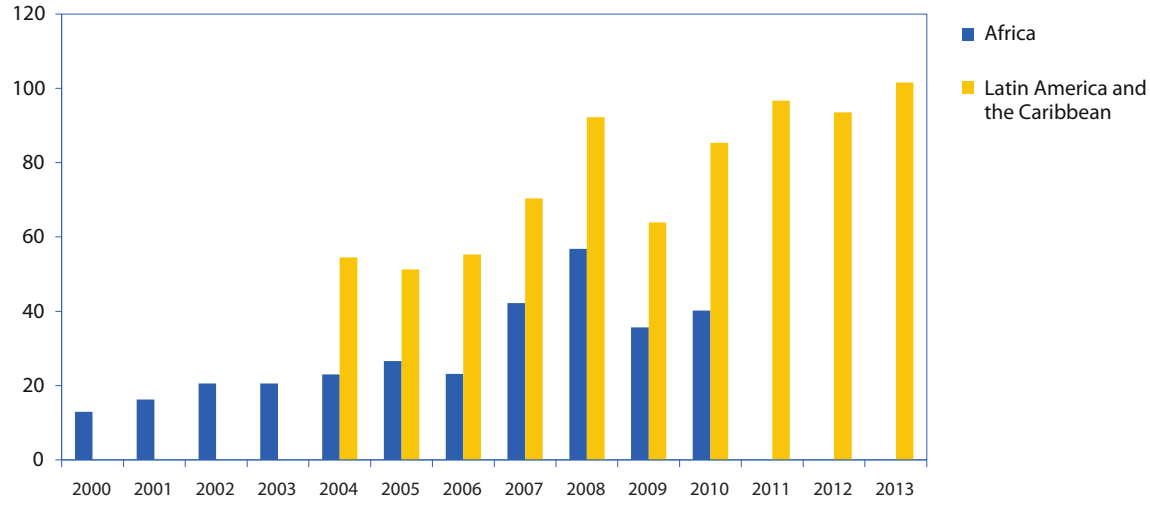
To more strategically tackle IFFs, the Task Force recommends conducting risk and vulnerability assessments, such as anti-money laundering/countering the financing of terrorism national risk assessments, to help countries focus their data, monitoring, and enforcement efforts to the channels most relevant to their country contexts. This is a multidisciplinary undertaking which will require increasing attention to policy coherence and coordination. Capacity-building to fight IFFs should

Table 2
Some estimates of selected elements of illicit financial flows, various years

Component or channel	Volume	Date of estimates	Estimate provider	Underlying data	Future work
Goods trade mis-invoicing (Figure 6)	Africa: $25 - $55 billion annually from 2005-2010	Africa: 2000 – 2010	Africa region: UN ECA	Trade databases	Other regions developing estimates include ESCAP and ESCWA, ECA planning updated estimates
	Latin America & the Caribbean: $50 – 100 billion annually	Latin America & the Caribbean: 2004 – 2013	Latin America & the Caribbean: CEPAL		
Off-shore undeclared financial holdings	$ 6.1 trillion in financial wealth in 2014	2015	Academic estimates[a]	Discrepancies in international investment position data, national data on offshore wealth management	unknown

a Zucman, Gabriel (2015). *The Hidden Wealth of Nations*. University of Chicago Press.

Figure 5
United Nations regional commission estimates of goods trade mis-invoicing, 2000 – 2013 (*Billions of United States dollars*)



Source: UNECA/CEPAL.

promote whole-of-government approaches to tackling financial crimes, encouraging inter-agency and international cooperation, as is done by the OECD Oslo Dialogue.

4.3 Return of stolen assets

The recovery and return of stolen assets has been referenced in Financing for Development outcomes since the Monterrey Consensus, and has been identified in the Addis Agenda as a crucial element towards the financing of the 2030 Agenda for Sustainable Development. It encourages the international community to develop good practices on asset return. The return of stolen assets is provided for under the United Nations Convention Against Corruption as a fundamental principle under international law. Return of stolen assets is different from and cannot substitute for other types of financial flows.

Since the Monterrey Consensus, progress has been made in all aspects of the process, including seizure, confiscation, management, return and disposal of stolen assets. Despite these efforts, only small amounts of resources have been returned to the countries of origin. In a recent survey of OECD members, foreign assets totalling $1.4 billion were frozen between 2010 and 2012, but only $147.2 million was returned to the country of origin.[14] Efforts are under way to speed the process and to increase resources for mutual legal assistance. The Stolen Asset Recovery (StAR) Initiative, a partnership between UNODC and the World Bank, has emphasised the importance of beneficial ownership registries and tackling the challenges to asset recovery posed by settlements when there are allegation of foreign bribery.

A multi-stakeholder process has led to the creation of Guidelines for the Efficient Recovery of Stolen Assets and a list of good practices, including a step-by-step guide to be followed in the procedure for freezing and returning potentates' assets. In a parallel process, an expert group meeting convened by UNODC, the Government of Ethiopia and the Government of Switzerland met in February 2017 to discuss lessons learned from past practices on the management of recovered assets and the use of returned assets to support sustainable development. Participants agreed that while the return of assets is unconditional, efforts should be made to ensure that returned assets are not stolen again.

5. Expenditure

While much of the Addis Agenda on domestic public resources focuses on revenue, it equally emphasizes that Member States are committed to the effective use of domestic resources. The Addis Agenda includes a commitment to align expenditures with sustainable development.

5.1 Fossil fuel subsidies

The sustained interest in energy subsidy reform reflects the detrimental environmental, fiscal, macroeconomic, and social consequences energy subsidies may have, if not applied with caution. In the Addis Agenda, Member States reaffirmed their commitment to rationalize inefficient fossil fuel subsidies that encourage wasteful consumption. Pre-tax consumer subsidies arise when the price charged to the consumer is less than the cost of supplying the energy. Post-tax consumer subsidies arise when the price charged to the consumer is less than the cost of the energy and the environmental damage associated with the supply (and consumption) of the energy.

In 2015, an IMF staff study estimated that post-tax energy subsidies are much more significant than previously assumed, accounting for $4.9 trillion (6.5 per cent of world gross product) in 2013, and projected to have reached $5.3 trillion (remaining at 6.5 per cent of gross product) in 2015.[15] Pre-tax subsidies accounted for $333 billion of that total. Energy subsidy reform could therefore generate substantial revenues for governments, estimated at $3.0 trillion in 2013 and projected at $2.9 trillion in 2015. Environmental, social, health and other costs account for more than 80 per cent of the post-tax energy subsidies; about three-fourths of these subsidies are related to local environmental damages and only about a quarter are due to global warming. This underscores that restructuring of taxation to account for the environmental damage of energy production would yield significant benefits directly to local populations. Reforms to energy subsidies should also deal with potential welfare and distributional affects.

5.2 Gender-responsive budgeting

The Addis Agenda underlines the importance of gender-responsive budgeting and tracking as a tool to address inequality and discrimination in fiscal policy and promote integration of gender analysis into government planning and expenditure. The creation and application of well-articulated, transparent and inclusive budget tracking systems is essential to ensure that resources are mobilized and allocated effectively to address inequality and discrimination, as well as to achieve gender equality and women's empowerment. Since 2001, UN Women has supported more than 80 countries in designing and implementing gender-responsive budgeting. A detailed review in the Asia-Pacific region concluded

14 World Bank and UNODC (2014). *Few and Far: The Hard facts on Stolen Asset Recovery,* StAR, p. 18.
15 See http://www.imf.org/external/pubs/ft/wp/2015/wp15105pdf.

that gender-responsive budgeting has helped improve both the quantity and quality of budgetary allocations for gender equality.[16] The Global Partnership for Effective Development Cooperation (GPEDC) Monitoring Framework includes an indicator that allows identification of some countries that track public allocations for gender equality and women's empowerment and make the information publicly available. In 2016, 58 countries, from a total of 81 that participated in monitoring, reported having a tracking system in place. The information is made public in 38 countries. Building on the GPEDC work, UN Women, together with the OECD and UNDP, are developing a methodology to measure the effort by all countries to implement transparent tracking systems for gender equality allocations.

6. Conclusion

Governments are beginning to take steps on both the revenue and expenditure side in the context of sustainable development strategies and financing plans. The thematic chapter of this report includes some discussion of the choices facing countries as they set national priorities and the difficult trade-offs this might entail. The Task Force's online annex comprehensively monitors the data and implementation of commitments and actions across the full range of the domestic public resources. As the data and information across the entire chapter improves, future editions of this report will focus on new and emerging challenges, providing policy options for consideration.

16 UN Women (2016). *Gender Responsive Budgeting in the Asia-Pacific region. A Status Report*.

Chapter III.B

Domestic and international private business and finance

1. Key messages and recommendations

The Addis Ababa Action Agenda calls on businesses to apply their creativity and innovation to solving sustainable development challenges, and invites them to engage as partners in implementation of the sustainable development agenda. Private business activity, investment and innovation are major drivers of productivity, employment and economic growth. The Addis Agenda builds on earlier Financing for Development outcomes on the role of the private sector, but broadens them in support of all three dimensions of sustainable development—economic, environmental and social.

Public policies set the enabling environment and the regulatory framework for private sector investment and activity. The Monterrey Consensus tasked Member States of the United Nations with building transparent, stable and predictable investment climates, and many countries have made great strides in this area, though more can be done to create competitive business environments. In the Addis Agenda, countries resolve to continue this work, while also aiming to better align business activities and investment decisions with sustainable development objectives.

In understanding the role of the private sector in financing sustainable development, it is important to recognize that the private sector includes a wide range of diverse actors, from individual households and international migrants to multinational corporations, and from direct investors to financial intermediaries, such as banks and pension funds. Policy frameworks thus need to be designed with an understanding of the incentive structures of different private actors and how each comes together in the supply chain of capital. While the large preponderance of private business activity remains profit driven, a growing number of institutions have double or triple (social and environmental) bottom lines. Yet, given the large-scale financing needs, as noted in the Addis Agenda, more must be done to better align private business activity and investment with sustainable development.

Domestically, Governments need to support development of both financial depth and financial breadth. Efforts to ensure inclusive finance can be based on a range of interventions, including the use of new technologies, the promotion of credit registries, and involving a range of institutions (such as microfinance, cooperative banks, and development banks.) ***More countries should adopt national financial inclusion strategies (NFIS). Countries should also continue to share experiences of financial inclusion, including for women, through regional and global forums, such as the Financing for Development Forum, and through the Alliance for Financial Inclusion. Moreover, countries should develop financial literacy programmes, including an emphasis on the impact of finance on sustainable development***.

One of the biggest challenges policymakers and stakeholders face in raising resources for sustainable development is how to address excessive short-term oriented decision-making and develop financial markets that are inclusive, long-term oriented, and that support sustainable development. ***The Task Force has begun work on mapping out incentive structures of different actors in the financial system, and will continue to develop this work.*** Task Force members will work on different elements of sustainable financial market development. ***The Addis Agenda emphasizes that the***

different elements of sustainable financial market development are integrated. The Task Force can thus be a platform for building collaborative solutions among its members.

Long-term investment, sustainability and stability of the financial system should be mutually reinforcing. Moreover, without a long-term perspective, firms won't incorporate long-term risks, such as climate change, into their investment decisions. ***Efforts by the private sector to better align their internal incentives with long-term investment and with sustainable development indicators should be supported, as should United Nations system initiatives (such as the United Nations Global Compact, the Sustainable Stock Exchange Initiative, Principles for Responsible Investing, and the United Nations Environment Programme Inquiry).***

However, even with long-term horizons, markets may provide insufficient financing in sectors important for sustainable development. This typically happens when market prices do not reflect the full economic cost of environmental and social externalities, and when risk-adjusted financial returns are not sufficient to attract adequate private investment. It is thus the responsibility of policymakers to set the appropriate incentives, which can be done through targeted interventions. ***This can be achieved through a package of taxes and subsidies to change relative prices, regulations and standards to guide investment behaviour, and appropriately designed risk-sharing instruments, including co-investments, public-private partnerships, and guarantees, depending on country priorities.***

Corporate sustainability benchmarks, which rank companies on their performances across a range of indicators, have been developed as part of voluntary initiatives. With the adoption of the Sustainable Development Goals (SDGs), there is an opportunity to align these benchmarks to the goals, which would allow companies to take an active role in their implementation. ***The United Nations and the financing for development process can provide a forum, with multi-stakeholder inputs, for discussions on methodologies for corporate sustainability benchmarks aligned with sustainable development.***

Member States will be presenting voluntary reviews of their progress on implementing the SDGs, including through national sustainable development strategies. Through their intended nationally determined contributions, communicated to the United Nations Framework Conference on Climate Change, (UNFCCC), countries also publicly outline what actions they intend to take to address climate change within the context of their national priorities. The Addis Agenda calls for these strategies and actions to be supported by "integrated national financing frameworks".[1] National strategies, supported by financing frameworks, can be seen as guideposts for investment priorities, and can showcase opportunities for partnerships***. Member States may wish to consider a global mapping of priority investment areas contained within national development strategies as a way to guide private investors, both foreign and domestic, for SDG-linked investment opportunities. This will also help support the development of pipelines of investable projects.***

2. Promoting inclusive financial systems for sustainable development

The purpose of the financial system is to intermediate credit from those with surplus funds to those in need. Promoting an inclusive financial system for sustainable development includes a wide range of actions on both the international and national levels, emphasizing long-term investment, sustainability, inclusiveness and stability. The Addis Agenda brings these different elements together into a cohesive framework for designing an effective financial system that supports implementation of sustainable development and the SDGs.

2.1 The investment climate

Many countries have made important strides in strengthening the enabling environment for private sector business and investment. These improvements

1 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 9. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

are reflected in the cost of starting a business,[2] which has fallen by more than 80 per cent on average in least developed countries (LDCs) since 2004 (figure 1). Nonetheless, in many countries, the decreases in costs have levelled off, implying that more can be done to create competitive business and investment climates.

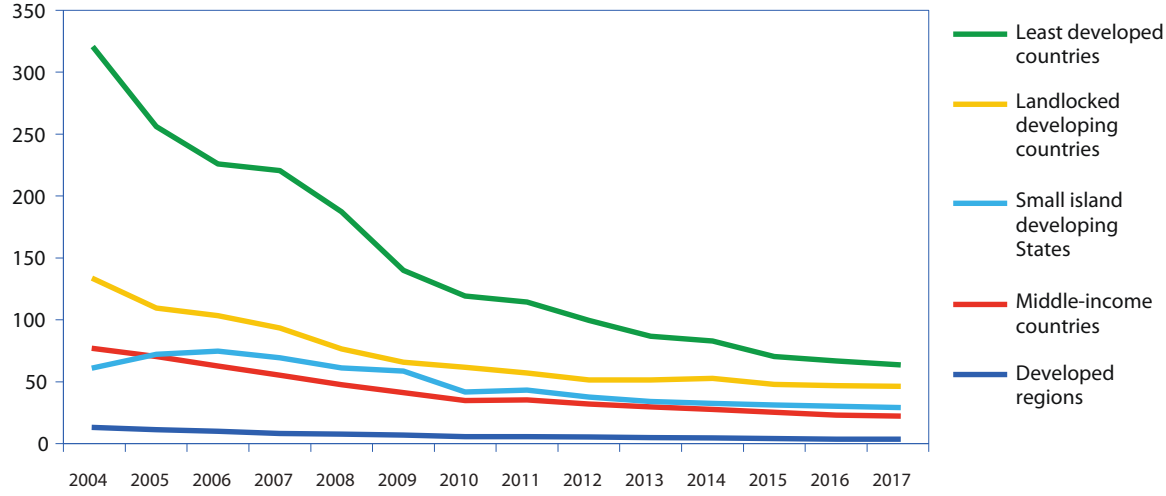
Strengthening the enabling environment entails a range of actions, such as reforms to the legal framework, promoting transparency, and reducing red tape. The most recent World Bank Doing Business survey[3] of domestic and foreign companies across 190 economies found that the most common obstacle to business operations was access to finance (in about a quarter of the countries surveyed), with tax rates, practices of the informal sector, and political instability also significant (see chapter III.A on domestic public resources for a discussion of tax incentives). This underscores that an enabling environment must incorporate inclusive finance as a core component of financial and private sector development.

Importantly, strengthening the enabling environment should also include the application of labour, environmental and health standards and the promotion of access to finance. The Addis Agenda supports a dynamic and well-functioning business sector that is committed to the protection of labour rights and environmental and health standards in accordance with relevant international standards and agreements, such as the UN Guiding Principles on Business and Human Rights.[4]

2.2 Financial inclusion

There has been enormous progress in financial market deepening in many developing countries. From 2000 to 2015, the ratio of private credit to gross domestic product (GDP) increased from an average of 11 per cent to 22 per cent in LDCs, and from 30 per cent to 48 per cent in middle-income coun-

Figure 1
Cost of starting a business, 2004 – 2016 *(Percentage of income per capita)*



Source: World Bank Doing Business database and UN/DESA calculations.

2 The cost of doing business includes official fees as well as additional private fees, such as for legal or professional services if such services are required by law or commonly used in practice. Fees for purchasing and legalizing company books are included if these transactions are required by law.

3 World Bank (2017). *Doing Business 2017. Equal Opportunity for All.* Available from: http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf

4 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 37. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

tries.[5] However, financial depth is not always linked to financial breadth—that is, financial sectors can become deep without delivering access to financial services to large segments of the population. For example, in some countries where the financial sector exceeds the size of GDP, less than a quarter of adults report having a formal bank account, while in other countries, with much less financial depth, account penetration is over 80 per cent.[6] Account ownership among women increased across the globe from 47 per cent (versus 54 per cent for men) in 2011 to 58 per cent (versus 65 per cent for men) in 2014.[7] This raises critical questions on the appropriate size of financial intermediation as financial markets develop and the appropriate set of policies to promote inclusiveness.

As of 2014, 62 per cent of the world's adult population has a bank account, up from 53 per cent in 2011, with the greatest increase in middle-income countries (an average increase of between 31.3 and 40.9 per cent). However, while more than 80 per cent of adults in developed countries have accounts, less than 50 per cent in developing countries and 27 per cent in LDCs do (figure 2). Globally, 2 billion people, primarily in rural areas in developing countries, do not have access to formal financial services.

At the same time, as noted above, surveys indicate that lack of finance is a major obstacle for SMEs in a number of developing countries. The unmet need for credit for SMEs has been estimated to be up to $2.6 trillion in developing countries and about $3.9 trillion globally, with 80 per cent of women-owned SMEs remaining unserved or underserved. More than 200 million micro, small and medium-sized enterprises in developing countries lack adequate financing, with the financing gap particularly wide in LDCs (figure 3).[8] This is a major constraint to private sector development, as in many developing countries SMEs constitute the lion's share of private businesses. SME and private sector development is therefore irremediably linked to achieving greater financial inclusion.

The Addis Agenda includes a commitment to consider including financial inclusion as a policy objective in financial regulation, as there is evidence that countries that adopt NFIS reduce exclusion twice as fast as those that do not.[9] To date, there are at least 58 developing countries with NFIS. Other elements that have worked well in promoting financial inclusion across countries include the involvement of a range of institutions in enhancing access to finance (including commercial banks, microfinance institutions, cooperative banks, postal banks and savings banks); the development of credit bureaus for assessing borrower loan-carrying capacity; and the use of new technologies with appropriate consumer protection.

Cooperative, savings, postal, and development banks can be vehicles for financial inclusion and employment. For example, in Europe, cooperative banks hold 32 per cent of total bank deposits.[10] Successful cooperatives and savings banks, such as those in Germany, are formal financial institutions with four general characteristics: they are locally based; cater to underserved segments of the population; have dual bottom lines (financial returns and the

5 World Bank (2017). *Domestic credit to private sector (% of GDP)*. Available from http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS

6 CGAG (2012). Measuring Financial Exclusion: How Many People Are Unbanked? Available from: http://www.cgap.org/blog/measuring-financial-exclusion-how-many-people-are-unbanked and; World Bank (2014). *Global Findex database*. Available from: http://www.worldbank.org/en/programs/globalfindex

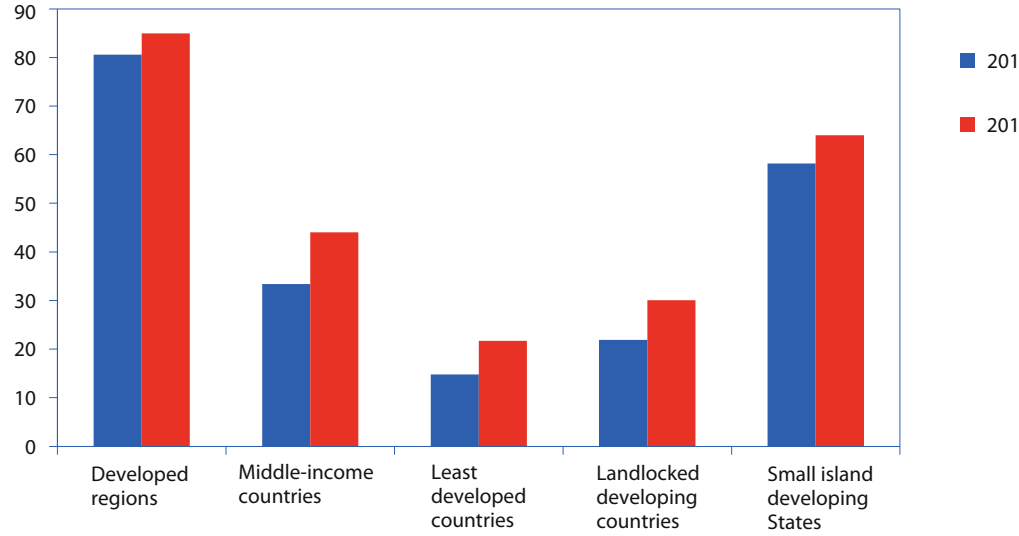
7 World Bank (2014). *Global Findex database*. Available from: http://www.worldbank.org/en/programs/globalfindex

8 IFC (2013). Access To Credit Among Micro, Small, And Medium Enterprises. Available from: http://www.ifc.org/wps/wcm/connect/1f2c968041689903950bb79e78015671/AccessCreditMSME-Brochure-Final.pdf?MOD=AJPERES

9 World Bank (2014). *Global Findex database.* Available from: http://www.worldbank.org/en/programs/globalfindex and; AFI (2015) National financial inclusion strategies: current state of practice. Available from http://www.afi-global.org/sites/default/files/publications/fisplg-state_of_practice.pdf

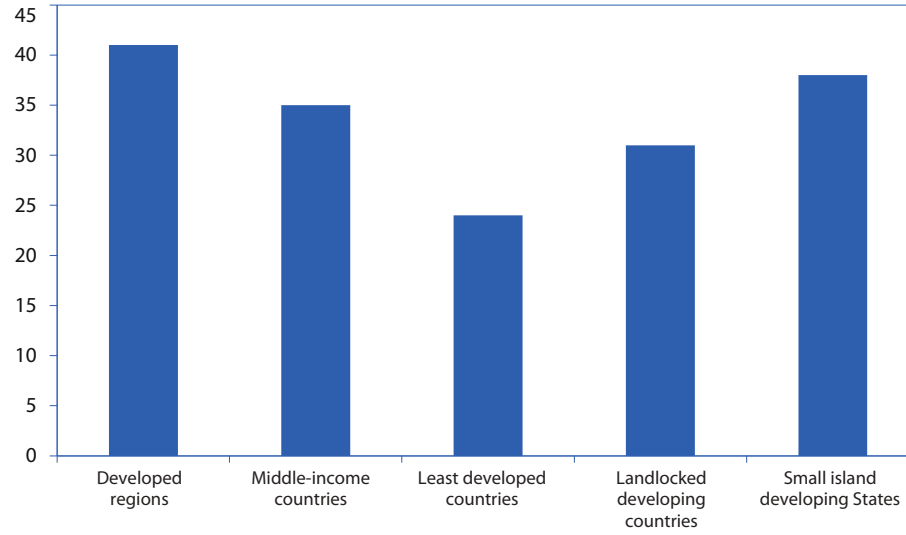
10 Lakshmi, P and S. Visalakshmi (2013). *Impact of Cooperatives in Financial Inclusion & Comprehensive Development*. Available from: http://pubs.sciepub.com/jfe/1/3/4/

Figure 2
Proportion of adults with bank accounts, 2011 and 2014 *(Percentage of adults, 15+)*



Source: World Bank Global Findex Database.

Figure 3
Firms with a bank loan or line of credit, 2002–2015 *(Percentage)*



Source: World Bank Enterprise Surveys.

welfare of the local clients); and often belong to networks of similar institutions.[11] The Task Force has begun work on better understanding the potential of these institutions in financial inclusion.

Public credit registry coverage has increased significantly in both developed and developing countries, rising from 16 per cent to 30 per cent from 2005-2015, though there are differences

11 Schmidt, Seibel and Thomes (2016). *From Microfinance to inclusive banking. Why local banking works*. Wiley, Weinheim, Germany.

across countries and regions.[12] Whereas over 35 per cent of adults are covered in Latin America and the Caribbean, less than 8 per cent are covered in sub-Saharan Africa.

New technologies are increasingly being used to reach underserved communities. Branchless banking and mobile banking technologies can be used in making government-to-person payments (e.g., for wage, pension and social welfare payments) with lower administrative costs and fewer leakages, especially when developed with appropriate regulation to ensure responsible digital finance and avoid abusive practices. For example, in Kenya, where 62 per cent of adults are active mobile money users, financial inclusion rose from 41 per cent in 2009 to 67 per cent in 2014. The effect of access to mobile banking on consumption was much more significant for female-headed households than for male-headed households. The use of mobile-money also helped 185,000 women move from farming to business occupations.[13]

Mobile money has evolved from operating as a purely domestic service to enabling transfers between more than 20 countries globally, and thus can be a tool in the transfer of remittances. In addition, new instruments, such as pooled financing mechanisms that create diversified portfolios of SME loans through securitization, can increase funds available for SME lending, though risks have to be well managed within an appropriate regulatory framework.

Measures to promote access to finance need to go hand in hand with efforts to enhance skills and know-how across enterprises. In addition to entrepreneurship training and business development services, financial literacy is seen as one element of financial capability and has proven to be important for employability, as well as for individuals to start and manage their own enterprises. One of the solutions for improving financial literacy would be for Governments to make it a core component of the school curriculum. This should go beyond basic money management and bank accounts, to include an understanding of how finance impacts people's lives and shapes the world around us.

2.3 Local currency bond markets

One important way that countries have deepened their financial markets is through the development of local currency bond markets. Deeper capital markets should provide a conduit for the long-term investment necessary for sustainable development. Domestic bond markets in developing countries have grown significantly since the 1990s, totalling $15 trillion as of 2015, though most of the growth has been in middle-income countries in Asia, Latin America, and Europe, with minimal issuance in Africa and LDCs (figure 4). Outside of Asia, the proportion of domestic debt with maturities of over five years, while rising, remains fairly low.

There are, however, risks associated with growth of domestic debt, which need to be managed. As discussed in chapter I of this report, the increase in domestic debt has mostly been in commodity sectors, and in some countries, debt may soon reach levels that could threaten debt sustainability (see also chapter III.E). Indeed, there is a risk that nascent markets will attract speculative capital, leading to short-term bubbles, which can reverse when global investor sentiment changes, causing negative shocks to the real economy. As such, capital market volatility can fuel volatility in the real economy, rather than contribute to long-term growth.

2.4 Cross border capital flows

To date, private international capital flows have been subject to volatility, driven by trends in the global economy and by short-term investment horizons, as discussed below.

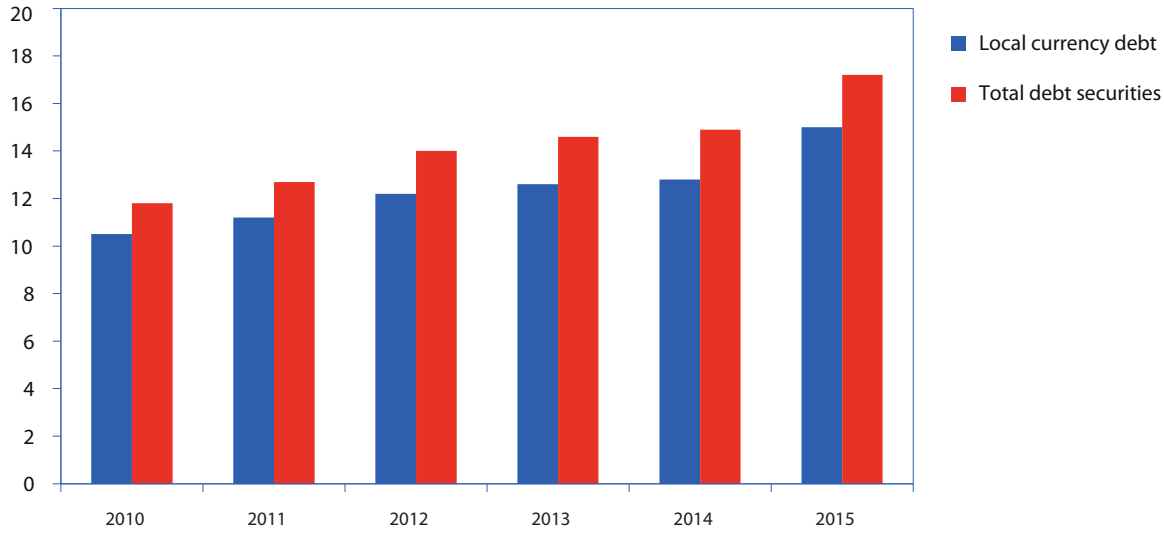
As noted in chapter I, foreign direct investment (FDI) has exhibited the largest trend increase over the last decade. Nonetheless, there are significant differences in the quantity and quality of FDI inflows accruing to different regions and countries, as well as concerns regarding the concentration and development impact of FDI. Greenfield investment

12 World Bank (2017). *Private credit bureau coverage (% of adults)*. Available from http://data.worldbank.org/indicator/IC.CRD.PRVT.ZS

13 Matheson (2016). *Mobile-money services lift Kenyans out of poverty*. Available from: http://news.mit.edu/2016/mobile-money-kenyans-out-poverty-1208

Figure 4

Outstanding local market debt and total debt, selected developing countries, 2010 – 2015 *(Trillions of United States dollars)*



Source: Bank of America Merrill Lynch (2015). *Size and Structure of Global Emerging Markets Debt*. July 2015; BIS; WBG staff calculations.

Note: The countries included are: Africa & Middle East (Bahrain, Egypt, Israel, Kuwait, Lebanon, Morocco, Nigeria, Qatar, Saudi Arabia, South Africa, Tunisia, United Arab Emirates), Asia Pacific (China, Hong Kong SAR, India, Indonesia, Kazakhstan, Malaysia, Pakistan, Philippines, Singapore, Republic of Korea, Sri Lanka, Taiwan Province of China, Thailand), Emerging Europe (Bulgaria, Croatia, Cyprus, Czech Republic, Hungary, Lithuania, Poland, Romania, Russian Federation, Slovenia, Turkey, Ukraine), and Latin America & Caribbean (Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Jamaica, Mexico, Panama, Peru, Trinidad and Tobago, Uruguay, Venezuela (Bolivarian Republic of).

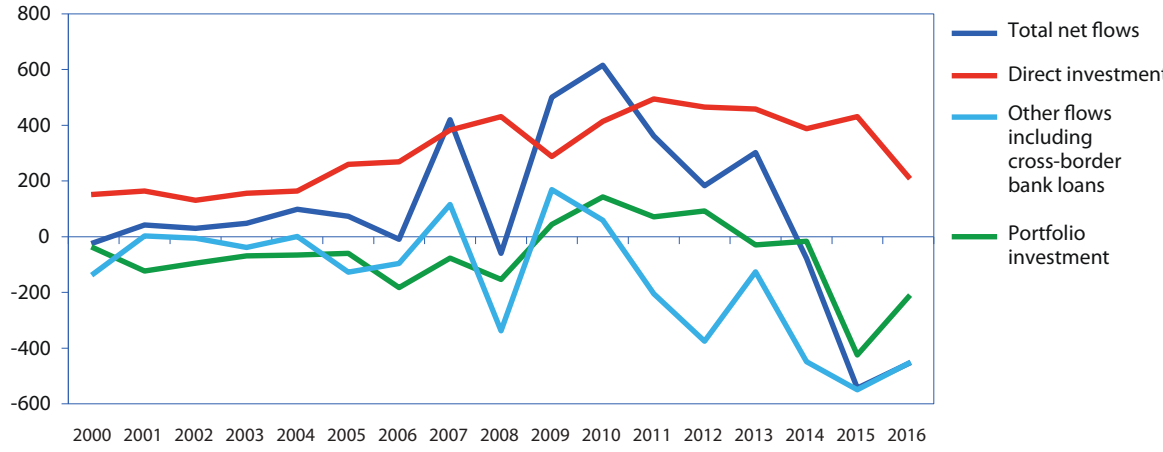
tends to have a greater impact on jobs and development than other forms of FDI, but the increase in global FDI in 2016 has been principally driven by cross-border mergers and acquisitions. The large majority of FDI to developing countries continues to be invested in Asia and Latin America while flows to Africa, though higher than a decade ago, remain limited. In addition, FDI flows to LDCs and small island developing States (SIDS) remain concentrated in extractives industries, where their development impact is limited (figure 6).

Investment in extractive industries (mining and quarrying, including petroleum and gas) is also significant in LLDCs where FDI in business activities includes extractive industry-related activities such as drilling for oil and creating gas pipelines. In addition, a few large developing countries have become an increasingly important source of outward FDI. From 2010 to 2015, they accounted for 28 per cent of world outward FDI on annual average, up from 9.9 per cent in the period 2000 to 2005.[14]

Cross-border bank (represented by other flows in figure 5) and portfolio flows to developing countries have been significantly more volatile than FDI. Bank flows have demonstrated particularly high volatility, reflecting deleveraging by a number of international banks since the financial crisis (see chapter II). This has affected long-term financing for infrastructure projects in emerging market and developing countries, a significant portion of which had previously been provided by large developed-country banks. Portfolio flows, which are primarily driven by institutional investors, also remain highly volatile, with net portfolio capital flows to developing countries negative since 2014. Indeed, in the context of the recent sell-off in emerging market assets, emerging market local currency funds have experienced significant losses.

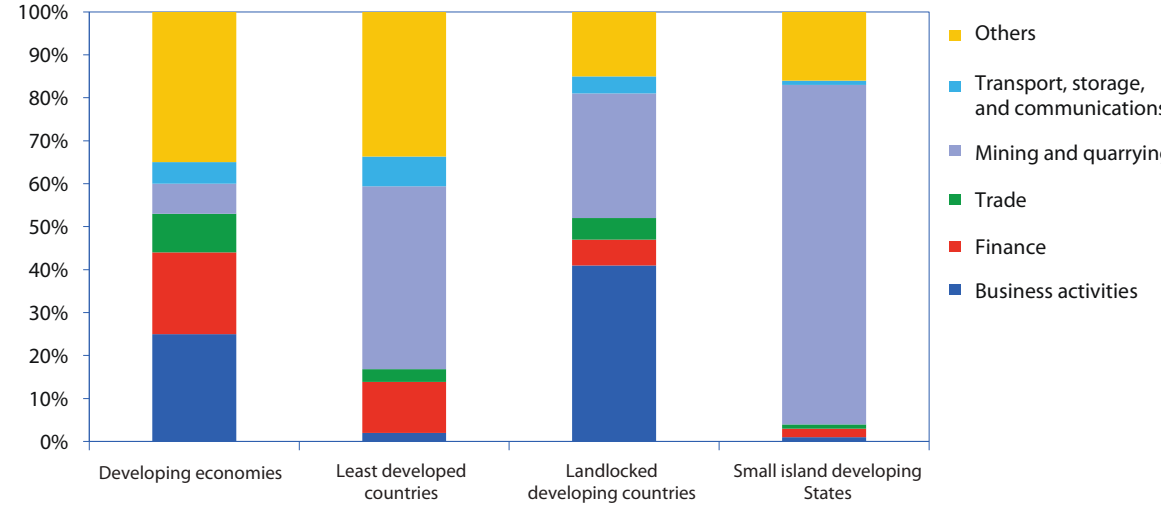
14 UNCTAD (2017). *FDI Statistics*. Available from: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics.aspx

Figure 5
Trends in cross-border net financial flows to developing countries and economies in transition, 2000 – 2016 *(Billions of United States dollars)*



Source: IMF World Economic Outlook database, October 2016, and UN/DESA calculations.
Note: The composition of countries is based on the country classification located in the statistical annex of the United Nations World Economic Situation and Prospects.

Figure 6
Distribution of foreign direct investment, by sector, 2015 *(Percentage)*



Source: UNCTAD Foreign Direct Investment Statistics database.

3. Addressing risks to financial stability

Given the volatility of capital flows, as well as systemic risks to the real economy from excessive financial leverage, it is important for countries to design robust regulatory frameworks, potentially including capital account management tools. The emerging market financial crises of the 1990s, along with the 2008 global crisis, underscored the need for regulatory frameworks that consider all areas of financial intermediation, from microfinance to complex derivative instruments.

Box 1
Migrant Remittances

Officially recorded remittances to developing countries are estimated to have totalled $432 billion in 2015. India was the largest remittance-receiving country, with an estimated $69 billion in 2015, followed by China ($64 billion), and the Philippines ($28 billion). While more stable than other cross-border private capital flows,[a] personal remittances have also been affected by the weakened global economy. Indeed, the growth of remittances had slowed considerably, from 3.2 per cent in 2014 to 0.4 per cent in 2015, largely due to economic weakness in the major remittance-sending countries.

The Addis Ababa Action Agenda and the 2030 Agenda for Sustainable Development include commitments to reduce transaction costs of migrant remittances to less than 3 per cent, and to eliminate corridors that charge more than 5 per cent. At the same time, the Addis Agenda also stresses the importance of maintaining adequate service coverage, especially for those most in need. Remittance costs have declined from an average of 8.0 per cent in the fourth quarter of 2014 to 7.4 per cent in the fourth quarter of 2015. Sub-Saharan Africa remains the region with the highest costs, with an average remittance cost of 9.5 per cent in the fourth quarter of 2015 in comparison with 11.5 per cent a year earlier. This is partly a function of the high expenses associated with remittance outflows from South Africa to nearby countries, with costs in some corridors averaging in the 18 to 20 per cent range.

Improved financial literacy and better access to financial services can help lower the high remittance transaction costs in underserved areas. Combining remittance receipts with broader access to other financial services can increase the impact of remittances on individual households` budgets and economic development in general by enabling savings and investments. For example, if the predominantly informal savings of remittance receivers in four Central American countries could be mobilized, it is estimated that formal savings would increase by $2 billion, representing about 1.7 per cent of gross domestic product in these countries.[b]

A major obstacle to expanding the provision of remittance services and reducing their costs arises from engagement by major international banks in de-risking behaviour. Due to concerns regarding money laundering and related financial irregularities, commercial banks have been shutting down the bank accounts of a number of money-transfer companies. There has also been a reduction in the number of correspondent banking relationships, which can impact access to the global financial system by customers in developing countries. In March 2016, the Financial Stability Board established a Correspondent Banking Coordination Group to help ensure implementation of an action plan agreed by the Group of Twenty to address the reduction in correspondent banking relationships. Revised guidance from the Financial Action Task Force in October 2016 sought to clarify the expectations with regard to enhanced due diligence, which has informed a revision of the guidance from the Basel Committee on Banking Supervision that is expected to be published in June 2017.

a Capital flows refer to flows accounted for in the capital account, including foreign direct investment portfolio flows, and other flows. Remittances are accounted for in the current account.

b Orozco, Y (2015). Remittances and Financial Inclusion: Opportunities for Central America. Available from: http://www.thedialogue.org/wp-content/uploads/2015/06/RemitFinancialInclusion_FINAL_223.pdf

At the same time, there is increasing understanding of the impact of financial regulations on incentives (see chapter III.F) for lending and providing financial services. The Addis Agenda emphasizes the importance of bringing together the financial inclusion and regulatory discussions. Enhancing stability and reducing risks, while promoting access to credit and increasing investment in sustainable infrastructure, presents a complex challenge for policymakers, as there can be trade-offs between them. At the same time, stability is a prerequisite for access and investment, while access can support stability through diversification. Policymakers need to design the regulatory and policy frameworks to strike a balance between these goals and maximize their synergies.

In 2015, the Group of Twenty (G20) requested the Financial Stability Board (FSB) to consider the financial stability risks associated with climate change. As a result of this work, the FSB established a private sector, industry-led Task Force on Climate-related Financial Disclosures (TCFD) in December 2015. The TCFD is developing recommendations for consistent, climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers and

other stakeholders. The recommendations focus on voluntary disclosures about the financial risks and impacts of climate change on the business of reporting entities, for disclosure within mainstream financial reporting, and not on sustainability reporting. Appropriate disclosures are a prerequisite for financial firms not only to manage and price climate risks accordingly, but also, if they wish, to take lending, investment or insurance underwriting decisions based on their view of transition scenarios. The final recommendations of the TCFD will be presented to the G20 leaders' summit in July.

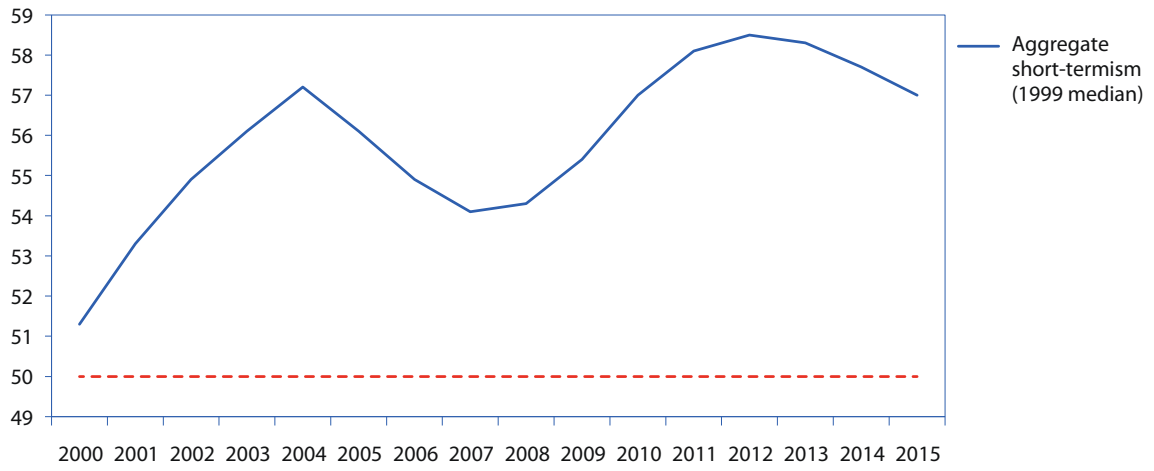
The Addis Agenda also notes the impact of regulations on incentives for long-term investment, as well as for investment in sustainability indicators. It calls for regulatory and policy frameworks to encourage long-term sustainable investment.

4. Long-term investment

Quality long-term investment is critical for infrastructure and other areas necessary for sustainable development. Long-term investment is also an important element of climate finance, since without a long-term horizon, investors will not price in the long-term risks associated with climate change that might affect their returns.

Yet, today, much private investment is short-term oriented. As noted above, cross-border portfolio flows (which are driven by institutional investors) have been highly volatile. A short-term investment horizon is also noticeable in investment in developed countries. In the United States of America, the average holding period for stocks fell from 8 years in the 1960s to 6 months in 2010.[15] Indeed, many business executives feel pressure to demonstrate short-term performance. A 2016 survey of senior executives found that more than half of the respondents felt pressure to perform within a year, up from 44 per cent three years earlier. A McKinsey index of corporate performance shows that short-termism has been rising since the turn of the century, though a dip prior to the 2008 world financial and economic crisis most likely reflected increases in fixed investment and strong earnings growth in that period (figure 7).[16]

Figure 7
Aggregate gauge of short-termism, 2000 – 2015 *(Annual percentile)*



Source: McKinsey, (2017). Measuring the Economic Impact of Short-termism.

15 Kleintop, J. (2012). *Weekly Market Commentary*. Available from: http://moneymattersblog.com/login/login/wp-content/uploads/2012/08/WMC080712.pdf

16 McKinsey (2017). *Measuring the Economic Impact of Short-termism*. Available from: www.mckinsey.com%2F~%2Fmedia%2FMcKinsey%2FGlobal%2520Themes%2FLong%2520term%2520Capitalism%2FWhere%2520companies%2520with%2520a%2520long%2520term%2520view%2520outperform%2520their%2520peers%2FMGI-Measuring-the-economic-impact-of-short-termism.ashx&usg=AFQjCNGz_znrjfDqt56YZ8kBEgX4MyBNmQ

There is, however, no clear definition of long-term investment. It is often described as financing with a maturity of one to five years.[17] The one- and three-year cut-offs are somewhat arbitrary and much shorter than what is needed for investments in long-term projects, such as infrastructure, which have life spans that can range from 15 to 100 years. Furthermore, defining long-term by the maturity of an asset can be misleading. Investors can sell longer-duration liquid instruments in secondary markets, turning a long-term instrument into a short-term investment. For example, during the crisis, some investors who were considered to be long-term investors were forced to sell their positions prior to the end of their investment horizon due to a lack of liquidity, causing the price of the assets being sold to collapse.

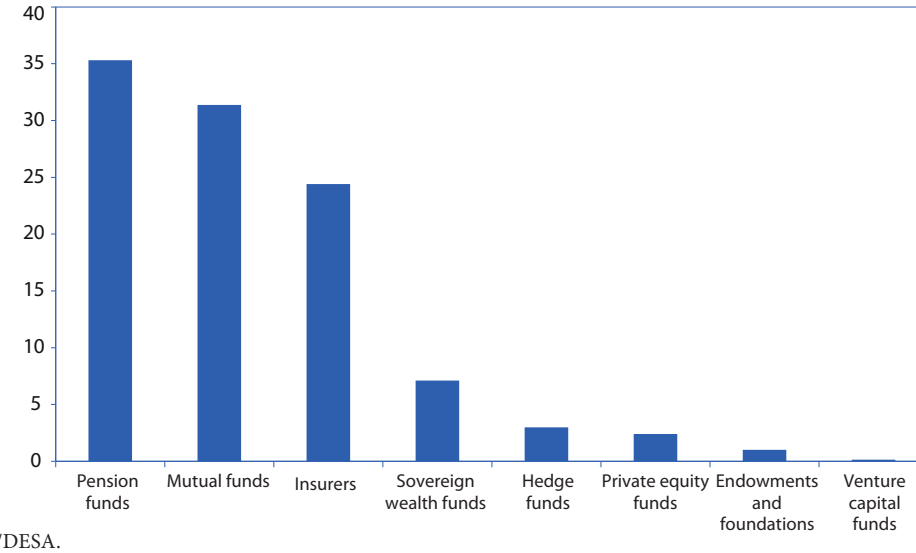
The Task Force has therefore focused *its* definition of long-term investment on the outlook of the investor rather than the maturity of the instrument. This includes two elements. The first is the investment horizon of the investor or the investor's *willingness* to hold a position. This is in line with the view of long-term investing associated with "patient" capital and buy-and-hold strategies. The second is the *ability* of an investor to hold a long-term position, which is related to the investor's liability structure, or the degree that investments are financed with borrowing that is significantly shorter term than the investment itself. Thus, pension funds, which have long-term liabilities in the form of future payments to pensioners, tend to be well suited to invest in long-term infrastructure projects.

Yet, to date, most institutional investors, even those with long-term liabilities (such as pension funds, life insurance companies, and sovereign wealth funds, which together hold about $78 trillion in assets under management),[18] continue to invest in liquid assets, often with a short-term investment horizon. For example, pension funds from the 7 largest pension markets hold about 76 per cent of their portfolios in liquid assets,[19] and less than 3 per cent in infrastructure.

There has, however, been a shift in asset allocation over the past few decades towards more illiquid

Figure 8

Assets under management by institutional investors, 2011 – 2016 *(Trillions of United States dollars)*



Source: UN/DESA.

17 Pu Shen (2005). *How Long Is a Long-Term Investment*? Available from https://www.kansascityfed.org/publicat/econrev/pdf/1q05shen.pdf

18 TheCityUK (2015). *Sovereign Wealth Funds*. June 2015. Available from: https://www.thecityuk.com/assets/2015/Reports-PDF/Sovereign-Wealth-Funds-2015.pdf

19 Willis Towers Watson (2016). *The Global Pension Assets Study 2016*. Available from: https://www.willistowerswatson.com/en/insights/2016/02/global-pensions-asset-study-2016

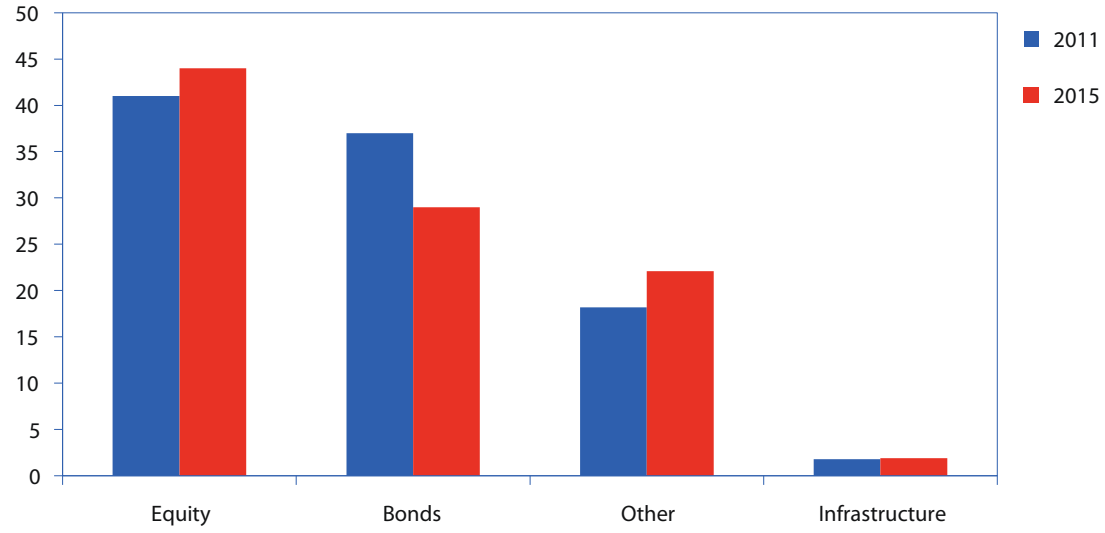
investments, which increased from about 5 per cent of their total portfolios in 1995 to 24 per cent in 2012. This shift partly reflects the "search for yield" in the current low interest rate environment, which would make it temporary and could imply a reversal of investor interest in these asset classes when interest rates rise; but it may also reflect structural changes and some realignment of investor assets and liabilities.

There are several likely reasons for long-term investors' focus on liquid assets. Many institutional investors lack the in-house capacity and expertise to do the necessary due diligence to invest directly in infrastructure. Internal institutional factors and compensation packages also shape investor incentives. Institutional investors with longer-term liabilities like pension funds, sometimes outsource funds to secondary financial intermediaries, such as hedge funds that can have very short-term liabilities and short-term incentives embedded in their compensation, which are not well suited for long-term investments. Regulations and accounting standards can also reduce the appetite for long-term investment. Capital requirements (e.g., Basel III on banking and Solvency II on insurance), which impose higher costs for riskier holdings based on maturity and credit rating, can penalize long-term investments, such as in infrastructure. Mark-to-market accounting, which values assets based on daily market prices, incorporates short-term market fluctuations into portfolio asset values. Investors are often incentivized to readjust their portfolio based on these short-term movements. In addition, high mobility of portfolio managers between firms may represent a further disincentive to long-term investing, as managers can earn a high bonus, and then move to another firm before the tail-risk has materialized.[20] For instance, the average tenure of a chief investment officer of a public pension plan is four years, with even shorter periods for more junior staff.[21] Firm culture can affect investment strategies, including how fiduciary responsibilities and non-financial impacts are viewed and taken into account in performance evaluations of individual managers.

In order to incentivize institutional investors to scale up longer-term investments in areas such

Figure 9

Institutional investment (pension funds) asset allocation, 2011 and 2015 *(Percentage)*



Source: Willis Towers Watson, 2016, The Global Pension Assets Study 2016, and UN/DESA calculations.
Note: "Other" includes investment in private equity fund of funds, direct hedge funds, direct private equity funds, funds of hedge funds, and illiquid credit.

20 Acharya, Viral, Marco Pagano and Paolo Volpin (2016). Seeking Alpha: Excess Risk Taking and Competition for Managerial Talent, *Review of Financial Studies*, Vol. 29 (10), pp. 2565–99.

21 World Economic Forum (2011). *The Future of Long-term Investing.*

as infrastructure, efforts may be needed in a number of areas. Public actors, such as multilateral and bilateral development finance institutions can help set up joint investment platforms that enable institutional investors to pool resources. Mechanisms such as public-private partnerships, equity investments, guarantees and insurance have become increasingly looked to as ways to use official resources to leverage private investment through risk-sharing between the public and private sectors, as discussed in chapters I, II and III.C of this report. There is also interest in promoting an "infrastructure asset class", which would allow investors to sell their positions if they choose, thus attracting investors that are wary of holding long-term illiquid assets. However, this would need to be done with care; there is a risk that short-term capital attracted to an infrastructure asset class would lead to increased volatility and risk creating bubbles during boom periods, which could then increase the probability of defaults in times of global risk aversion when the bubbles burst.

The presence of institutional investors in developing countries is significantly lower than in high-income countries, though it has been growing. Developing-country pension funds are estimated to manage $2.5 trillion in assets.[22] Building a long-term domestic institutional investor base could help provide a stable source of investment finance. A sizable portion of these portfolios is invested in domestic sovereign debt, though in some developing countries national pension funds have also been investing directly in national or regional infrastructure, including in Chile, Ghana, Mexico, Peru and South Africa. In most developing countries, building an institutional investor base will require upgrading expertise and skills, as well as reforms in licensing, portfolio requirements and changes to security laws. Good governance and an enabling environment are crucial for effective mobilization of domestic financial resources. Developing countries should learn from developed-country experiences, and lessons learnt among themselves, with the aim of building institutional investor bases and capital markets that are long-term and that "promote incentives along the investment chain that are aligned with long-term performance and sustainability indicators, and that reduce excess volatility," as called for in the Addis Agenda.[23]

5. Aligning private investment with sustainability indicators

Alignment of private activity with the SDGs can be seen as a continuum from pure financial investment to philanthropy. The vast majority of investment is focused purely on financial returns. Indeed, many pension plans are bound by fiduciary duty to "run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses,"[24] which is generally interpreted by pension trustees, investors and others as a duty to maximize financial returns to the exclusion of environmental, social and governance (ESG) considerations, even though taking ESG considerations into account often provides benefit to the beneficiaries. The resulting situation acts as a barrier to the consideration of ESG in investment decision-making.

Nonetheless, a growing number of investors are considering social and environmental factors in their investment decisions. Some large public pension funds have been incorporating "do no harm" criteria into their investment guidelines for over a decade. The area of impact investing, where investors aim to maximize both financial and non-financial factors, such as environmental, ESG, is also growing. In this context, philanthropy can be viewed as focusing exclusively on ESG. Data on philanthropy is incomplete; however, statistics from the Organiza-

22 Inderst, G. and Stewart, F. (2014). Institutional Investment in Infrastructure in Developing Countries: Introduction to Potential Models, World Bank. Available from: http://documents.worldbank.org/curated/en/238121468325297049/pdf/WPS6780.pdf

23 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 38. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

24 This is how the United States Department of Labor described the primary responsibilities of fiduciaries under the Employee Retirement Income Security Act (ERISA). See https://www.dol.gov/general/topic/retirement/fiduciaryresp.

tion for Economic Cooperation and Development show that, as of 2010, annual net private grants from developed to developing countries were approximately $30 billion.

Just because investment is profit oriented does not mean that it is necessarily opposed to sustainable development. Quality private investment has always been a critical element of most development models. More recently, studies have shown a positive relationship between ESG compliance and long-term corporate financial performance.[25] In this regard, the SDGs can also open new business opportunities. Over the next year, countries will be presenting voluntary national reviews of their progress on implementing the SDGs through national sustainable development strategies. National strategies, supported by financing frameworks can serve as guideposts to priority areas for investment and partnerships. Indeed, the Business and Sustainable Development Commission found that achieving the SDGs could unlock $12 trillion in market opportunities across three sectors: food and agriculture; cities, energy and materials; and health and well-being.[26]

SDG 12 on ensuring sustainable consumption and production patterns encourages companies to adopt sustainable practices and to integrate sustainability information into their reporting cycle. The Addis Agenda takes this further and encourages greater accountability by the private sector to embrace business models that have social and environmental impacts, and that operate sustainably.

A recent study found that there were almost 400 sustainability reporting policy instruments in 64 countries in 2016, up from 180 instruments in 44 countries in 2013.[27] In over 80 per cent of countries studied, Governments had implemented some type of sustainability reporting policy instrument, with about two-thirds of the instruments mandatory, and one-third voluntary. Stock exchange and financial market regulators accounted for almost one-third of all those instruments. Today, more than 92 per cent of the world's 250 largest companies report on their sustainability performance in one form or another. More than 9,000 businesses participate in the UN Global Compact and are required to report to their own stakeholders on an annual basis on their ESG performance, including on their actions to respect and support human rights. In addition, more than 2,000 businesses in 90 countries adhere to the guidelines of the Global Reporting Initiative (GRI).[28] Organizations setting the standards for sustainability reporting include the GRI, the International Integrated Reporting Council, the Sustainability Accounting Standards Board, the Carbon Disclosure Project, and the UN Guiding Principles Reporting Framework on Business and Human Rights. As shown in figure 10, GRI reporting has grown rapidly since the first GRI compliant report published in 1999.

Yet, despite these trends, it is unclear whether reporting alone is enough to change investment and business behaviour. This raises two sets of issues. The first relates to whether the quality of reporting needs to be strengthened, either with regard to the areas covered or whether the material is presented in a way that is easily understandable to investors and consumers. There has been a proliferation in competing reporting guidelines for businesses and a lack of standardization in sustainability metrics. A recent survey found that 82 per cent of investors were dissatisfied with the comparability of sustainability reporting between companies in the same industry, while 74 per cent were dissatisfied with the relevance and implications of sustainability risks being reported.[29] At the same time, the available analysis of relative corporate performance today is inaccessible to individual asset owners and civil

25 McKinsey (2016). *Sustaining sustainability: What institutional investors should do next on ESG*. Available from: http://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/sustaining-sustainability-what-institutional-investors-should-do-next-on-esg

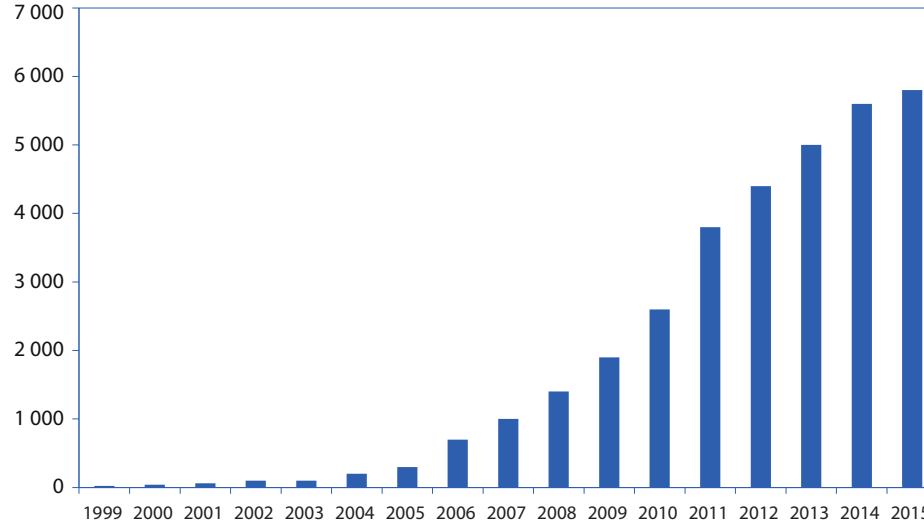
26 Business Commission (2017). *Better Business, Better World*. Available from: http://report.businesscommission.org/report

27 Carrots & Sticks (2016). *Global trends in sustainability reporting regulation and policy*. Available from: http://www.carrotsandsticks.net/wp-content/uploads/2016/05/Carrots-Sticks-2016.pdf

28 Business Commission (2107) *Better Business, Better World*.

29 PwC (2015) *Sustainability disclosures – is your company meeting investor expectations?* Available from: http://www.pwc.com/us/en/cfodirect/assets/pdf/in-the-loop/sustainability-disclosure-guidance-sasb.pdf

Figure 10
Number of GRI sustainability reports, 1999 – 2016



Source: GRI Sustainability Disclosure Database, October 2016.

society, due to high paywalls, lack of transparency in methodology and complexity of reporting. The report of the World Business Council for Sustainable Development recommends, among other things, the creation of an International Sustainability Standards Board to oversee progress towards global sustainability, which should be a multi-stakeholder initiative.[30] The second issue concerns whether reporting on its own is sufficient to change behaviour. More research is needed, but what is clear is that reporting is a necessary step to understanding the impact of business activity on society and the environment.

There has also been a range of complementary initiatives, in partnership with the private sector, geared to encouraging businesses to incorporate ESG criteria into their decision-making (box 1). While there are a number of existing sustainability indices (for example, Dow Jones Sustainability Index, FTSE4Good), efforts are being made to create a set of publicly available corporate sustainability benchmarks that are more closely linked to the SDGs. These would rank companies across a range of indicators such as climate change, gender, access to health care and other key aspects of the SDGs. This would go a step further in providing transparent information to investors and civil society and investors on how companies are aligning their activities with sustainable development objectives.

The Addis Agenda calls for promoting incentives aligned with sustainable development across the investor chain, this includes credit rating agencies, stock exchanges, brokers, investment advisors, standard-setting bodies (see chapter III.E on addressing systemic issues), and the full range of investors, from hedge funds to sovereign wealth funds. Globally, first steps have been taken in this direction, with developing countries taking the lead in many areas. Several countries are including ESG in their financial governance architecture. For example, the Central Bank of Brazil focuses on socio-environmental risk management flows as part of its core functions as a prudential bank regulator; the Bangladesh Bank supports rural enterprises and green finance; and the Bank of England has a prudential review of climate risks for the insurance sector of the United Kingdom of Great Britain and Northern Ireland, based on a connection between its core prudential duties and the United Kingdom Climate Change Act.[31]

Overall, much is happening in the sphere of private investment, but more is needed if we are to

30 WBCSD (2015). *World Business Council for Sustainable Development Report*.

31 UNEP (2016). *The financial system we need: from momentum to transformation. Inquiry: Design of a sustainable financial system*. Second edition, October 2016. Available from http://unepinquiry.org/wp-content/uploads/2016/09/The_Financial_System_We_Need_From_Momentum_to_Transformation.pdf

achieve sustainable development within one generation. This can be achieved by partnerships between the public and private sector, and with policy and regulatory frameworks aimed at better aligning incentives with long-term sustainable development.

Box 2

Examples of initiatives to align business activity with sustainable development

Major initiatives to incorporate environmental, social and governance (ESG) criteria into their decision-making include the following:[a]

The United Nations Global Compact. Encourages businesses to adopt sustainable and socially responsible policies, and to report on their implementation. The Compact has two objectives: i) to mainstream its ten principles on human rights, labour, the environment and anti-corruption in business activities and ii) to catalyse actions in support of broader United Nations goals, such as the Sustainable Development Goals (SDGs). Currently 9,269 companies from 164 countries are signatory to the Principles.

The United Nations Guiding Principles on Business and Human Rights. A set of guidelines for countries and companies to prevent the risks of adverse of human rights linked to business activities. They apply to all businesses everywhere and guidance on the state's duty to protect human rights from corporate abuse, on corporations' responsibilities to respect human rights and on remedying human rights abuses committed in business operations.

The Principles for Responsible Investment (PRI). Six voluntary and aspirational principles for incorporating ESG issues into investment practice. PRI currently has nearly 1600 signatories, from over 50 countries, representing $60 trillion of assets under management.

The Equator Principles. 10 principles for financial institutions for determining, assessing and managing environmental and social risk in projects. They apply globally to all industry sectors and to four financial products: (i) Project Finance Advisory Services; (ii) Project Finance; (iii) Project-Related Corporate Loans; and (iv) Bridge Loans.

The United Nations Environment Programme (UNEP) Inquiry. Maps the practice and potential for advancing a transition of the financial system towards a sustainable, low-carbon economy.

The UNEP Finance Initiative (UNEP FI) Principles for Sustainable Insurance. A global framework for the insurance industry to address environmental, social and governance risks and opportunities.

The Sustainable Stock Exchanges (SSE) initiative. Co-organized by United Nations Conference on Trade and Development (UNCTAD), the United Nations Global Compact, UNEP FI and the United Nations PRI. The SSE is a peer-to-peer learning platform for exploring how exchanges, investors, regulators, and companies, can enhance corporate transparency on ESG issues. SSE currently includes 61 exchanges in 59 countries.

The Green Bond Principles (GBP). Voluntary principles, led by the International Capital Markets Association, that promote the development of the Green Bond market.

The Global Reporting Initiative (GRI). Maintains a database that monitors the progress of ESG reporting and the number of sustainability reports disclosed in each country.

The ESG Credit Rating initiative. Initiated by eight credit rating agencies across the world, (including Moody's Corporation and S&P Global Ratings). The signatories recognize that ESG factors are important elements in assessing the creditworthiness of borrowers.

The World Business Council for Sustainable Development (WBCSD). A CEO-led, global association of about 200 companies dealing with business and sustainable development.

The SDG investing (SDGi). An initiative of 18 Dutch financial institutions that collaborate to unlock greater SDG investment.

Innovative Finance. A World Bank and BNP Paribas initiative to promote the 2030 Agenda for Sustainable Development through Innovative Finance.

a Initiatives are described in greater detail in the online annex to the Inter-agency Task Force report.

Chapter III.C

International development cooperation

1. Key messages and recommendations

Implementing the 2030 Agenda for Sustainable Development places significant demands on public budgets and capacities and on developing countries, in particular the poorest and most vulnerable. These demands were exacerbated in 2015 by a number of weather- and climate-related disasters, conflict and large-scale humanitarian crises.

In the face of these rising needs, international public finance increased in the past two years. Official Development Assistance (ODA) increased 8.9 per cent in real terms, to reach $142.6 billion, partly due to higher costs for in-donor refugees. Net ODA also rose as a share of gross national income (GNI), to 0.32 per cent, but continues to fall far short of commitments. ***ODA providers should work to fulfil the commitments they have made.*** Preliminary data also show that in 2016, bilateral net ODA to least developed countries (LDCs) fell in real terms, after increases in 2015. ***It will be important that projected additional increases in ODA to LDCs in the coming years be realized, so as to meet the commitments in the Addis Ababa Action Agenda to reverse the decline in ODA to LDCs.*** Other vulnerable countries—small-island States that have graduated from access to concessional windows, for example—are struggling to access sufficient official financing.

Lending by multilateral development banks (MDBs) has increased, with MDBs taking important steps to address this dearth of financing for vulnerable countries. In the context of the World Bank's International Development Association's (IDA) eighteenth replenishment, the World Bank Group is increasing the flexibility of graduation policies and of the terms of project-specific financing for potentially transformative projects. ***As more developing countries pass per capita income thresholds, additional efforts will need to be made to broaden eligibility criteria for concessional financing that more accurately reflect continued vulnerabilities.***

Partial data indicate that South-South cooperation efforts are making inroads across a wide range of financing, including in climate, humanitarian and infrastructure spending, and other means of implementation. Two newly established Southern-led MDBs began operations. ***With its emphasis on developing-country ownership, South-South cooperation should be further leveraged to strengthen the means of implementation of the 2030 Agenda for Sustainable Development.***

Urgent needs associated with a number of large scale humanitarian crises command an increasing share of development finance. While humanitarian finance remains vastly insufficient, and more international support will be needed for emergency responses, there is also a need for a greater focus on increasing the supply of concessional resources for long-term investment in resilience building and sustainable development. Allocating more development finance to emergency responses must not divert resources from long-term investments in sustainable development. As development cooperation providers work to increase their contributions, they should ***protect and increase concessional development financing, with a particular focus on long-term investments in sustainable development.*** New funding modalities are also being developed and beginning to be deployed for both crisis prevention and ex post support. ***Further analysis on the current scope and gaps in crisis prevention and alternative funding mechanisms, including better use of public and private insurance for natural disasters, is warranted.***

The broadening of global development priorities in the 2030 Agenda for Sustainable Development is changing the sectoral allocation of develop-

ment cooperation, including through a greater focus on how the private sector can be effectively engaged. As the use of modalities such ***as blended finance grows, it is critical that deployment is assessed on a case-by-case basis, with risks and returns shared fairly, as called for in the Addis Agenda. Careful consideration should be given to the overarching principles of development effectiveness, in particular strong country ownership, aligning programmes and projects with country priorities, and transparency.***

Progress is being made in enhancing the quality and effectiveness of international development cooperation, and in aligning it with sustainable development. Nonetheless, there are areas with significant potential to increase coherence. ***At the country level, implementing well-defined national development cooperation policies, linked to a country's national sustainable development strategy has been identified as a practical enabler of more accountable and effective development cooperation***.

The United Nations system is also moving to implement a more coherent approach in response to the 2030 Agenda for Sustainable Development, including through guidance provided by the Quadrennial Comprehensive Policy Review (QCPR) resolution adopted in December 2016. ***Culminating a two-year dialogue among Member States, the 2016 QCPR provides a framework to reorient the United Nations system as a whole towards improved effectiveness and impact in the implementation of the 2030 Agenda for Sustainable Development.***

2. Global financing flows

The provision of international public finance increased in the past two years, continuing a rising trend since the turn of the millennium. Despite this growth, international public financial flows have fallen short of commitments made and remain insufficient to fill financing gaps for public investments in sustainable development.

ODA by members of the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) totalled $142.6 billion in 2016, representing a rise of 8.9 per cent from 2015 in real terms. This continues a long-term rising trend in ODA, which has doubled in real terms since the adoption of the Millennium Declaration in 2000. However, since 2010, the increase in ODA has to a large extent been due to humanitarian aid and in-donor refugee costs, with the share of in-donor refugee costs increasing from 2.7 per cent in 2010 to 10.8 per cent in 2016 (figure 1). Many donors also still fall short of ODA commitments. ODA from 28 countries in the OECD DAC[1] averaged 0.32 per cent of gross national income (GNI) in 2016. Only six countries met the target of 0.7 per cent of GNI.

Loans by MDBs complement largely grant-based ODA. MDB lending has grown substantially in the last 15 years, with loan disbursements reaching $66.8 billion in 2015 (figure 2). Annual disbursements peaked in 2010 in the aftermath of the global economic and financial crisis, at $74.4 billion, underlining the important countercyclical role that MDBs have been playing. MDBs are critical in supporting infrastructure investment in particular. In 2014, they disbursed USD 31 billion for infrastructure, representing half of the disbursements of all providers in this area.[2]

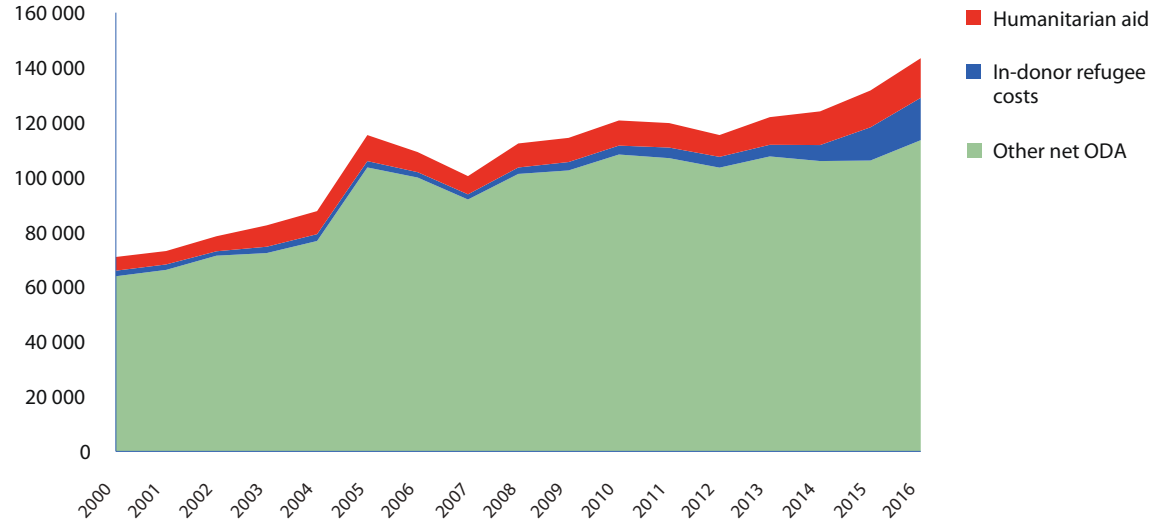
In 2015, two new multilateral financial institutions were established in the South — the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB). The NDB approved seven investment projects for a total of $1.5 billion in 2016. The AIIB approved $1.7 billion for nine projects as of January 2017, and expects to provide between $10 billion and $15 billion in loans annually over the next 15 years.[3] In addition, national development banks, such as the China Development

1 In 2016, Hungary joined the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC), which, including the European Union, now has 30 members.

2 Miyamoto, K. and Chiofalo, E. (2016). *Official Development Finance for Infrastructure: With a Special Focus on Multilateral Development Banks*, OECD Development Cooperation Working Papers, No. 30, OECD Publishing, Paris.

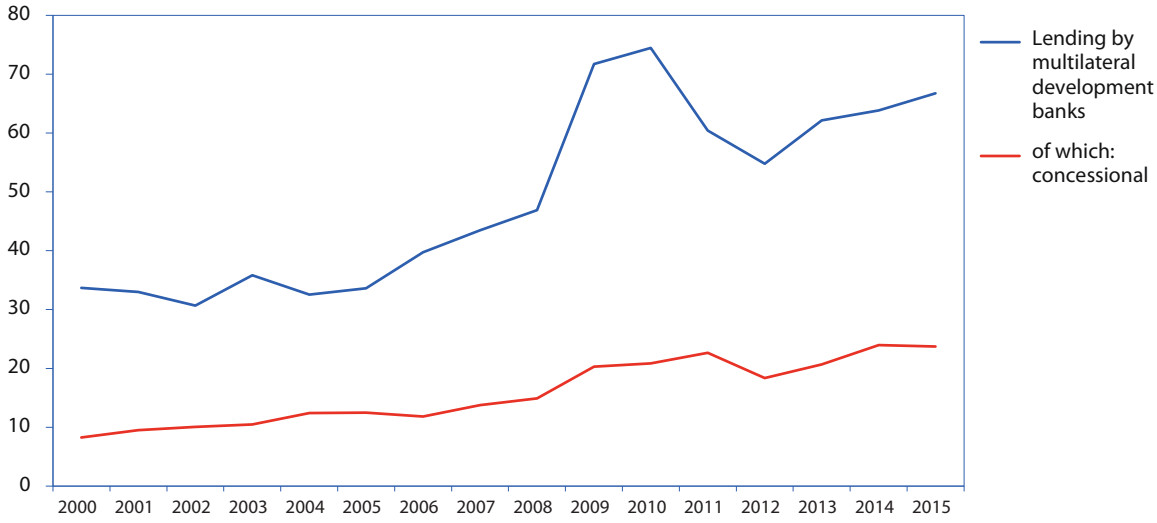
3 United Nations (2016). *Trends and progress in international development cooperation*. Report of the Secretary-General, E/2016/65. Available from: http://www.un.org/ga/search/view_doc.asp?symbol=E/2016/65

Figure 1
Net ODA by DAC donors, 2000 – 2015 (*Billions of United States dollars, 2014 constant*)



Source: OECD/DAC data.

Figure 2
Lending by multilateral development banks, 2000 – 2015 (*Billions of United States dollars, current*)



Source: World Bank World Development Indicators.
Note: Includes disbursement of loans and credits from the World Bank, regional development banks, and other multilateral and intergovernmental agencies. Concessional lending is defined as loans with an original grant element of 25 per cent or more.

Bank, the Export and Import Bank of China and the Brazilian National Development Bank, have taken a more prominent role in financing regional and subregional infrastructure. In 2014, the loans disbursed by these three banks amounted to $1,762 billion (UNCTAD, 2015).

It is difficult to quantify the non-financial component of South-South cooperation, which is recognized in the Addis Agenda as an important element of international cooperation for development as a complement, not a substitute, to North-South cooperation. Estimated financial values are only

Box 1

Multilateral development bank policies in support of the 2030 Agenda for Sustainable Development

In 2016, multilateral development banks (MDBs) continued to enhance coordination and collaboration and have agreed on common actions to address critical issues of the 2030 Agenda for Sustainable Development in areas such as forced displacement, climate finance, infrastructure, private investment, and urbanization. This included the launch of the first Global Infrastructure Forum in April (see section on infrastructure), as well as two new facilities to bridge the gap between humanitarian and development assistance by ensuring support to countries hosting large numbers of refugees: the World Bank's Global Concessional Financing Facility, part of its Global Crisis Response Platform, and the European Investment Bank's new Resilience Initiative for the European Union's Southern Neighbourhood and Western Balkans.

In line with the Addis Ababa Action Agenda, MDBs have also individually and collectively implemented several measures to make optimal use of their resources and balance sheets. The Group of Twenty put forth a similar call in their Antalya Summit Leaders' communiqué in November 2015 and in the March 2017 Communiqué of Finance Ministers and Central Bank Governors. Among other measures, MDBs have introduced economic capital models that assess capital adequacy by assessing risks of specific operations, rather than general equity-to-loan ratios. Five MDBs have collaborated to establish a framework to exchange loans to diversify their portfolios and reduce sovereign risk. Three bilateral exposure exchange agreements for a total of $6.5 billion were approved in December 2015.

The World Bank Group's International Development Association is adopting a new financing framework to better target concessional resources in the context of its eighteenth replenishment. Changes include a greater engagement in small States, making official finance on non-concessional terms available for transformational projects in blend countries[a], and a new Private Sector Window.

In March 2017, the World Bank Treasury issued equity-index linked bonds that link investors' returns to the stock performance of companies included in the Solactive Sustainable Development Goals World Index. The index includes 50 companies that, based on methodology developed by Vigeo Eiris' Equitics, dedicate at least one fifth of their activities to sustainable products, or are recognized leaders in their industries on socially and environmentally sustainable issues. The bonds were arranged by BNP Paribas and raised a total of EUR 163 million from institutional investors in France and Italy. Proceeds will be used to financing projects that are aligned with the Sustainable Development Goals.

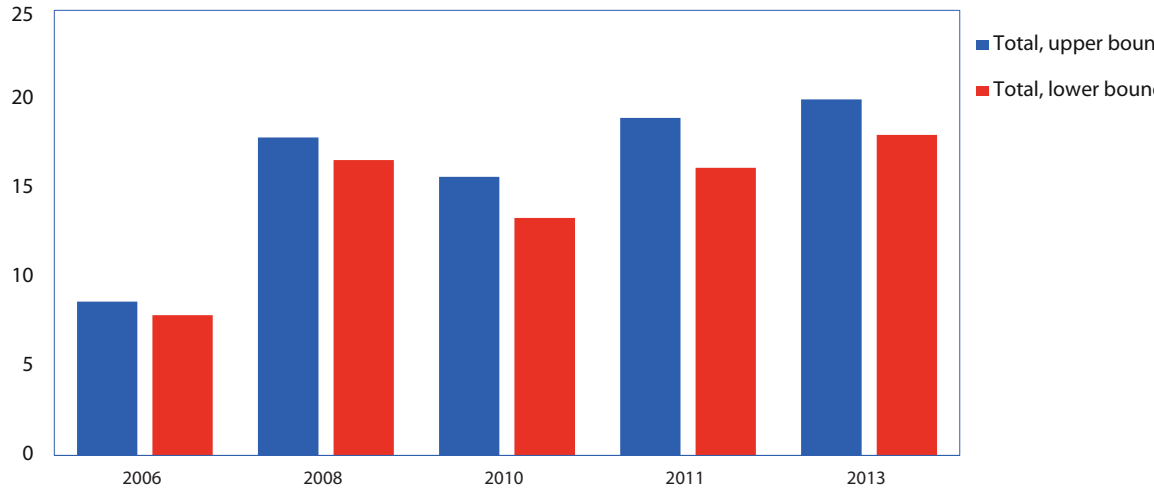
[a] Countries that are eligible for assistance from the International Development Association based on per capita income levels and are also creditworthy for some borrowing from the International Bank for Reconstruction and Development.

indicative. Existing data shows that concessional South-South cooperation, has been increasing. The United Nations Department of Economic and Social Affairs (UN/DESA) estimates that official concessional resources[4] provided by the South for development purposes increased from $7.9 billion in 2006 to between $18 billion and $20 billion in 2013. Partial data which includes concessional export credits suggest that South-South development cooperation surpassed $20 billion in 2014 (figure 3).[5] The estimated total lower bound values reflect a narrower definition of South-South development cooperation which excludes concessional export credits. Non-financial South-South cooperation modalities applicable, for example, to capacity support and policy change have also increased. A number of recent initiatives of Southern partners to expand the scope and magnitude of their development cooperation corroborate the trends noted above. In 2015, China established two funds totalling $5.1 billion to help developing countries address climate change and implement the 2030 Agenda for Sustainable Development. India has announced a $10 billion concessional line of credit to Africa over the next five years, as well as grant assistance of $600 million that would include an India-Africa Development Fund of $100 million, an India-Africa Health Fund of $10 million, and 50,000 scholarships for African students over the same period. South-South cooperation providers also significantly increased their contributions to

4 Defined as concessional loans and grants, debt relief and technical cooperation.

5 United Nations (2016). *Trends and progress in international development cooperation*. Report of the Secretary-General, E/2016/65. Available from: http://www.un.org/ga/search/view_doc.asp?symbol=E/2016/65

Figure 3
Concessional South-South cooperation, selected years, 2006–2013 (*Billions of United States dollars*)



Source: UN/DESA.

the United Nations development system and other multilateral organisations working on development.[6]

3. Allocation to countries and sectors

In the Addis Agenda, countries committed to focusing the most concessional resources on those countries with the greatest needs and least ability to mobilize other resources, while also considering and addressing the diverse development needs of middle-income countries. These commitments could bring greater rationality to the global allocation of bilateral aid in particular, which remains largely uncoordinated.

3.1. Addressing diverse needs and specific challenges of country groups

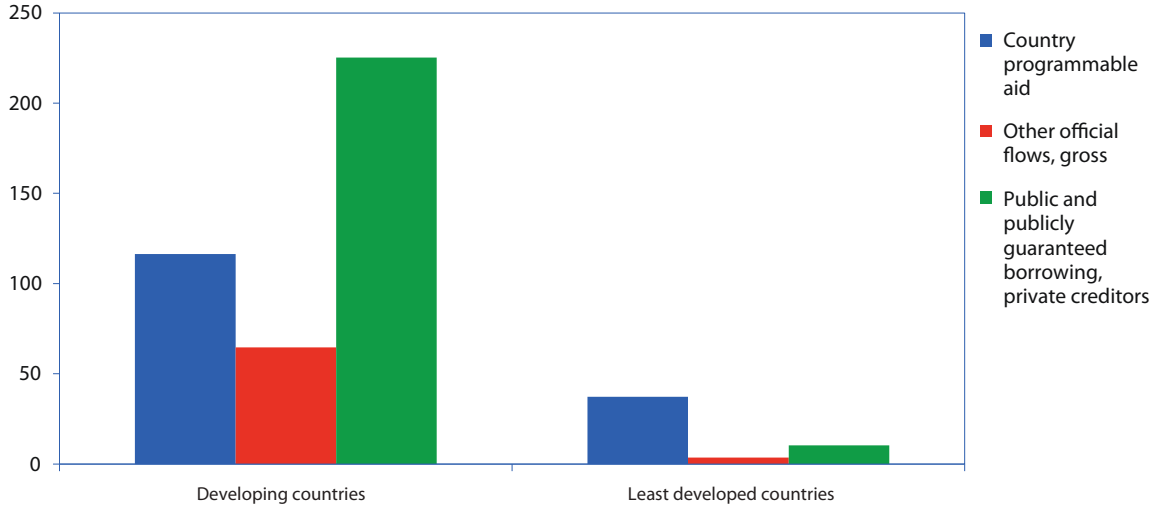
LDCs remain reliant on global support, owing to a combination of high vulnerabilities, high poverty rates and limited access to other sources of international financing. Access to official or officially supported financing other than grants—such as other official flows that do not meet the eligibility criteria for ODA—is limited, and despite an increase in public borrowing from private creditors in LDCs in recent years, it still plays a very small role (figure 4).

In this light, the increase of ODA in 2015 (a total net increase to LDCs by 8 per cent in real terms, reaching $43 billion in 2015[7]) was welcome and in line with the Addis Agenda commitment to reverse the fall in ODA to LDCs. However, preliminary data available for 2016 show that bilateral net ODA to LDCs decreased by 3.9 per cent in real terms compared to 2015. The OECD Survey on Donors' Forward Spending plans through 2019 suggested that country programmable aid to LDCs should rise, and it will be important that these projected increases will be realized, so as to meet the respective commitment in the Addis Agenda. ODA instruments used in LDCs also on average have more concessional financial terms than in developing countries as a whole. At the same time, these flows fall short of the lower bound of the United Nations target of 0.15 per cent, at 0.09 per cent of gross donor national income on average in 2014 and 2015. In 2015, only seven countries met the United Nations target

6 OECD (2015) *Multilateral Aid 2015: Better Partnerships for a Post-2015 World*. Available from: http://www.oecd.org/dac/multilateral-aid-2015-9789264235212-en.htm

7 Adjusting for inflation and the appreciation of the US dollar, currencies of DAC members depreciated significantly against the US dollar in 2015.

Figure 4
Official flows and sovereign borrowing by developing countries and least developed countries, 2014
(*Billions of United States dollars*)



Source: OECD.Stat, World Bank International Debt Statistics.
Note: Developing countries defined here as official development assistance (ODA) recipients.

(down from eight in 2014), with five donors meeting or exceeding the upper target of 0.2 per cent of donor GNI to LDCs.

The Addis Agenda also recognizes the specific development needs of middle-income countries. This group is highly diverse, with countries being subject to a range of vulnerabilities, and widely varying rates of per capita incomes, poverty and inequality. This diversity is reflected in different financing modalities. Overall, the share of borrowing from official creditors (both concessional and non-concessional) has decreased steadily over the last 15 years – from over 55 per cent in 2000 to about 40 per cent in 2015 – while borrowing from private creditors has increased. Access to financial markets is a sign of stronger balance sheets, but borrowing from private creditors also adds risks, due to shorter maturities and higher and more variable interest rates (see chapter III.E on debt and debt sustainability).

Middle-income countries have seen their share of global ODA fall from just above 60 per cent at the turn of the millennium to about 50 per cent in recent years. In parallel, the use of less concessional instruments has become more prominent. ODA loans reached 45 per cent of gross ODA disbursements in 2015. Middle-income countries were also the primary recipient of private sector instruments such as guarantees and equity investments. Lower-middle-income countries and upper-middle-income countries received 32 per cent and 41 per cent of private financing flows mobilized by ODA private sector instruments, respectively.

The global aggregates can, however, hide important differences between countries. Many middle-income countries continue to struggle in accessing affordable financing. Kharas, Prizzon and Rogerson found that as countries' per capita income increases above low-income thresholds, their access to external (concessional and non-concessional) public finance decreases faster than can be compensated by increasing tax revenues, in per capita terms.[8] As a result, they have less public financing available. The shift away from grants and from concessional to non-concessional lending is also often accompanied

8 Kharas, Homi, Annalisa Prizzon and Andrew Rogerson (2014). *Financing the post-2015 Sustainable Development Goals. A rough roadmap*. ODI. Available from: https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/9374.pdf

by changes in sectoral allocations, with less financing available for the social sectors.[9]

This challenge is exacerbated in small-island developing States (SIDS), which face a number of common development and development financing challenges. Due to their small size, remoteness, and vulnerability to external and environmental shocks, they have limited capacity to mobilize public resources domestically and therefore remain dependent on official concessional financing, despite their relatively high per capita income levels. ODA to SIDS increased from $2.7 billion in 2014 to $3.1 billion in 2015. It is, however, projected to remain stagnant through 2019, calling for special attention and monitoring given the structural vulnerabilities of SIDS. These vulnerabilities are also not fully considered in eligibility criteria for concessional official financing, particularly by MDBs, which often limit their criteria to income levels and measures of countries' creditworthiness.

Different approaches have been put forward to address these concerns. Several multilateral development banks are considering or have made changes to their concessional lending frameworks. For example, the IDA is increasing its engagement with small States by including extending favourable lending terms for small island economies to all small States (i.e., countries with a population of 1.5 million) in the context of its eighteenth replenishment. The Asian Development Bank is considering an update to its graduation policies in the context of its new Road to 2030 strategy—as most of its developing-country members are expected to be classified as middle-income countries by 2020 and many will soon exceed the threshold for funding other than for emergency purposes—and in the light of new development challenges, such as climate change. As more developing countries pass per-capita income thresholds, it will be important to make additional efforts to broaden eligibility criteria for concessional financing that more accurately reflect continued vulnerabilities in many developing countries.

3.2. Sectoral priorities of international public finance

In the era of the Millennium Development Goals, sectoral allocation of international public financing flows reflected the prioritization of basic social needs, such as health and education. The 2030 Agenda for Sustainable Development has significantly broadened the set of global development priorities, and this is already reflected in allocation decisions of development cooperation providers. This section highlights the focus on climate finance. The year 2015 also saw the continuation of several large-scale humanitarian crises, and the urgent needs associated with them commanded an increasing share of development finance. The subsequent section will highlight the increasing emphasis on using public finance to leverage additional private investments and support private sector development.

Climate finance

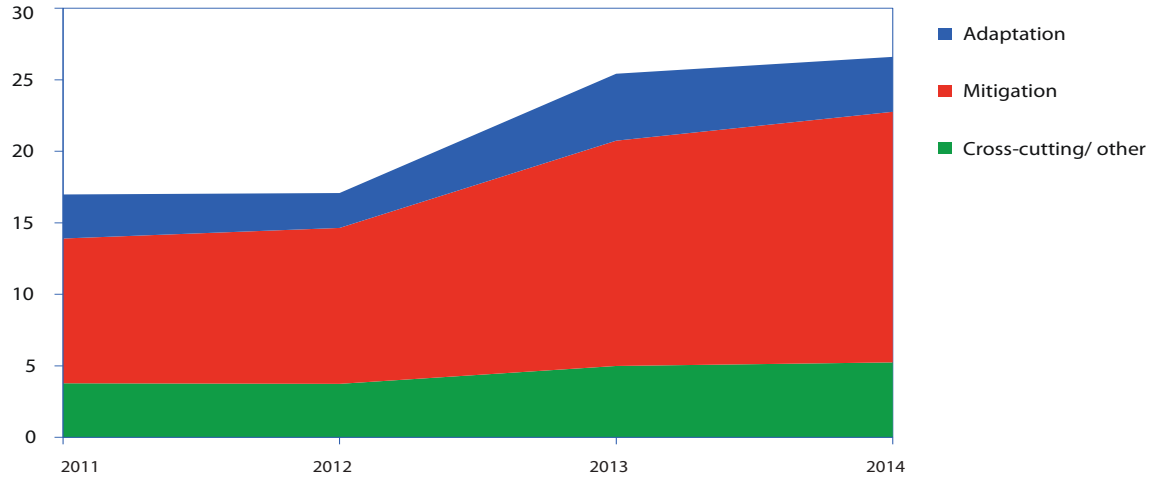
Mitigating and adapting to climate change is integral to the 2030 Agenda for Sustainable Development, and considerable resources are needed to meet the investment needs for low-carbon and climate-resilient development. Development finance can make an important contribution to meeting these needs. At the same time, climate finance remains tilted towards mitigation activities, which benefits donor and recipient countries alike, and international assistance targeting global carbon emissions has been heavily concentrated in middle-income countries. The challenge for international development cooperation is to meet the large financing needs for climate mitigation while assuring that sufficient development finance remains available for the poorest countries.

Total public climate-specific finance from developed to developing countries rose by about 50 per cent between 2011 and 2014—from $17 billion to $26.6 billion—with a clear bias towards climate-mitigation interventions (figure 5).[10]

9 Prizzon, Annalisa, and Andrew Rogerson (2017). *Moving away from aid? The case of Indonesia*. ODI Report, March 2017. Available from: https://www.odi.org/sites/odi.org.uk/files/resource-documents/11345.pdf

10 UNFCCC Standing Committee on Finance (2016). *2016 Biennial Assessment and Overview of Climate Finance Flows.* Available from: http://unfccc.int/files/cooperation_and_support/financial_mechanism/standing_committee/application/pdf/2016_ba_technical_report.pdf

Figure 5
Annex II parties' public climate finance support to developing countries, 2011–2014, (*Billions of United States dollars*)



Source: UNFCCC Standing Committee on Finance (2016) Biennial Assessment and Overview of Climate Finance Flows Report.

Climate-related ODA has increased steadily, and there has also been an increase in South-South cooperation in this area. For example, China announced the establishment of a $3.1 billion South-South Climate Cooperation Fund in 2015 to help developing countries tackle climate change. In addition to bilateral flows, MDBs provided $25.7 billion of their own resources for climate finance in developing countries in 2014. More than 80 per cent of MDB lending targeted climate change mitigation.

The largest dedicated climate fund is the Green Climate Fund, which has raised the equivalent of $10.3 billion in pledges from 43 Member State Governments, including from 8 developing countries, as of December 2016. Currently, 48 entities, almost half of which are either national or regional entities, are accredited to access the Fund's resources to finance projects and programmes, thus providing developing countries with direct access to funds.

Humanitarian finance

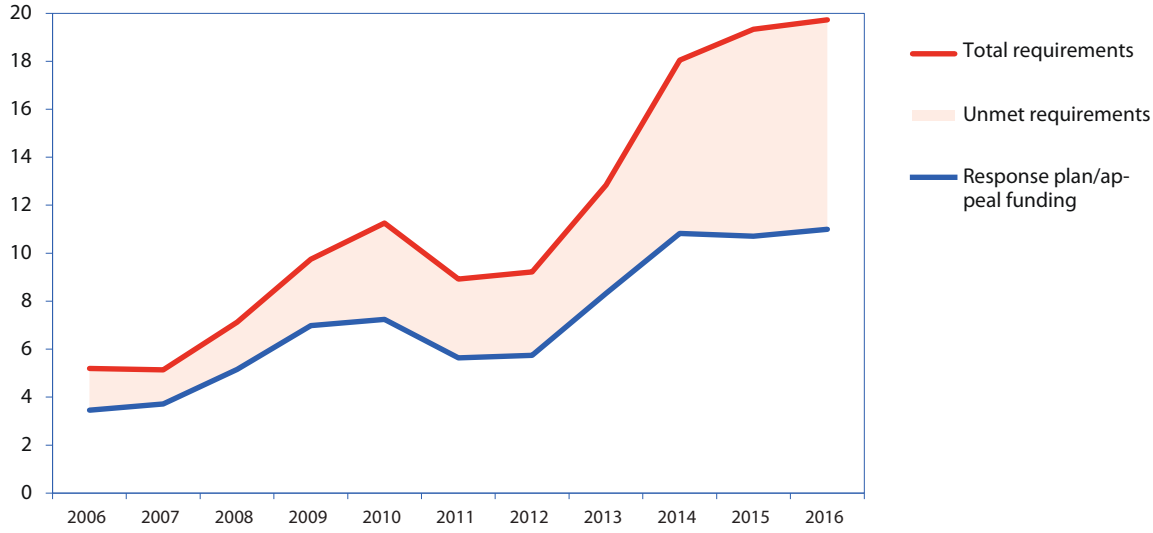
A number of large-scale crises and emergencies are driving a dramatic increase in humanitarian financing needs. Financing requirements for inter-agency humanitarian appeals and refugee response plans coordinated by the United Nations have risen significantly over the last decade, from $5.2 billion in 2006 to $22.1 billion in 2016. While funding also rose over the same period—from $3.4 to $12.6 billion (as of 30 December 2016)—it increasingly falls short of what is needed (figure 7), and only 56 per cent of requested funding was received in 2016.[11] While humanitarian financing is thus vastly insufficient, the crises it addresses create additional burdens to existing sustainable development challenges and require additional financing. Allocating more development financing to emergency responses should not divert resources from long-term investments in sustainable development.

Overall global funding for humanitarian action—which includes all public and private international humanitarian aid, United Nations coordinated appeals and beyond—reached $28 billion in 2015, $6.2 billion of which came from private donors.[12] Governments beyond the OECD DAC account for an increasing share of public humani-

11 OCHA (2016). *Global Humanitarian Overview, Humanitarian Funding Update, 30 December 2016*. Available from http://reliefweb.int/report/world/humanitarian-funding-update-december-2016-united-nations-coordinated-appeals

12 Development Initiatives (2016). *Global Humanitarian Assistance Report 2016*. Available from: http://www.globalhumanitarianassistance.org/wp-content/uploads/2016/07/GHA-report-2016-full-report.pdf

Figure 6
Humanitarian response plan/appeal funding and unmet requirements (excluding refugee response plans), 2006 – 2016 (*Billions of United States dollars*)



Source: UN/OCHA Financial Tracking Service.

tarian finance; their contribution has increased from 4 per cent in 2006 to 12 per cent of the total in 2015, largely owing to increased contributions by Gulf States to fund crisis responses in the Middle East. Turkey was the second highest contributor in terms of volume, providing approximately $3.2 billion in aid.

Coherence of humanitarian and development financing

Many humanitarian crises are protracted in nature: they unfold over many years, blurring the line between humanitarian and development needs. The average duration of humanitarian United Nations inter-agency appeals is seven consecutive years. At the same time, the poor are most exposed to and most affected by crises. According to estimates, more than three quarters of all people living in extreme poverty globally live in countries that are environmentally vulnerable, conflict-affected or fragile.[13] Enhancing the coherence of development and humanitarian action and finance is therefore critical.

The Secretary-General's Agenda for Humanity, which guided the overarching framework of the first World Humanitarian Summit in Istanbul, Turkey, in May 2016, proposed a number of shifts of humanitarian interventions in this regard, including working over multi-year time frames, recognizing the reality of protracted crises and aiming to contribute to longer-term development gains. These have implications for financing too, including shifting programming to promote preparedness, reducing risk, reducing vulnerabilities, and developing local capacities to respond — areas that require a mix of both humanitarian and development sources. First steps to overcome silo approaches include greater collaboration between the United Nations and international financial institutions, exemplified by two new facilities launched by MDBs to bridge the gap between humanitarian and development assistance (box 1).

The most effective measures are preventative, such as investments in disaster risk reduction, peace and security. While investments in implementing early warning systems, protective infrastructure, land-use policies and building codes, and other measures of risk reduction are primarily financed through national budget allocations, many develop-

13 Development Initiatives (2016). *Global Humanitarian Assistance Report 2016*. Available from: http://www.globalhumanitarianassistance.org/wp-content/uploads/2016/07/GHA-report-2016-full-report.pdf

ing countries rely on international support. Yet, the financing landscape for international public climate and disaster resilience financing is complex; a range of mechanisms that provide access to ex ante financing for resilience and to ex post support following natural disasters are available, but with diverse eligibility criteria and complex financing terms.[14]

To provide quickly disbursing ex post finance, several market-based mechanisms have been set up — in particular, sovereign insurance — although they so far remain regional in reach. They include the Caribbean Catastrophe Risk Insurance Facility (CCRIF), which offers catastrophe insurance to Caribbean Governments against tropical cyclones, earthquakes and excess rainfall. Since 2007, CCRIF has made 22 payouts to 10 members, totalling approximately $69 million, all within two weeks after each event. Other regional mechanisms include the Pacific Catastrophe Risk Assessment and Finance Initiative and the African Risk Capacity Insurance Company, with the former providing payments in the aftermath of cyclones and tsunamis, and the latter covering drought and other extreme weather events. To meet increased demand for such products, and to further diversify risks, the international community could also consider setting up such mechanisms at the global level. The Task Force can bring together and carry forward analytical work to help develop appropriate funding instruments.

4. Blended finance

There has been an increasing focus on using public funds to leverage additional public and, in particular, private resources. This focus is grounded in the recognition that private investments and private sector development are indispensable to sustainable development. Blended finance aims to unlock sources of finance that are not yet available for development purposes by providing public funds to increase investability of the development outcome. Indeed, when the social returns of an investment exceed the private returns, a subsidy may be warranted. This is of course not the only way to support private sector development; public investments in basic infrastructure, health and education, and many other areas provide the preconditions without which markets cannot function well. The allocation of scarce public resources to support specific private investments must therefore be carefully considered, and should follow recipient countries' expressed priorities. This perspective is reflected in the Addis Agenda, which develops a deeper understanding of appropriate conditions for blended finance, how it should be utilized and structured, and how associated risks can be evaluated and managed.

Measuring the extent to which development finance is currently used to catalyse private investment at the international level is challenging. MDBs have created a joint Task Force to harmonize methodologies that quantify catalysed private finance and plan to publish a first report on 2016 commitments using the new methodology in April 2017. The OECD DAC has also been working on developing an international standard for measuring the amounts mobilized from the private sector by official development finance interventions.[15] From 2017 forward, data will be collected on amounts mobilized from guarantees, syndicated loans, and shares in collective investment vehicles in the DAC statistical system. A survey launched in September 2016 further pilots methodologies for credit lines and direct investment in companies.

The OECD survey[16] has found that over four years, $81.1 billion was mobilized from the private sector by the five instruments and mechanisms surveyed (guarantees contributed 44 per cent of the total), 26 per cent of which targeted climate-related projects (figure 5). The survey also indicates that annual amounts mobilized have followed an upward trend over the period studied.

14 OECD and World Bank (2016). *Climate and Disaster Resilience Financing in Small Island Developing States*. Available from: http://www.oecd-ilibrary.org/development/climate-and-disaster-resilience-financing-in-small-island-developing-states_9789264266919-en

15 In February 2016, the DAC agreed on a set of principles on how to measure such instruments in official development assistance statistics in future (see DAC High-level Meeting Communiqué, available from http://www.oecd.org/dac/DAC-HLM-Communique-2016.pdf).

16 For more information, see http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/Preliminary-results-MOBILISATION.pdf

Several new initiatives are also under consideration, such as the recently launched European Fund for Sustainable Development, which aims to mobilize public and private investments of up to €44 billion based on an initial European Union contribution of €4.1 billion, primarily in Africa and the European neighbourhood.

Discussions on the effectiveness and quality of blended finance have found that trade-offs between commercial and sustainable development objectives may sometimes be difficult to reconcile. As private sector involvement in public investments increases the need to generate financial returns for private partners, there is also a broader risk of focusing efforts on projects with lower-risk profiles and less development impact. Existing surveys on private sector instruments show that their use is concentrated in middle-income countries. Finally, transparency practices vary greatly, partly because blended financing mechanisms are often implemented through third parties. Such discussions have taken place in the context of the Development Cooperation Forum (DCF), for example, with a focus on building the evidence base, providing policy guidance, and capacity development.

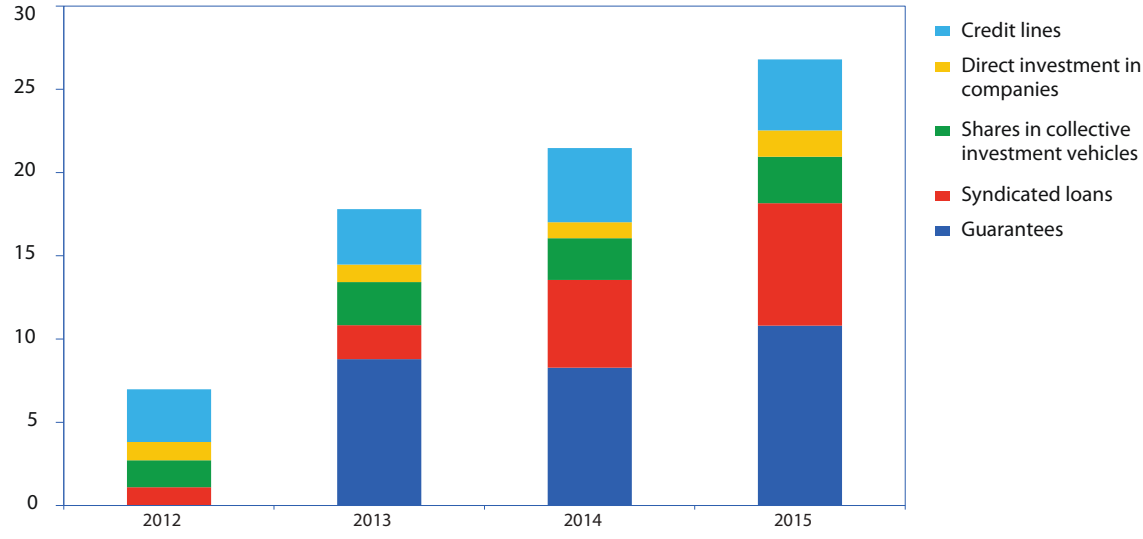
In this light, it is critical that the overarching principles of development effectiveness are applied—in particular, transparency, aligning programmes and projects with country priorities, and ensuring strong country ownership. The principles for blended finance and public-private partnerships contained in the Addis Agenda provide additional guidance (see also the discussion on public-private partnerships in this report). With regard to transparency, the OECD DAC principles on the measurement of private sector instruments note that the official effort will be counted as ODA, while the flows mobilized will be tracked in the broader measure on flows for sustainable development (box 2). The principles also contain provisions to enhance safeguards, and are an important first step in ensuring that blended finance meets effectiveness criteria.

5. Effective development cooperation aligned with the 2030 Agenda for Sustainable Development

The Monterrey Consensus called not only for a substantial increase in ODA and other resources for

Figure 7

Amounts mobilized from the private sector by official development finance interventions, 2012–2015
(*Billions of United States dollars*)



Source: OECD.
Note: In syndicated loans, the official institution arranges and/or retains a portion of the loan on its own account; shares in collective investment vehicles with official participants are those invested in entities that allow investors to pool and jointly invest in a portfolio of companies.

Box 2

Total official support for sustainable development

In December 2014, Ministers of the Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) agreed to carry out consultations and analytical work to develop a new measurement framework for development finance in support of sustainable development, provisionally called Total Official Support for Sustainable Development (TOSSD). In the current proposal, TOSSD would include all officially supported resource flows to promote sustainable development in developing countries and to support development enablers or address global challenges at regional or global levels. Private finance mobilized through public interventions would thus be counted in TOSSD, while the public effort will be recorded as official development assistance (ODA).

Following the call in the Addis Ababa Action Agenda for open and inclusive discussions on TOSSD, the OECD has held a series of consultations with different stakeholders, including by publishing a TOSSD Compendium for public consultation in June 2016. The Inter-agency Task Force itself has held two technical meetings with the OECD on the proposal and on broader questions of measuring international public financing flows and development cooperation efforts in 2016. The meetings provided occasion to discuss critical perspectives on the proposal, and to compare and contrast the scope and methodologies behind the proposed TOSSD measure against the monitoring of financing for development commitments by the Task Force. As a result, the OECD has adjusted the technical parameters to reflect recommendations of the IATF and consultations with Member States.[a]

The meetings had three key findings. First, the ongoing Task Force monitoring of commitments on concessional and non-concessional international public financing flows (Action Area III.C of the Addis Agenda) largely encompasses the components of what the OECD proposes to measure under the cross-border flows pillar of TOSSD. The meetings identified specific gaps in data and data inconsistencies in this area — such as lending by multilateral development banks, South-South cooperation and leveraging of private finance — where the Task Force could welcome and work with others towards greater harmonization and standardization of data, in the context of TOSSD and beyond. The OECD has carried out pilots in Senegal[b] and the Philippines to understand how an aggregate metric such as TOSSD could best respond to partner country needs and priorities. Second, Task Force monitoring of financing for development commitments is broader in scope than TOSSD. Financing for development commitments include provider-focused commitments (on ODA in particular), as well as a focus on quality and effectiveness (including when it comes to purchasing power parity and mobilization of private resources), which are difficult to measure in a single indicator. Third, the nature of these financing for development commitments, with their emphasis on the qualities, characteristics and origins of different components, also means that the Task Force recommended to ensure that TOSSD is designed is such a way that all different flows are separately identifiable and thereby cautioned adding-up all components into a single metric.

Going forward, the OECD is planning to continue consultations and pilot studies. A new multi-stakeholder TOSSD Task Force will be launched aiming to address conceptual and technical issues and implementation options, with a view to finalise the TOSSD definition in time for the High Level Political Forum (HLPF) on Sustainable Development and the High-level Dialogue on Financing for Development under the auspices of the General Assembly in 2019.

a http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/TOSSD%20Flyer%20crops.pdf

b For more information, see: https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/Senegals%20perspective.pdf

development, but also for enhanced effectiveness of development cooperation. The Addis Agenda welcomed the efforts that have been made since then to improve the quality, impact and effectiveness of assistance, including the progress achieved in elaborating the principles that apply to respective efforts to increase the impact of cooperation, and further noted that efforts to pursue effective development cooperation will be addressed primarily in the DCF of the United Nations Economic and Social Council (ECOSOC), while taking into account complementary efforts of other relevant forums, such as the Global Partnership for Effective Development Cooperation.

The Addis Agenda reiterated that cohesive nationally owned sustainable development strategies are at the heart of implementation efforts. These strategies and the priorities they formulate should in turn guide how a country engages in development cooperation. National development cooperation policies

articulate the vision and objectives of development cooperation, identify the roles of different actors, and make clear the lines of accountability. A full 90 per cent of developing countries surveyed in the 2016 DCF Global Accountability Survey[17] have such policies, showing a slight increase from the previous survey. Some countries have also started to reflect key aspects of the 2030 Agenda for Sustainable Development in their policies, including the importance of all three dimensions of sustainable development, commitments to address inequality, and the universal importance of sustainable development. Survey results also show the need for capacity support for developing-country Governments as they monitor and review development cooperation, and for supporting stakeholders' engagement in the process.

Development partners' commitment to align activities with these national priorities has been

Box 3

Cambodia's national development cooperation and partnership strategy

Cambodia has achieved impressive progress in socioeconomic development over the past decade with gross domestic product growth averaging 7.7 per cent annually, and its poverty rate reduced from 53.2 per cent in 2004 to 13.5 per cent in 2014. In June 2014, the Royal Government of Cambodia approved the country's "Development Cooperation and Partnerships Strategy 2014-2018".[a] The strategy aims to support implementation of Cambodia's National Strategic Development Plan,[b] covering the same time period. It elaborates the country's vision and specific strategies for country-led and country-owned development cooperation, and showcases how a well-defined national development cooperation policy, linked to a country's national sustainable development strategy, can facilitate accountable and effective development cooperation.

Cambodia's strategy establishes partnership principles and tools, with strong emphasis on programme-based approaches as its preferred mode of partnership. A set of Joint Monitoring Indicators, negotiated by the Government and its development partners across major sectors and reform programmes, provides for results-based mutual accountability.

Cambodia had officially established programme-based approaches as its priority approach for implementing sector strategies and core reforms in November 2010 as a mechanism to promote national ownership of development programmes; ensure coherent programming of resources; strengthen national capacities and systems; and, most importantly, deliver development results.[c]

According to the Government's assessment, the extended use of programme-based approaches since 2010 has yielded several important developments:

(i) greater harmonization of development cooperation, with establishment of a common strategy and programming framework for all development partners, bringing improved alignment and strengthened country ownership;

(ii) more opportunities for refining institutional coordination arrangements, which have promoted more effective dialogue with all development partners and actors and improved implementation of reforms, such as public financial management, through strengthening and use of country systems;

(iii) development of more robust and inclusive multi-stakeholder partnerships involving different line ministries of government, bilateral and multilateral development agencies, civil society organizations, the private sector and regional actors, including Southern partners;

(iv) an increased focus on results and mutual accountability.

These developments have collectively contributed to strengthened capacities of national institutions and mechanisms for managing development cooperation.

a Available from http://cdc-crdb.gov.kh/cdc/documents/Sector_Strategy/14_Partnership_Harmonization/Final_DCPS_2014_2018_EN.pdf.

b Available from http://cdc-crdb.gov.kh/cdc/documents/NSDP_2014-2018.pdf.

c Please refer to RGC concept Note (October 2010): http://cdc-crdb.gov.kh/cdc/pba/pba_concept_note_en.pdf.

17 United Nations (2016). National mutual accountability and transparency in development cooperation: Study on the findings of the Fourth DCF Survey. Available from: https://www.un.org/ecosoc/sites/www.un.org.ecosoc/files/files/en/dcf/dcf-accountability-study-v4.pdf

partially achieved: while 85 per cent of their new projects and programmes have objectives aligned to national priorities, only 62 per cent of results indicators are drawn from country-led results frameworks, and only 50 per cent align with their monitoring and evaluation systems.[18]

Well-performing public financial management and procurement systems ensure that spending on national priorities translates into development progress. Country performance in strengthening public financial management systems is mixed, however. Overall, 51 per cent of development cooperation disbursements to the public sector used country systems in 2015, compared to 45 per cent in 2010.

Moving from planning to "managing for results" also remains a challenge for countries and their development partners. Country results frameworks monitor development cooperation against national development priorities, linked to global sustainable development objectives. Countries need to further strengthen their results-based budgeting, monitoring and evaluation systems. On the other hand, while development partners have aligned with existing country systems in the planning phases, they need to extend this to monitoring and evaluation, including relying on countries' own monitoring indicators and sources of data, and carrying out joint evaluations with Governments.

In this context, the 2016 QCPR of the United Nations General Assembly guides the United Nations development system to strengthen its support to national institutions in planning, management, statistical and evaluation capacities. The 2016 QCPR also lays the foundation for making the United Nations development system fit to support the implementation of the 2030 Agenda for Sustainable Development, and requests the Secretary-General to include options for better aligning funding modalities with its functions, including by incentivizing the system to work together as a whole. At the same time, the United Nations system is moving to implement a more coherent approach on the ground through strengthening the Delivering as One agenda.

Development cooperation is a central aspect of the broader financial and policy landscape that provides the means for implementing national sustainable development strategies. All financing sources and policies have to be considered in what the Addis Agenda calls "integrated national financing frameworks". Strengthening these frameworks will be imperative, along with increases to the volume of international public finance and allocation of that financing to priority groups of countries.

18 GPDEC (2016). *Making Development Co operation More Effective. 2016 Progress Report*. Available from: http://www.undp.org/content/undp/en/home/librarypage/development-impact/making-development-co-operation-more-effective--2016-progress-re.html

Chapter III.D

International trade as an engine for development

1. Key messages and recommendations

As noted in the Addis Ababa Action Agenda, international trade is an engine for inclusive economic growth and poverty reduction, and is a means of implementation for the Sustainable Development Goals (SDGs). It has been a significant source of public and private finance in developing countries. The decades before the 2008 global financial and economic crisis saw significant expansion in world trade. During this period, rapid trade growth contributed to a steady improvement in many countries' income generating capacity, which helped reduce extreme poverty. More recently, however, trade growth has slowed significantly, as outlined in chapter I. Faced with the current challenging scenario in international trade, the trade-related commitments in the Addis Agenda—which include measures to strengthen the multilateral trading system, facilitate international trade, and promote policy coherence in trade—take on new importance.

It is important to recognize that trade has distributional effects. To contribute to the SDGs, trade must become more inclusive and beneficial to all, and create wealth and decent jobs, especially for the poor. ***Governments should work together to resist inward-looking and protectionist pressures, and to ensure that the benefits of trade are spread more widely and equitably. International institutions should work with Governments to address any distributional effects of international trade and trade agreements and promote world trade growth that is consistent with the SDGs.***

Increased uncertainty in world trade disproportionately harms least developed countries (LDCs) and small economies. Governments should work towards improving market access conditions for the exports of LDCs, landlocked developing countries (LLDCs) and small island developing States (SIDS) by reducing the trade costs facing them and simplifying and harmonizing preferential rules of origin. In addition, increasing Aid for Trade aimed at value addition and economic diversification can contribute.

To date, small and medium-sized enterprises (SMEs) are not benefiting sufficiently from the international trading system. ***Governments, with support from the international community where necessary, should ensure that SMEs have access to adequate and affordable trade finance, including by reducing limitations that hinder access, increasing the size of publicly backed trade finance programmes where possible, increasing capacity-building and support in the local banking sector, and maintaining an open dialogue with trade finance regulators.***

Higher wages for female employees are likely to have knock-on effects on the wider economy. Women's participation in international trade supports several SDGs, but has been constrained by a number of challenges. ***To further efforts to address the constraints on women's participation in trade, the international community should work collaboratively to enhance the availability of gender-disaggregated economic and social data in this field.***

Non-regulated trade can undermine the livelihoods of people, species and ecosystems. Governments should collectively reduce non-regulated trade such as poaching and trafficking of protected species and hazardous waste, among others.

The Eleventh World Trade Organization (WTO) Ministerial Conference will be held in Bue-

nos Aires, Argentina, in December 2017. A positive outcome will help affirm the importance of the multilateral trading system. Discussions on the issues that can inform the ministerial decisions of the conference are ongoing. ***WTO members should take action on issues that are linked with the implementation of the SDGs, including public stockholding for food security, reductions on domestic support in agriculture, and the prohibition of certain fishery subsides that cause overfishing and overcapacity as called for in the Addis Agenda. The outcome of the United Nations Oceans Conference in June 2017 should provide impetus towards agreement on fishery subsidy disciplines at the WTO***.

An enabling environment for inclusive trade growth calls for policy coherence at all levels. In the Addis Agenda, Member States committed to strengthen the coherence and consistency among bilateral and regional trade and investment agreements, and to ensure they are compatible with WTO rules. Regulatory harmonization, often sought through free trade agreements (FTAs), can offer benefits. ***Governments should reduce the potential for regulatory measures in the areas of food, health, environment, and labour policies to inadvertently act as non-tariff barriers to exports from developing countries.*** The Addis Agenda also commits to strengthen the role of the United Nations Conference on Trade and Development (UNCTAD) as the focal point within the United Nations system for the integrated treatment of trade and development, and interrelated issues in the areas of finance, technology, investment and sustainable development.

2. Strengthening the multilateral trading system

The Addis Agenda states that increasing trade's contribution to economic growth and poverty reduction requires a universal, rules-based, open, transparent, predictable, inclusive, non-discriminatory and equitable multilateral trading system. The members of the WTO have delivered a range of important agreements in this context in the last few years.

2.1 Multilateral actions that support the SDGs

At the Tenth WTO Ministerial Conference in Nairobi in December 2015, WTO members agreed to abolish export subsidies on farm products, which is highly relevant to SDG 2, Zero Hunger.

In support of SDG 3, Good Health and Well-Being, an amendment to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) entered into force on 23 January 2017, as called for in the Addis Agenda. This amendment makes it easier for poor countries to obtain less expensive generic versions of patented medicines. Developing countries and LDCs who have accepted the amendment now benefit from a secure legal pathway to access affordable medicines according to WTO rules.

At the end of February 2017, the Trade Facilitation Agreement (TFA), agreed at the Ninth WTO Ministerial Conference in Bali in December 2013, also entered into force. This agreement aims to cut trade costs; expedite the movement, release and clearance of goods; and promote effective cooperation among members on trade facilitation and customs compliance, as discussed in more detail in the next section.

2.2 Trade-restrictive and trade-facilitating measures

Recent global policy uncertainty surrounding international trade has not yet increased the level of trade protection under the multilateral trading system. The number of new trade-restrictive measures initiated during the first 10 months of 2016 was more or less the same as in the previous years (figure 1). According to the November 2016 overview of developments in the international trading environment, WTO members introduced 182 new trade-restrictive measures for the period between mid-October 2015 to mid-October 2016, or an average of about 15 measures per month.[1] While this represents a reduction in the monthly figure compared to the recent peak in 2015, it is actually a return to the trend level for new trade restrictions since 2009.

1 See https://www.wto.org/english/news_e/news16_e/trdev_09dec16_e.htm.

Of the 2,978 trade-restrictive measures recorded for WTO members since 2008, only 740 had been removed by mid-October 2016. The overall stock of measures has increased by almost 17 per cent compared to the previous annual overview, with the total number of restrictive measures still in place now standing at 2,238. The rollback of trade-restrictive measures recorded since 2008 remains slow, and continues to hover just below 25 per cent, while the recorded monthly average of trade-remedy (i.e., anti-dumping, countervailing duty measures, and safeguard actions) investigations by WTO members was the highest since 2009. Nonetheless, WTO members also continued to adopt trade-facilitating measures, implementing an average of 18 measures per month, slightly above the average in the period 2009-2015. These include a number of import-liberalizing measures implemented in the context of the expanded Information Technology Agreement.

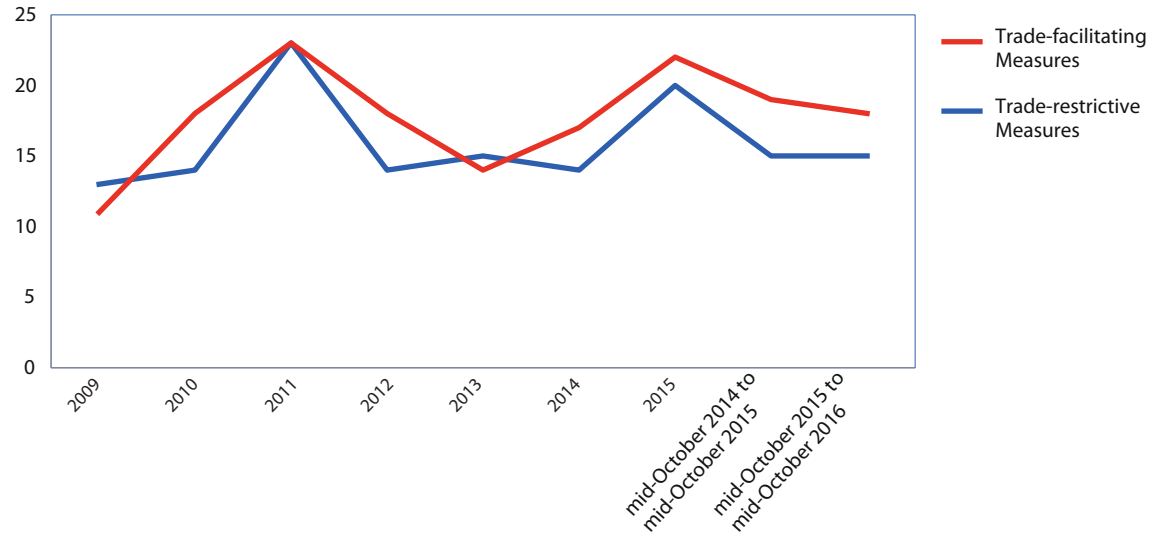
2.3 Market access conditions facing LDCs

Market access conditions facing exports of LDCs have remained steady. LDCs receive full or significant duty-free and quota-free market access conditions from most developed countries (figure 2). A total of six other WTO member countries have also notified the WTO secretariat that they grant preferential market access to LDCs, although the scope and coverage of such preferences vary.

In reality, not all exports from LDCs take advantage of the preferences being accorded, largely due to the complexity associated with compliance with strict rules-of-origin requirements. The Nairobi Ministerial Decision on Preferential Rules of Origin for LDCs[2] builds on the earlier 2013 Bali Ministerial Decision by providing more detailed directions on specific issues, such as methods for determining when a product qualifies as "made in an LDC", and when inputs from other sources can be cumulated — or combined together — into the consideration of origin. The provisions also call on preference-granting members to consider simplifying documentary and procedural requirements related to origin as well as other measures to further streamline customs procedures.[3] In March 2017, the WTO secretariat presented to the Committee on Rules of Origin a preliminary estimate of prefer-

Figure 1

WTO trade-restrictive and facilitating measures, excluding trade remedies, 2009 – 2016 (*Average per month*)

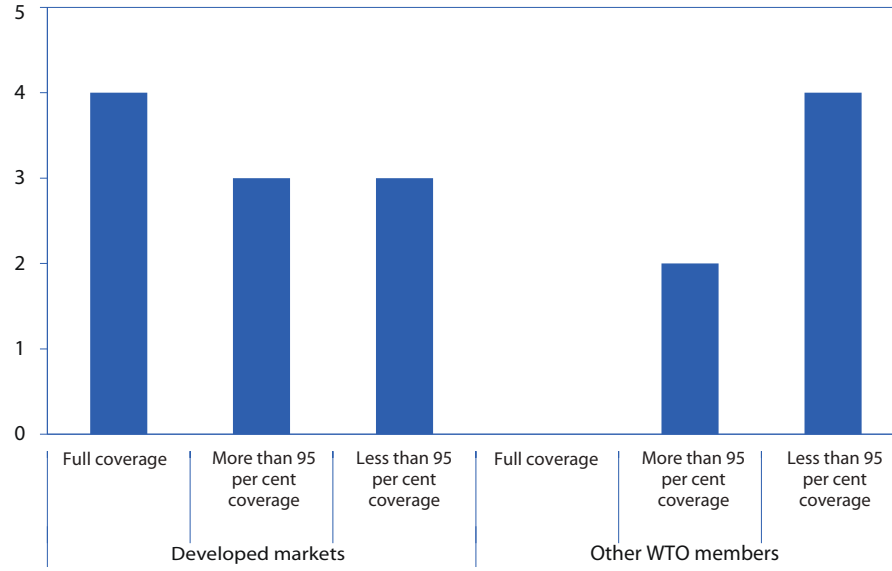


Source: WTO secretariat.

2 WT/L/917/Add.1

3 WTO (2016). Overview of Developments in the International Trading Environment, http://www.wto.org/english/news_e/news16_e/trdev_09dec16_e.htm.

Figure 2
Duty-free coverage in generalized schemes of preferences, 2016 (*Number of WTO members*)



Source: WTO secretariat.
Note: The European Union is considered a single market by the WTO. Switzerland and Liechtenstein form a customs union.

ence utilization granted to products exported from LDCs in the year 2015.[4] The estimate was made on the basis of data from the WTO notifications of nine preference-granting countries, both developed countries and other WTO members. The estimate was made using a methodology proposed by the WTO secretariat to the Committee,[5] in which "the share of those imports that have reportedly benefited from a preferential duty scheme [is] compared to those imports on tariff lines eligible for preferential duty treatment". The preliminary estimate suggests that the average rate of preference utilization ranges from 8 per cent to 88 per cent across preference-granting countries, and between 12 per cent and 55 per cent across 19 productive sectors.

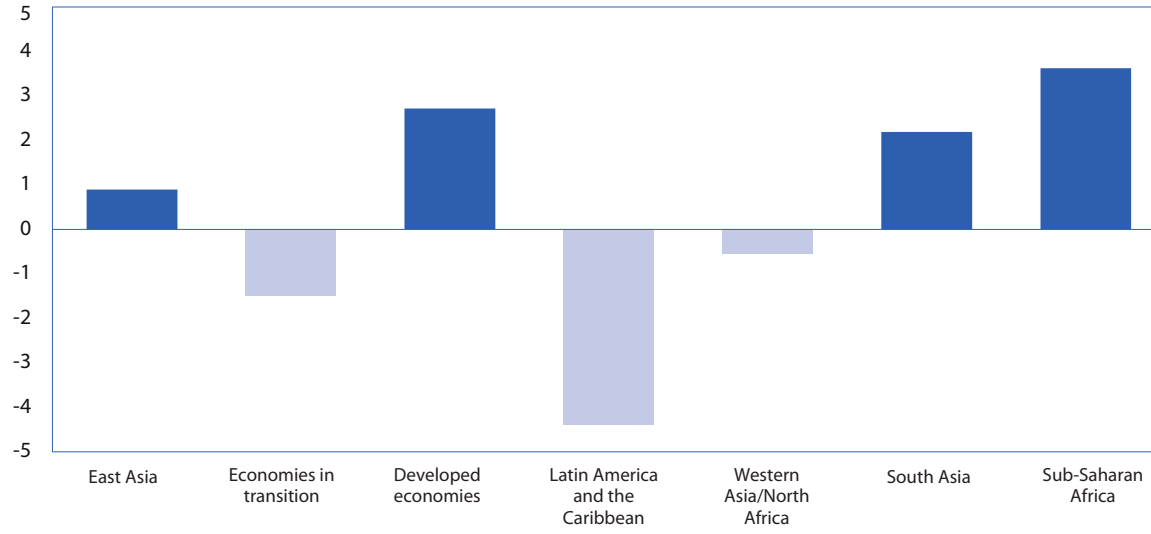
Another potential hindrance to the real value of preferences granted to LDCs arises from the fact that a large share of international trade today takes place under bilateral, regional or inter-regional FTAs. The real value of preferential tariff margins enjoyed by LDCs should be assessed against market access conditions provided to other exporting countries through bilateral or regional FTAs. In 2015, the relative preferential margin LDCs enjoyed in developed-country markets was, on average, 3 percentage points vis-à-vis tariff rates applied to non-LDC exporters (figure 3). As regards developing-country markets, the relative preferential margins vary considerably among LDCs, ranging from 3.6 per cent in sub-Saharan Africa to -4.4 per cent in Latin America and the Caribbean, indicating that LDC exports to this region face a tariff rate that is, on average, 4.0 per cent higher than other competing exporters to the region.

3. Facilitating international trade

The Addis Agenda calls for actions by the international community towards increasing developing countries' participation in international trade in a manner consistent with sustainable development objectives. Key areas of action suggested by the Addis Agenda include support to increasing developing countries' value addition in trade, and measures to enhance inclusive trade growth such as increasing trade finance, Aid for Trade and trade-facilitation measures.

4 G/RO/W/168.
5 G/RO/W/161.

Figure 3
Average relative preferential margins facing LDCs, 2015 (*Percentage*)



Source: UNCTAD Key Statistics and Trends in Trade Policy 2016.
Note: Countries classified according to the United Nations World Economic Situation and Prospects, https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/2017wesp_annex_en.pdf

3.1 Growth and diversification of developing countries' exports

Developing countries' share in world merchandise trade steadily increased in the past couple of decades, rising from 29 per cent in 2001 to 42 per cent in 2015, always maintaining an overall trade surplus vis-à-vis the world. In the recent global trade slow-down described in chapter I, however, developing countries' year-to-year merchandise export growth declined to about 0.1 per cent, compared to 3.0 per cent between 2006 and 2010, and 1.9 per cent between 2010 and 2013. In world services trade, developing countries' share continues to grow, reaching 31 per cent of world services exports—or 39 per cent of world imports—in 2015.

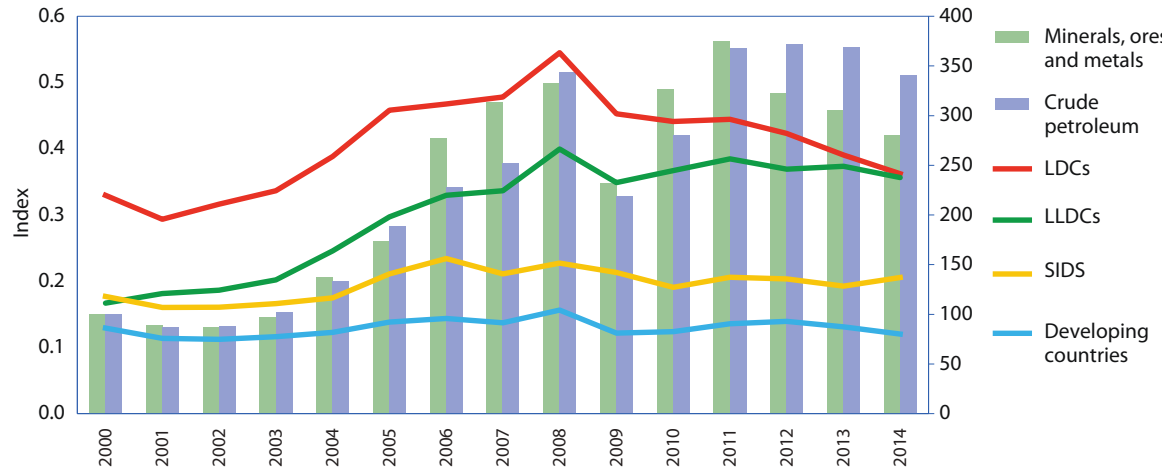
As regards LDCs, the 2011-2020 Istanbul Programme of Action for LDCs, the Addis Agenda and SDG target 17.11 pledged to double the LDC share in global exports by 2020. However, the LDC share in world merchandise exports actually decreased from 1.1 per cent to 0.9 per cent between 2011 and 2015. Much of this change may be explained by a recent fall in the commodity prices, as many LDC exports are concentrated in a small number of primary commodities such as minerals, ores and fuels. As regards services, the LDC share remains small, at 1.7 per cent of world services imports and less than 1.0 per cent of world services exports.

Beyond the quantitative trade growth, the Addis Agenda pays particular attention to developing countries' need to increase value addition in their exports—that is, to diversify from the commodity sectors to the manufacturing and processing sectors. There is not much positive news on this front. Between the years 2000 and 2014, the degree of export concentration in developing countries remained at about 0.2 (figure 4). The export concentration index of LDCs and LLDCs was much higher and moved in tandem with the changes in the world commodity prices; during the period of rising commodity prices (between 2003 and 2008), the rate of export concentration of these countries significantly increased, from 0.3 to 0.5 in the case of LDCs and from 0.2 to 0.4 for LLDCs.

3.2 Actions to enhance inclusiveness in trade

The Addis Agenda also recognizes the importance of inclusiveness in trade growth. This requires increased participation of SMEs in world trade. According to the World Bank Enterprise Surveys, SMEs accounted for over 60 per cent of formal

Figure 4
Export concentration index and commodity price indices, 2000 – 2014 *(Index between 0 and 1, price indices 2000=100)*



Source: UNCTADstat database.

non-agricultural private employment, yet their participation in international trade is still limited.[6] The WTO World Trade Report 2016 estimates that, in developing countries, exports account for less than 8 per cent of total sales of SMEs in the manufacturing sector, compared to 14 per cent for large enterprises.[7] As essential global actions towards enhancing the effective participation of SMEs in international trade, the Addis Agenda encourages actions by the international community on measures such as trade finance, Aid for Trade, and trade facilitation.

The 2016 edition of the *Global Survey on Trade Finance* by the International Chamber of Commerce indicates that trade finance is one of the main impediments for SMEs in developing countries trying to participate in international trade.[8] Access to finance is a general problem for SMEs, as discussed in chapter III.B. It is estimated that up to 80 per cent of global trade is supported by some sort of financing or credit insurance.[9] However, the 2008 world financial and economic crisis reduced the availability and accessibility of trade finance to SMEs. The lack of adequate trade finance is particularly acute in Africa and developing Asia. The global excess demand for trade finance is estimated to be as high as $1.6 trillion in 2015.10 The 2016 report by the WTO, *Trade finance and SMEs: Bridging the gaps in provision,* emphasizes the importance of multilateral agencies working together in response and provides a set of recommendations for addressing the gap in trade finance provision.[11]

The Aid for Trade initiative, launched at the Sixth WTO Ministerial Conference in Hong Kong in 2005, focuses on supporting developing countries, particularly LDCs, in building trade capacity, enhancing their infrastructure and improving their ability to benefit from trade opening opportunities. Figures from the Organization for Economic

6 See http://www.enterprisesurveys.org/.
7 See https://www.wto.org/english/res_e/booksp_e/world_trade_report16_e.pdf.
8 See http://www.iccgermany.de/fileadmin/user_upload/Content/Banktechnik_und_-praxis/ICC_Global_Trade_and_Finance_Survey_2016.pdf.
9 JaeBin Ahn (2011). *A Theory of Domestic and International Trade Finance*, IMF Working Papers 11/262, International Monetary Fund).
10 Asian Development Bank (2016). *Trade Finance Gaps, Growth, and Jobs Survey.*
11 See https://www.wto.org/english/res_e/booksp_e/tradefinsme_e.pdf.

Cooperation and Development (OECD) suggest that Aid for Trade disbursements totalled $333.1 billion for the period 2006-2015. A little more than half of this total ($174.7 billion) has been disbursed for projects related to infrastructure development. Disbursements to LDCs have grown steadily, starting from $5.4 billion annually in 2006 and reaching $11.7 billion in 2015, an increase of $1.2 billion on 2014.

The 2015 Fifth Global Review of Aid for Trade found that high trade costs, including tariffs, transport costs and regulatory costs notably related to border clearance, are a significant barrier to many developing countries and LDCs, and in particular LLDCs and SIDS. The burden of trade costs also falls disproportionately on the agriculture sector and micro, small and medium enterprises.

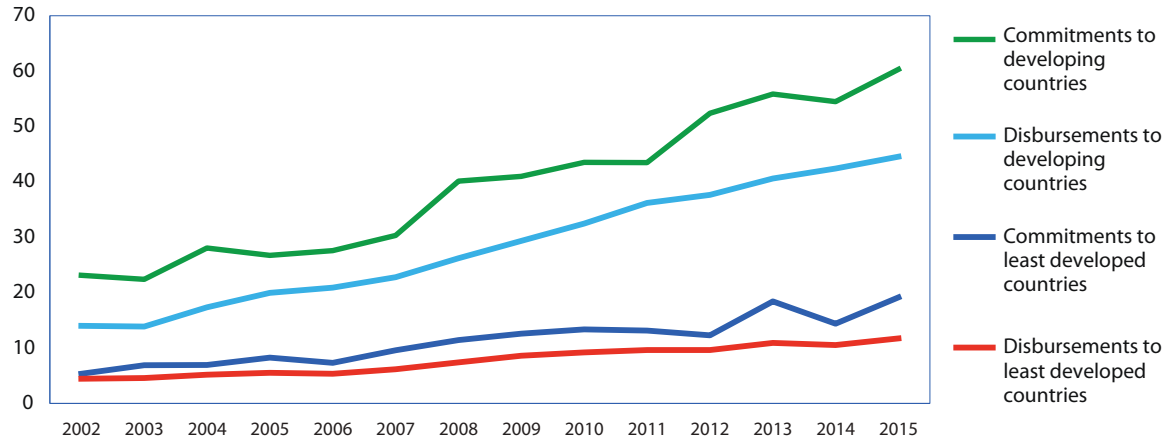
The 2016-2017 Aid for Trade work programme aims to expand this analysis of physical trade costs to consider how digital connectivity can promote the inclusion of developing countries and their firms in international markets, and how it intertwines with other forms of physical connectivity. The 2017 Global Review of Aid for Trade is scheduled for 11-13 July 2017, with the theme of "Promoting Connectivity". It will showcase the results of an extensive monitoring and evaluation exercise that includes more than 300 replies from a diverse range of different stakeholders.

The Enhanced Integrated Framework (EIF) is the only global Aid for Trade programme dedicated to addressing the trade capacity needs of LDCs. Based on partnership among LDCs, the donor community and international agencies, the EIF provides a global framework for the coordination and delivery of Aid for Trade to LDCs. The EIF Phase Two started in January 2016. So far, the multi-donor trust fund of the EIF Phase Two has received pledges of $90 million from 15 donors, which accounts for one third of the required budget for the full duration of the programme (2016-2022).

3.3 Trade Facilitation Agreement

The Addis Agenda calls on WTO members to fully and expeditiously implement the Ministerial Declarations and Decisions agreed at the Ninth WTO Ministerial Conference in Bali in 2013. One of the major components of the Bali Package is the TFA. Having obtained the necessary number of acceptance instruments, the TFA entered into force on 22 February 2017. The TFA prescribes measures to improve transparency and predictability of trading across borders and create a less discriminatory business environment. The agreement also contains measures for effective cooperation on trade facilitation and customs compliance issues between customs and other authorities.

Figure 5
Aid for Trade commitments and disbursements, 2002 – 2015 (*Billions of constant 2014 United States dollars*)



Source: OECD, Creditor Reporting System.

The *World Trade Report 2015* of the WTO estimated that, once the TFA is fully implemented, developing countries would increase the number of products exported by as much as 20 per cent (35 per cent for LDCs).[12] Recognizing capacity constraints faced by developing countries, the TFA allows developing countries to set their own timetables for implementation, and allows them to designate certain provisions as requiring acquisition of capacity through technical assistance and capacity building. A Trade Facilitation Agreement Facility was created at the request of developing and least developed countries to help ensure they receive the assistance needed to reap the full benefits of the TFA, and to support the ultimate goal of full implementation of the new agreement by all members.[13]

4. Promoting policy coherence in trade

International trade provides developing countries with opportunities for economic growth. Maximizing trade's contribution to sustainable development in all three dimensions of sustainable development—economic, environmental and social—requires complementary actions at the national level, and policy coordination at the regional and international levels.

4.1 National level actions

At the national level, the Addis Agenda calls for policy actions that are complementary to trade policy changes, with a view to supporting households and businesses to capture economic opportunities arising from trade. Trade policy per se will not effectively address socioeconomic challenges, such as those arising from trade liberalization. Far-reaching and cross-cutting policy responses are needed, touching on aspects of education, skill development, and improved adjustment support for the unemployed. Domestic policies play a key role in creating a better, more inclusive economic model, including by ensuring that the gains of trade are better shared across society.

Gender equality and women's socioeconomic empowerment also requires coordinated policy actions at the national level. The Addis Agenda calls for gender mainstreaming in the formulation and implementation of all financial, economic, environmental and social policies, including facilitating women's equal and active participation in domestic, regional and international trade. The NTM Business Survey conducted by the International Trade Centre indicates that the share of firms owned or managed by women range between 10 per cent and 30 per cent across productive sectors, with female employment skewed towards the textile and clothing sectors (figure 6).[14]

Increasing export participation by women-owned businesses can help address gender-based wage gaps and reduce inequalities. The average wage paid by exporting women-owned businesses is approximately 1.6 times higher than the average wage at non-exporting women-owned businesses. This "exporter premium" is larger than the equivalent premium for male-owned businesses. Higher wages for female employees are likely to have knock-on effects on the wider economy, given that women in developing countries tend to have a higher propensity than men to invest in their families and in the community at large.

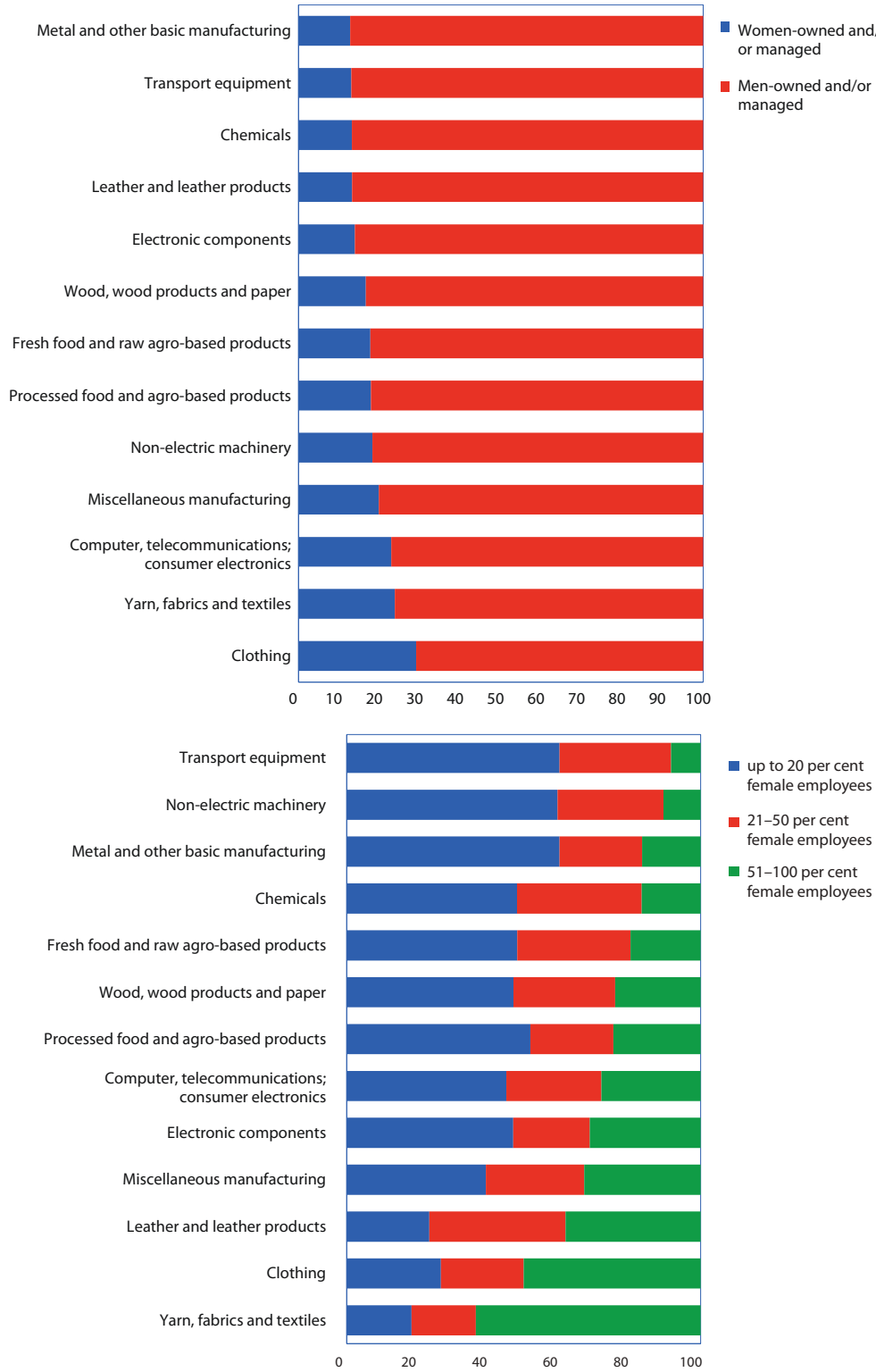
4.2 Regional level actions

The Addis Agenda highlights the importance of regional economic integration to the promotion of inclusive growth and sustainable development via, inter alia, strengthening regional economic cooperation. Several initiatives have been taken to assess the degree of regional integration. An excellent example is the Africa Regional Integration Index, a joint initiative by the African Union, the African Development Bank and the United Nations Economic Commission for Africa, which provides an online tool for assessing regional integration in Africa.[15] According to the 2016 report on the Index, the trade dimension demonstrates the highest integration score while the financial and macroeconomic dimension shows the

12 See https://www.wto.org/english/res_e/publications_e/wtr15_e.htm.
13 See http://www.tfafacility.org/notifications.
14 See http://ntmsurvey.intracen.org/home.
15 See https://www.integrate-africa.org/fileadmin/uploads/afdb/Documents/ARII-Report2016_EN_web.pdf.

Figure 6

Share of women in exporting companies, by economic sectors, 2010 – 2015 (*Percentage*)



Source: NTM Business Survey, 2010–2015, www.ntmsurvey.org.

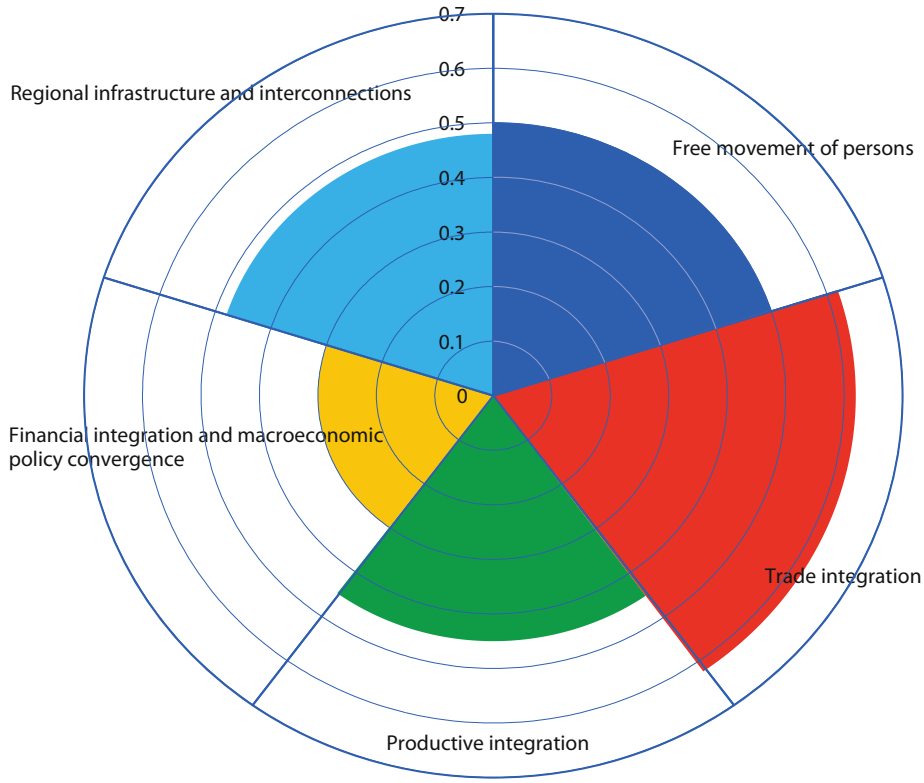
lowest, partly due to the current limitation in ensuring the convertibility of currencies in some countries (figure 7). The Economic and Social Commission for West Asia (ESCWA) secretariat proposed an Arab Common Citizens Economic Security Space (ACCESS) to further regional integration.[16] ESCWA Member States stressed the importance of efforts and initiatives to enhance regional integration by developing an Arab customs union and promoting a common Arab market to establish an Arab development space that employs Arab economic security in facing sustainable development financing challenges.[17]

4.3 International level actions

The current downturn in global trade and investment is also taking place amid a rise in anti-globalization discourse in some countries and communities, some of whom do not benefit from trade or fear economic disruption from it. It is important for the international community to acknowledge this sentiment and address its causes. Trade is an enormous force for development and economic empowerment, but the case for this has to be made coherently by Governments and international institutions.

International cooperation in international trade is also required when non-regulated trade can undermine the livelihoods of people, species and ecosystems. In this respect, the Addis Agenda encourages global support for efforts to combat poaching and trafficking of protected species, trafficking in hazardous waste, and trafficking in minerals, and for increasing the capacity of local communities to pursue sustainable livelihood opportunities, among others. The Convention on International Trade in Endangered Species (CITES) collects baseline data

Figure 7
African regional integration (*Index*)



Source: The Africa Regional Integration Index.

16 ESCWA (2016). *Arab Development Outlook: Vision 2030 Report*.
17 E/ESCWA/29/12/Report.

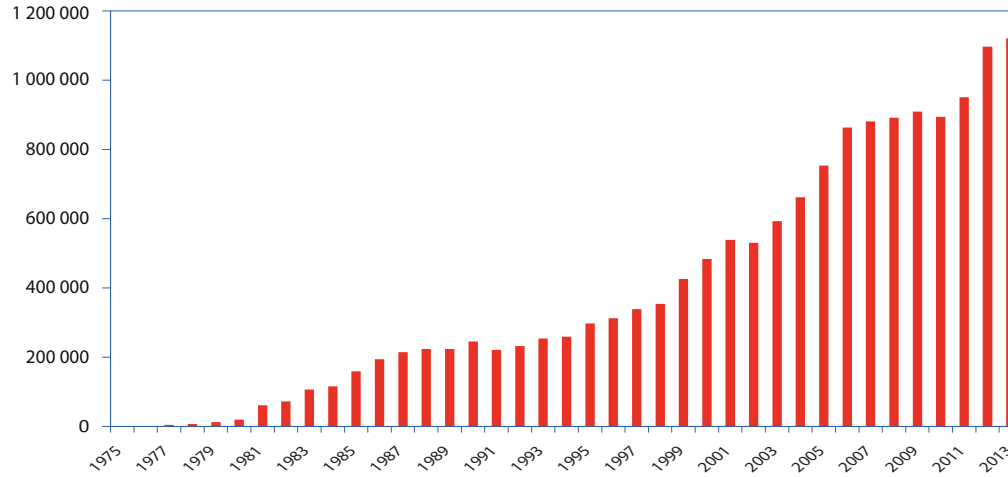
on legal trade transactions in CITES-listed species (figure 8) in the 183 Parties of CITES.[18] CITES Parties will also begin the submission of annual illegal trade reports from 2017. Data on illegal trade (seizures) is currently compiled by the United Nations Office on Drugs and Crime (UNODC) in World WISE, a new data platform that contains seizures related to wildlife crime, including illegal logging, from 120 countries.

The Donor Roundtable on Wildlife and Forest Crime—established in 2015 and comprising CITES, the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP), UNODC, and the World Bank Group, among others—commissioned a study to analyse multilateral, bilateral and other international funds committed by donors to directly address the illegal wildlife trade crisis.[19] It found that a total of $1.3 billion was committed by 24 international donors between 2010 and June 2016, funding 1,105 projects in 60 different countries and various regional and global projects, with 63 per cent of the funds going towards efforts in Africa and 29 per cent to Asia.

At UNCTAD14 (July 2015), 90 countries granted support to the UNCTAD-FAO-UNEP Joint Statement that called for increased transparency on all fishery subsidies and prohibition of subsidies that contribute to overfishing and overcapacity, among other concerns.[20] At the WTO, there has been an increasing debate over whether control over fishery subsidies could be a potential deliverable of the Eleventh WTO Ministerial Conference in Buenos Aires. The United Nations Oceans Conference, planned for June 2017, which will discuss implementation of SDG 14 on life below water, may also provide impetus towards an agreement on fishery subsidy disciplines.

Figure 8

Total number of recorded legal trade transactions in CITES-listed species, 1975 – 2013



Source: CITES trade database.

18 See https://trade.cites.org/.

19 The study was undertaken by the Global Wildlife Program, a World Bank led global partnership, available from http://documents.worldbank.org/curated/en/695451479221164739/Analysis-of-international-funding-to-tackle-illegal-wildlife-trade.

20 See http://unctad.org/meetings/en/SessionalDocuments/U14ditc_d16_FishSub_Statement_en.pdf.

Chapter III.E

Debt and debt sustainability

1. Key messages and recommendations

Global gross public and private debt of the non-financial sector reached a record high in 2015, showing the continued risks of high leverage, largely due to increases in public debt and continued high levels of private debt. Changes in the composition of debt—including elevated levels of corporate debt in a number of emerging market economies and the rising trend in short-term debt—pose additional risks to an already fragile global economy. In developing countries, although debt ratios remain significantly below their levels in the early 2000s, debt levels have shown a rising trend of late. A much less favourable external environment, the impact of the 2008 world financial and economic crisis, and other risks such as commodity price shocks and an increase in bond issuances in frontier markets—have contributed to renewed increases in aggregate debt ratios and risks to debt sustainability in a number of countries, including some least developed countries (LDCs) and small island developing States (SIDS).

Rising levels of domestic debt also highlight the importance of public debt sustainability assessments. To effectively carry out such assessments, ***it is important to improve the comprehensiveness, reliability, and timeliness of domestic and external debt data, as well as data on government assets and contingent liabilities.***

Assisting developing countries "through coordinated policies aimed at fostering debt financing, debt relief, debt restructuring and sound debt management, as appropriate"[1] is thus as urgent as ever. Indeed, the goal of debt sustainability has been one of the salient features of the financing for development process, which recognizes borrowing, both by governments and private entities, as an important tool to finance sustainable development investments.

While there has been notable progress in a number of areas, implementation of this policy agenda remains incomplete. The focus to date has been on sovereign debt management, debt crisis prevention and on market-based solutions for sovereign debt restructuring. International organizations are providing technical assistance for upstream and downstream debt management. Debtor-creditor engagement issues are under discussion, including in the context of the International Monetary Fund (IMF) revisions of its lending-into-arrears (LIA) policy. There is also work in the United Nations toward a platform for debtor-creditor engagement between sovereigns and their private creditors, which should be taken forward. Separately, the IMF is also working on improving information on sovereign debt restructurings. Bilateral official and multilateral creditors have set up new facilities to provide debt relief in the event of natural or public health disasters.

There is also renewed interest among policy makers in state-contingent debt instruments. However, establishing investor confidence in these instruments remains a challenge. ***A case can be made for public creditors to increase the use of state-contingent instruments in their lending, building on existing experiences by some donors.***

With regard to private creditors, significant progress has been made in incorporating enhanced collective action and *pari passu* clauses in sovereign bond contracts, with the stock of bonds without clauses beginning to decline, albeit slowly. The

1 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 94. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

importance of providing "breathing space" to a sovereign at the time of debt distress has been highlighted in the policy debate, but remains to be fully addressed. In addition, work on contractual technology for bank loans is lagging behind. While the share of bond debt in total debt has increased over time, for many developing countries commercial bank loans remain the pre-dominant source of external financing. In this context, ***further work on commercial bank loan contracts is thus warranted.*** In a new development, a few jurisdictions have passed or debated legislation to discourage hold-out creditors in a bond debt restructuring by limiting creditors' potential profits from secondary market purchases. Yet, significant concerns surround the operation of creditors buying distressed debt on secondary markets, and whether their activity may go beyond the desirable function of providing market liquidity. ***Further policy actions to deal with hold-out creditors in a debt restructuring should be considered***.

Concerns remain both over the efficiency and equity of these solutions. In the Addis Agenda, countries committed to work toward a global consensus on guidelines for debtor and creditor responsibilities, building on existing initiatives, such as the United Nations Conference on Trade and Development (UNCTAD) principles for responsible borrowing and lending. This work is continuing, including in the United Nations and the Group of Twenty (G20). ***The ECOSOC Forum on Financing for Development follow-up could be a useful forum to take up these discussions, in continued cooperation with the international financial institutions, in particular the IMF, relevant United Nations entities, including UNCTAD, and other relevant entities.***

2. Debt trends

Global gross debt of the non-financial sector reached $152 trillion, or 225 per cent of world gross product, in 2015,[2] two thirds of which are liabilities of the private sector. One of the triggers of the 2008 world financial and economic crisis was the build-up of excessive debt and leverage in the private financial sector in many advanced economies. Following the crisis, their public debt increased significantly, partly due to the realization of contingent liabilities and bank bailouts. Progress on private sector deleveraging has been uneven. If global growth remains subdued, debt servicing and deleveraging will remain challenging for highly indebted countries and could in turn weigh on growth prospects, including in those parts of the euro area characterized by balance-sheet weaknesses.

In developing countries, external-debt-to-GDP ratios declined since the early 2000s and until the 2008 world financial and economic crisis, due to prepayment of debt by some middle-income countries, rapid growth, and debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI). Their overall debt situation remains relatively benign, but debt has recently increased in some cases and the ratio of short-term debt to total external debt is on a rising trend in PRGT-eligible countries, raising additional risks (see online annex).

Declines in export revenue and widening fiscal deficits in the context of slow growth — and, in some cases, commodity price declines — have led to greater demand for external financing and increases in external-debt-to-GDP ratios in low-income countries and LDCs (figure 1). In SIDS, some of which have been caught in debt difficulties for many years,[3] average debt-to-GDP ratios increased from 27 per cent in 2008 to 45 per cent in 2016. Assessing debt sustainability through aggregate indicators can conceal risks in individual countries, however. In five SIDS, external debt-to-GDP ratios rose by 40 percentage points or more over this period. The 20 low- and lower-middle-income countries with the largest increases in debt saw their external debt-to-GDP ratios increase by almost 27 percentage points on average between 2010 and 2015.[4]

2 International Monetary Fund (2015). *Global Financial Stability Report October 2015*. Available from http://www.imf.org/external/pubs/ft/gfsr/2015/02/pdf/c3_v2.pdf.

3 See, for example, United Nations. *MDG Gap Task Force Report (2015) Taking Stock of the Global Partnership for Development* (United Nations publication, Sales No. E.15.I.5.) Available from http://www.un.org/millenniumgoals/pdf/MDG_Gap_2015_E_web.pdf.

4 See online annex. Available from http://www.developmentfinance.un.org.

Figure 1.a
External debt of low-and-middle income countries, weighted averages, 2000 – 2016
(*Percentage of GDP*)

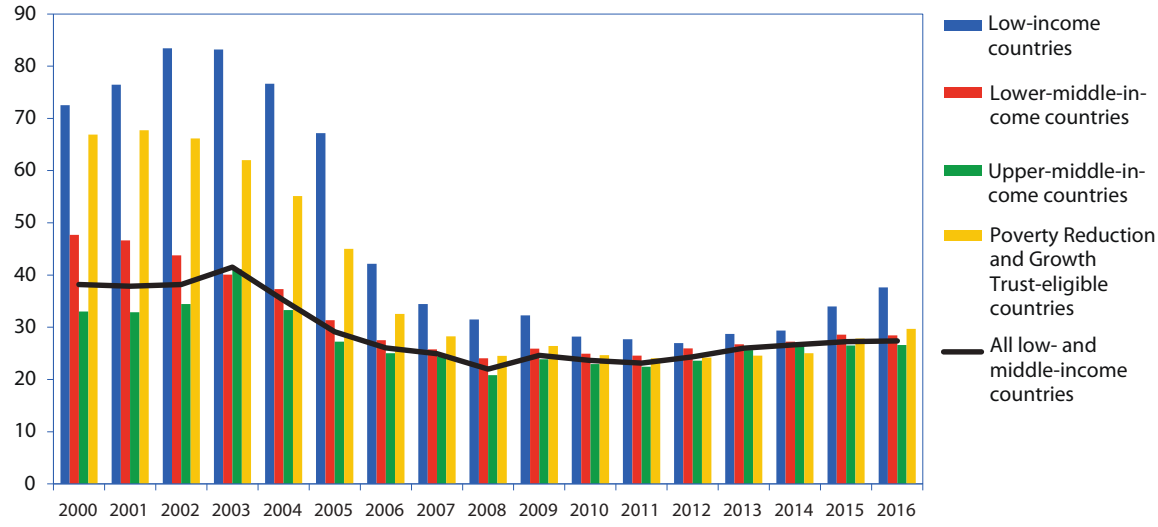
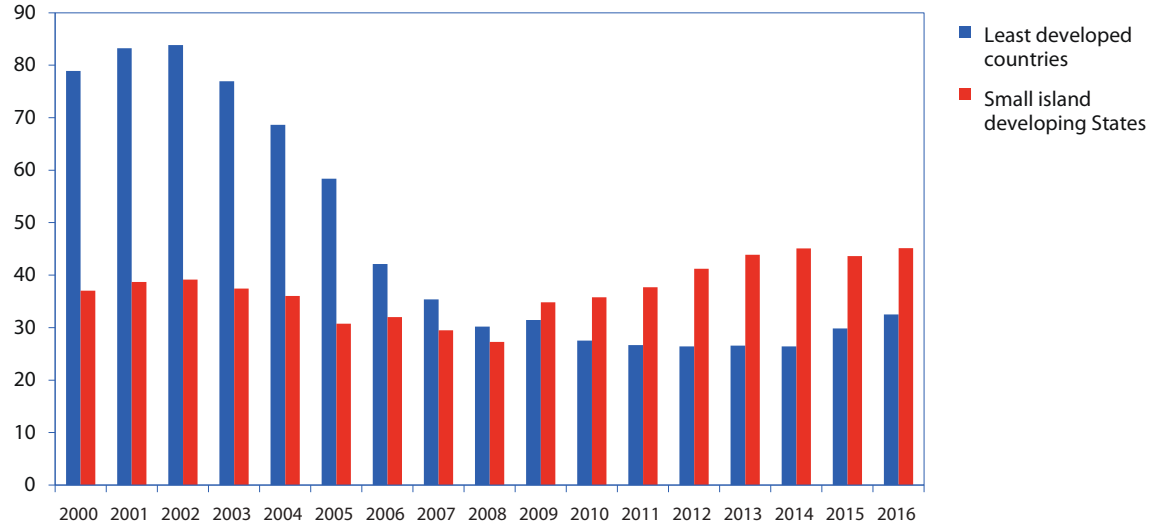


Figure 1.b
External debt of least developed countries and small island developing States, weighted averages, 2000 – 2016 (*Percentage of GDP*)



Source: IMF World Economic Outlook database, UN/DESA calculations.
Notes: Low-income, lower-middle-income and upper-middle-income countries' series: countries classified according to 2016 World Bank income classification; Least developed countries and small island developing States series: classified according to United Nations classifications; Poverty Reduction and Growth Trust-eligible countries: countries eligible to receive concessional funding by the IMF, broadly aligned with IDA graduation practices, as of end-September 2016 (for consistency, this series includes 74 countries, including countries that were part of the 2015 PRGT graduation (Bolivia (Plurinational State of), Mongolia, Nigeria, and Viet Nam)).

In commodity-exporting countries, low commodity prices have led to deteriorating current-account balances and fiscal positions, and to higher debt and falling reserves, particularly in countries dependent on fuel exports. Foreign reserves are set to fall to below three months of prospec-

tive imports in 15 out of 26 commodity-exporting low-income countries, more than double the number in 2014.[5] Overall, external financing requirements[6] as a share of reserves have increased across developing countries since the financial and economic crisis, with increases most pronounced in LDCs (figure 2).

The averages also mask rapid debt build-up in a number of countries. Following a significant net improvement in ratings on risk of debt distress since 2007, the IMF and World Bank's low-income country debt sustainability framework (LIC DSF, box 1) has recently started to show deterioration for some low-income countries. Ratings reached their most favourable point in 2013; only 24 per cent of countries eligible to use the IMF concessional resources under the Poverty Reduction and Growth Trust were rated as facing high risk of debt distress, down from 43 per cent in 2007. Since then, there has been a net deterioration in risk ratings, with relatively more downgrades than upgrades (figure 3). This includes countries that benefited from HIPC and MDRI: as of March 2017, 9 post-completion point HIPCs are considered at high risk of debt distress by the IMF and the World Bank.

Changes in the composition of debt in developing countries warrant careful attention. Corporate debt has reached elevated levels in a number of emerging market economies. For example, since 2008 the debt of non-financial corporations in 15 emerging and large developing economies more than tripled to about $25 trillion.[7] In some countries, corporate debt is backed by sovereign guarantees, but even if debt is not guaranteed, a socialization of these debts can occur via Governments bailing out banks holding non-performing corporate loans. Possible currency mismatches also present risks. A further appreciation of the United States dollar due to rising interest rate differentials could escalate these risks.

A second major development has been an increase in the number of developing countries, including LDCs, that have been able to borrow on international capital markets over the last five years. As a result, the share of external public and publicly guaranteed debt raised from private creditors has increased significantly in developing countries. Accessing international bond markets allows developing countries to raise untied resources while diversifying their financing options. At the same time, it also increases risks — both currency and roll-over risks — and further exposes borrowing countries to changes in global economic conditions. Indeed, as capital flows to developing countries declined in 2015, bond spreads widened sharply, in particular in commodity-exporting countries.[8]

There is also evidence of rising levels of domestic debt. According to data published by the Bank for International Settlements, the share of domestic debt in total debt securities rose from about 56 per cent in 2000 to 87 per cent in 2015 in 65 developing and emerging countries.[9] Domestic borrowing in developing countries typically carries a higher interest rate than external borrowing,[10] but it can help reduce currency risk and volatility. To effectively carry out debt sustainability assessments, it is important to improve the comprehensiveness, reliability and timeliness of both domestic and external debt data, as well as data on government assets and contingent liabilities.

5 IMF (2017). *Macroeconomic Developments and Prospects in Low-Income Developing Countries – 2016*. Available from https://www.imf.org/en/Publications/Policy-Papers/Issues/2017/01/13/PP5086-Macroeconomic-Developments-and-Prospects-in-Low-Income-Developing-Countries-2016.

6 Defined as current-account balance plus amortization of total short-term external debt at remaining maturity and of long-term debt maturing during the current year.

7 United Nations (2017). *World Economic Situation and Prospects 2017* (United Nations Publication Sales. No. E.17.II.C.2). Available from https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/2017wesp_full_en.pdf.

8 International Monetary Fund, op. cit.

9 United Nations (2016). *Report of the Secretary-General to the General Assembly on External debt sustainability and development*. Available from: http://www.un.org/ga/search/view_doc.asp?symbol=A/71/276

10 See, for example, Hosny, A. and Bakhache, S. (2015). *Public debt vulnerabilities in low-income countries: the evolving landscape.* IMF Staff Report, December 2015. Available from: http://www.imf.org/en/News/Articles/2015/09/28/04/53/sores011416b

Figure 2.a

External financing requirements of low- and-middle-income countries, weighted averages, 2000 – 2016, (*Share of international reserves*)

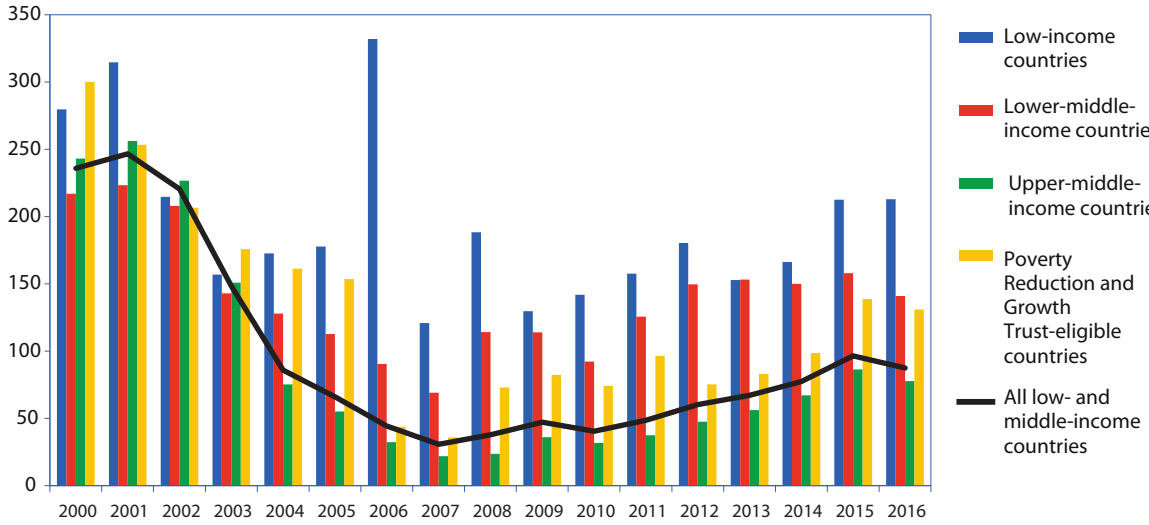
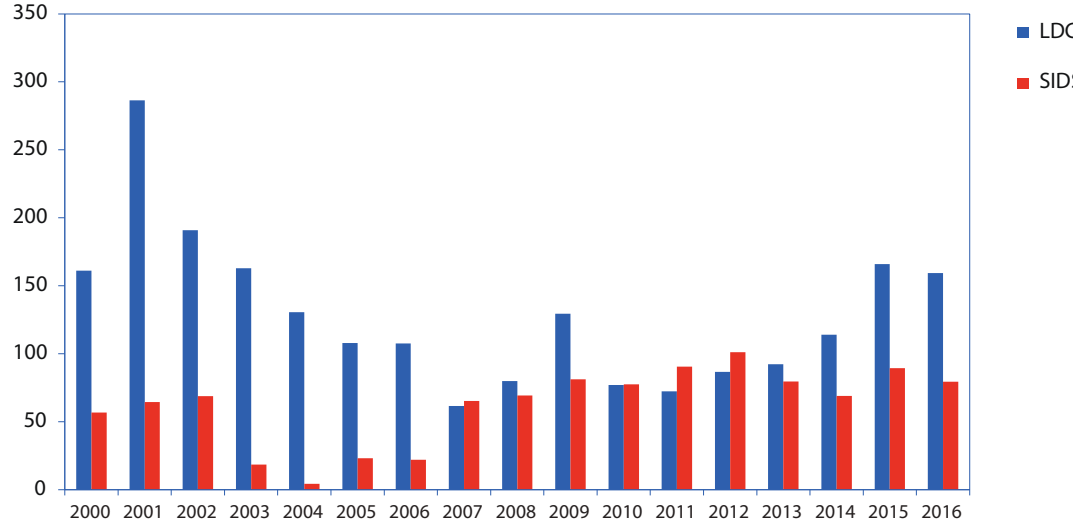


Figure 2.b

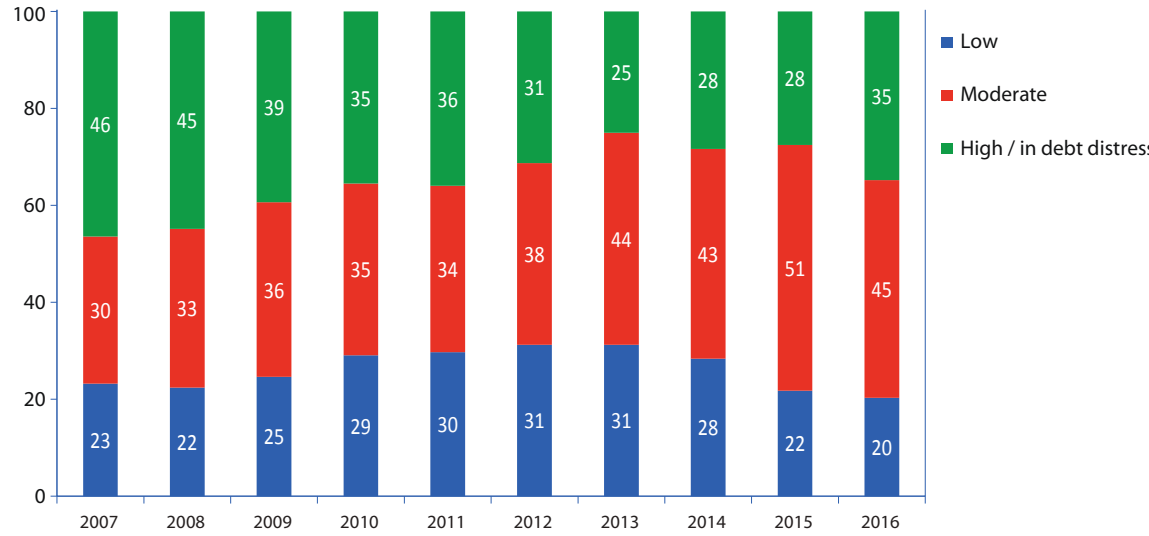
External financing requirements of least developed countries and small island developing States, weighted averages, 2000 – 2016 (*Share of international reserves*)



Source: IMF World Economic Outlook database, UN/DESA calculations.

Notes: Low-income, lower-middle-income and upper-middle-income countries' series: countries classified according to 2016 World Bank income classification; Least developed countries and small island developing States series: classified according to United Nations classifications; PRGT-eligible countries: countries eligible to concessional funding by the IMF, broadly aligned with IDA graduation practices, as of end-September 2016 (for consistency, this series includes 74 countries, including countries that were part of the 2015 PRGT graduation (Bolivia (Plurinational State of), Mongolia, Nigeria, and Viet Nam)). The 2006 spike in low-income countries is due to accounting for MDRI debt relief in a number of low-income countries as serviced debt.

Figure 3
Evolution of the risk of debt distress (*Percentage of total*)



Source: The IMF Debt Sustainability Framework for low-income countries, and UN/DESA calculations.
Note: Available DSAs produced up to end-December 2016 were considered for PRGT-eligible countries (based on the end-2015 list). If a DSA was not conducted in a particular year, the previous risk rating is used.

3. Innovative instruments for managing debt burdens

State-contingent debt instruments—which tie a sovereign's net payment obligations to its payment capacity—have drawn renewed interest from policymakers. Such instruments are designed to provide automatic protection against pre-defined shocks, thus providing both a countercyclical and a risk-sharing function. They can be an important component of efforts to prevent debt crises.

Several types of state-contingent debt instruments have been either discussed or implemented in recent years. GDP-linked bonds, where the coupon and/or the principal of sovereign bonds are indexed to GDP growth, have been discussed since at least the 1980s. Important benefits of GDP-linked bonds include their ability to make balance sheets safer, provide fiscal space during downturns, and decrease the likelihood of debt distress.[11] However, take-up has been limited thus far, and they have primarily been used in debt restructuring contexts or in the form of commodity hedges. Several Governments have issued GDP warrants, which pay out additional interest if GDP growth is higher than pre-defined levels—for example, Argentina (in the context of its debt restructuring in 2005), Greece and Ukraine. However, warrants do not provide symmetric adjustments in cases of lower-than-expected growth.

State-contingent instruments have also been used in official lending. The French Development Agency has issued concessional loans in the past that include a maturity extension if export revenues fall below specified levels, and are thus similar in effect to sovereign contingent convertible bonds. To anticipate shocks from natural disasters, Grenada's 2015 debt rescheduling agreement with the Paris Club and private creditors included a "hurricane clause", which seeks to provide debt relief in the aftermath of a natural disaster (box 2). A case can be made for official creditors to increase use of such instruments in their regular lending.

Building on work carried out by the Bank of England, the G20 International Financial Archi-

11 Benford, J., Best, T., Joy, M. and Krueger, M. (2016). *Sovereign GDP-linked bonds*. Financial Stability Paper No. 39, September 2016. Available from: http://www.bankofengland.co.uk/financialstability/Documents/fpc/fspapers/fs_paper39.pdf.

Box 1

Review of the low-income country debt sustainability framework

The low-income country debt sustainability framework (LIC DSF) is currently being reviewed by staff from the International Monetary Fund (IMF) and the World Bank. The LIC DSF assesses the risk of external debt distress of countries eligible for assistance from the Poverty Reduction Growth Trust (PRGT), taking into account several external public debt burden indicators, as well as the quality of borrower countries' governance. It plays an important role in the international financing architecture: beyond its main role of giving early warning of potential debt distress, the LIC DSF determines countries' eligibility for and terms of concessional financing, and provides key input for the application of the IMF debt limit policy, among others.

Preliminary work and external consultations have revealed a number of issues, including forecast errors in medium-term debt projections and inadequate capture of some sources of risks, such as market risk. Additional concerns voiced by stakeholders include the use of the World Bank Country Policy and Institutional Assessment (CPIA) scores as a proxy for the quality of governance. In light of the large investment needs to achieve the SDGs, there have also been calls to better reflect productive investments and their relationship to growth and thus repayment capacity.[a]

A number of reforms to improve the framework are being considered by the IMF. These include (i) developing tools that would help to assess the underlying macro assumptions in baseline projections, enhance stress testing, and reflect market-related risks; (ii) updating the empirical model underpinning the derivation of debt thresholds and the methodology for classifying countries to better reflect country-specific information and to improve the framework's capacity to predict debt distress; (iii) refining the approach to assigning risk ratings, including streamlining the number of debt indicators; and (iv) strengthening the assessment of total public debt.

a Mitchell, T. (2016). *Review of the Joint WB-IMF Debt Sustainability Framework: 'Readjusting the IMF's Loss Function'*. Commonwealth Secretariat Discussion Paper 22.

tecture Working Group has analysed the potential of state-contingent financial instruments — GDP-linked bonds in particular. In this context, a working group including private sector representatives convened to draft a model "term sheet" for a GDP-linked bond. This could be a starting point for further engagement with investor trade bodies such as the International Capital Market Association. As of now, establishing investor confidence in these instruments remains difficult.

4. Resolving unsustainable debt situations

Considerable progress has been made since the Monterrey Consensus in reducing the debt overhang in highly indebted poor countries, whose main creditors have been in the public sector. Private creditors also contributed to the debt write-down for some of these countries, although a few holders of private sector claims pursued litigation strategies, which at times negated the efforts of the official sector.

4.1. Actions by official creditors

Beyond the HIPC Initiative and MDRI, which are nearly complete, the IMF has implemented new facilities to help countries cope with natural disasters and other shocks, such as the Catastrophe Containment and Relief Trust (CCR), which provides debt relief in the event of catastrophic natural disasters and public health disasters. Guinea, Liberia and Sierra Leone tapped the CCR in 2015 to cope with the fallout from the Ebola outbreak. Reforms to the IMF Exceptional Access lending framework were enacted in 2016 to eliminate the systemic exemption, introduced in 2010, which has proven ineffective in addressing debt problems and preventing contagion. They instead allow for appropriate flexibility, including the use of a "debt re-profiling" option, in situations when debt is assessed as sustainable but not with high probability.

The IMF also revised its policy on arrears to official bilateral creditors in December 2015. Under the new policy, the IMF can consider lending into arrears owed to official bilateral creditors in carefully circumscribed circumstances. The revision aims to strengthen incentives for collective action among official bilateral creditors and to promote more efficient resolution of sovereign debt crises. The recent IMF programme reviews for Ukraine — completed in a context where there were outstanding arrears to

Box 2

State-contingent lending instruments and public creditors

In some cases of debt distress following major shocks and crises, public creditors have responded by easing debt repayment obligations (e.g., the grant assistance from the International Monetary Fund to the Ebola-affected countries to pay-off future debt service payments totaling about $100 million). Grenada's recent debt restructuring also introduced an extra innovative feature, specifically a "hurricane clause", which allows for a moratorium on debt payments in the event of a natural disaster.

Recent analyses stress that instead of case-specific and ex post responses, there is a case for increased use of state-contingent lending instruments, which aim to automatically trigger downward adjustments in debt service during shocks.[a] These instruments have the potential to improve debt sustainability, help countries manage risk and more effectively cope with shocks.

One such instrument is countercyclical lending contracts (CCLs), which allow debt service to automatically fall or cease when a major shock occurs (shocks are measured in a specific way, e.g., a significant fall in the value of exports or increase in the price of imports). The idea behind CCLs is to ensure that debt service is countercyclical. They aim at building flexibility ex ante for borrowers and contributing to reducing the risk of a debt crisis and costly ex post debt restructuring. The benefit for lenders would be the prevention of any eventual losses on their claims.

Since 2007, the Agence Francaise de Développement (AFD) has extended CCLs to six African countries (Burkina Faso, Madagascar, Mali, Mozambique, Senegal and the United Republic of Tanzania) for various projects in the areas of urban development, electrification, access to water and sanitation, education and vocational training, and food security. The total of CCL lending implemented by AFD as of mid-2016 was about 300 million euros.

Another effective instrument could be GDP-linked official sector lending. Many of the challenges in extending GDP-linked bonds (e.g., the absence of fully developed markets where these securities can be traded) are not applicable to external debt with official creditors, which does not require the intermediation of financial markets since it typically involves sovereign states and/or international public financial institutions.

GDP-linked official sector lending could make an important difference in developing countries, as external debt with official creditors often constitutes a major source of government finance, especially in low-income and least developed countries. A significant case can be made for scaling up these innovative approaches to more effective debt management, and for public creditors to take a leading role in this regard.

a Hurley, G. and Voituriez, T. (2016). *Financing the SDGs in the Least Developed Countries (LDCs): Diversifying the Financing Toolbox and Managing Vulnerability*. Agence Française de Développement and United Nations Development Programme. Available from: http://www.undp.org/content/undp/en/home/librarypage/poverty-reduction/afd-undp-financing-sustainable-development-and-managing-vulnerab.html.

an official bilateral creditor, no representative Paris Club agreement, and no creditor consent—was the first (and so far only) case where an assessment of the criteria was provided to the IMF board in order to allow completion of the review.

Lastly, the IMF staff is examining issues related to debtor-creditor engagement in the context of a review of the Fund's LIA policy. By encouraging dialogue, information sharing, and early input into the debt restructuring strategy, the Fund's LIA policy aims at promoting efficient resolution of debt crises and a speedy normalization of debtor-creditor relations. In this context, a key issue under consideration is where to draw the perimeter for official claims for purposes of the Fund's arrears policies.

4.2. Involving private creditors in debt restructurings

As more developing countries tap international financial markets and more countries draw upon alternative sources for sovereign financing, borrowing needs to be managed prudently. Even so, the number of countries that need a more comprehensive approach to debt crisis workouts may grow, especially in a challenging global environment. The Monterrey Consensus welcomed consideration of an international debt workout mechanism. However, proposals for a statutory mechanism did not receive sufficient political support. The focus has instead been on market-based solutions, such as contractual clauses in bond contracts, and "soft-law" approaches

such as principles and guidelines for debtor and creditor responsibilities.

In 2014, the International Capital Market Association published a new model of enhanced collective action and *pari passu* clauses for use primarily in international sovereign bond contracts, with a view to reducing issuers' vulnerability to hold-out creditors in case of a debt restructuring. The enhanced clauses, key features of which have been endorsed by the Executive Board of the IMF, were developed partly in response to New York courts' interpretation of the *pari passu* clause in litigation against the Argentina and growing concerns over strategic behaviour by bondholders to build blocking positions in individual bond series. The enhanced clauses allow a supermajority of creditors to approve a debt restructuring proposal in one vote across multiple bond series. The revised *pari passu* clause specifies that equal ranking of debt securities does not imply a requirement to pay all creditors on a ratable (pro rata) basis. In late 2012, in litigation involving Argentina with its hold-out creditors, the United States District Court for the Southern District of New York had interpreted the *pari passu* clause as requiring ratable payments, and blocked scheduled payments to exchange bondholders until it paid litigating hold-outs. This caused concern that sovereign debt restructurings would become much more difficult to achieve.

Since that time, progress has been made in incorporating these provisions in international sovereign bonds. Based on information available as of October 2016, the IMF reported that 154 out of a total of 228 international bond issuances since October 2014 have included enhanced collective action clauses, representing 74 per cent of the nominal principal amount.[12] The modified *pari passu* clause is largely incorporated along with enhanced collective action clauses, with some exceptions. However, the outstanding stock of international sovereign bonds without the enhanced clauses — at about $846 billion as of end-October 2016 — remains a challenge. Only about 18 per cent of the total outstanding stock of approximately $1.031 trillion includes such clauses; the share of stock without clauses is declining, but slowly.

In December 2016, five years after the original ruling that assessed Argentina to be in breach of its *pari passu* clause, the United States District Court for the Southern District of New York found that the same sovereign's payments to other creditors did not violate rights of non-settling investors and did not breach the *pari passu* clause. Only actions affecting the ranking of payment obligations would constitute such a breach.

4.3. Legislative efforts to address non-cooperative minority creditors

While the new collective action clauses aim to reduce the ability of non-cooperating bondholders to undermine voluntary restructuring of sovereign debt, the success of ex post litigation has highlighted a gap in the architecture for debt crisis resolution. Largely in response to litigations in their courts, a few jurisdictions have passed or debated legislation to discourage hold-out creditors by limiting creditors' potential profits from secondary market purchases, including the United Kingdom of Great Britain and Northern Ireland, Belgium, and most recently France. Most of this legislation has focused on limiting claims against countries that benefitted from debt relief under the HIPC Initiative. For example, in the United Kingdom of Great Britain and Northern Ireland, a law was passed in 2010 that prevents creditors from suing in the United Kingdom court to enforce payment on the sovereign debt of HIPC debtors on terms more favourable than agreed under the HIPC Initiative. Similar legislation was also adopted by Jersey and the Isle of Man in 2012 and debated in Australia and the States of Guernsey in 2012 and in the United States of America in 2008.

In contrast, a Belgian law adopted in 2015 is not restricted to heavily indebted poor countries. The law limits creditors' ability to seek enforcement by Belgian courts of claims that are clearly disproportionate to the purchase price if the debt was purchased in the secondary market (the law applies to the debt of any sovereign). In order for this limit to apply, any one of a number of conditions must be satisfied, such as the creditor's refusal to participate in a debt restructuring process, the creditor's sys-

12 IMF (2017). *Second progress report on inclusion of enhanced contractual provisions in international sovereign bond contracts*. Available from: http://www.imf.org/external/np/pp/eng/2017/122716.pdf

tematic use of legal proceedings to obtain payment on repurchased claims, or the creditor's abuse of the weakness of the debtor state to negotiate an imbalanced repayment agreement.

4.4. Debt financing principles

In the Addis Agenda, Member States committed to work towards a global consensus on guidelines for debtor and creditor responsibilities, building upon existing initiatives, and in this context took note of the UNCTAD principles on sovereign lending and borrowing and other relevant efforts. This work is continuing, including in the United Nations and the G20.

Most recently, the G20 in collaboration with the Paris Club, has started to work on operational guidelines for the sustainable financing of development.[13] The United Nations General Assembly adopted resolution A/RES/69/319 on basic principles in sovereign debt restructuring processes. The resolution declared that sovereign debt restructuring processes should be guided by basic principles of sovereignty, good faith, transparency, impartiality, sovereign immunity, legitimacy, sustainability and majority restructuring.

The ECOSOC Forum on Financing for Development follow-up could be a useful forum for discussing these issues, in continued cooperation with international financial institutions, in particular the IMF, relevant United Nations entities, including UNCTAD, and other relevant entities.

4.5 Looking ahead

It will be important to continue seeking improvements to existing market-based solutions and consider ways to address outstanding issues. Indeed, as recognized in the Addis Agenda, "there is scope to improve the arrangements for coordination between public and private sectors and between debtors and creditors, to minimize both creditor and debtor moral hazards and to facilitate fair burden sharing and an orderly, timely and efficient restructuring that respects the principles of shared responsibility".[14] Among the issues under discussion in the international community are whether commercial bank loan contracts can be improved to facilitate restructuring; how to ensure that during a time of debt distress the borrower has time (breathing space) to identify and implement mutually beneficial policies that promote sustainable adjustment, preserve asset values and support growth; debtor-creditor engagement and creditor coordination as bond finance has become more significant; how to ensure that there are effective mechanisms to restructure every component of debt, given the increasingly important role of new providers of development finance (e.g. non-Paris Club creditors); as well as issues related to regulation in trade and finance and their impact on the debt restructuring process.

13 See http://www.clubdeparis.org/en/communications/press-release/paris-forum-2016-29-11-2016.

14 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 99. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

Chapter III.F

Addressing systemic issues

1. Key messages and recommendations

The 2008 world finance and economic crisis underscored how systemic risks can undermine progress towards poverty alleviation and development. Today, risks in the global economy highlighted earlier in this report underscore the seriousness of the systemic challenges facing the international community in its efforts to achieve the 2030 Agenda for Sustainable Development. As repeatedly demonstrated by the transmission of financial crises, events in one country can have effects across borders, impacting jobs, employment and growth. There are cross-border spillovers from social and environmental systems as well. For example, instability, crime, poverty and inequality have the potential to provoke extremism or drive irregular migration, both of which have cross-border implications.

International cooperation is essential to addressing these risks. Indeed, such cooperation can boost the economic, social and environmental performance of all countries. For example, the actions of the Group of Twenty (G20) in the wake of the 2008 world financial and economic crisis helped contain the crisis, and global financial regulatory standards have helped improve the financial safety of all countries. Similarly, cooperative efforts towards social development produce results in the near term and prevent costlier problems and instability in the future, while efforts to improve environmental sustainability are often only effective with joint actions across borders.

While important steps have been taken to reduce vulnerabilities in the international system and to increase the voice of developing countries, the Addis Ababa Action Agenda states that more needs to be done. Continuing these efforts, while further aligning international institutions, most of which were not designed with sustainable development as a goal, to support the agenda are at the heart of this chapter on addressing systemic issues.

The United Nations development system is moving to implement a more coherent approach aligned with sustainable development, as are other regional and global organizations, although efforts are more advanced in some institutions than others. ***All regional and global organizations, especially those with norm-setting functions, should continue efforts to align their strategies, policies and practices with the Sustainable Development Goals (SDGs).*** While the Inter-agency Task Force will continue to report on the coherence of international systems, ***international organizations' self-assessments of coherence with the sustainable development agenda, reported to their own governance mechanisms, could contribute. Additional standard-setting bodies that are not currently part of the follow-up process could be invited to voluntarily join this effort through the Task Force platform.***

The Addis Agenda recognizes the need to further strengthen the global financial safety net (GFSN) to ensure that no one is left behind. ***Member States should work to remove gaps in the GFSN's coverage, ensure adequate levels of financing, increase its flexibility and strengthen its countercyclicality.*** The world continues to face large and volatile capital flows, which the Addis Agenda acknowledges can be dealt with through necessary macroeconomic policy adjustment, supported by macroprudential policies and, where appropriate, capital flow management measures. ***Greater international macroeconomic coordination, including cooperation between capital flow source and destination countries, can help reduce the impact of spillovers and financial flow volatility.***

Financial reforms need to achieve and maintain the right balance among stability, safety and sustainability, while also promoting access to finance. Much technical work has been done on financial reform and adopting macroeconomic policies to protect against future financial crises, though the regulatory reforms are not yet complete and more needs to be done. ***Efforts to implement already agreed financial regulatory reforms should be sped up and strengthened.*** However, the efficacy of these reforms has not yet been tested, with some indicating that they are not sufficient, while others have called them too onerous. The Addis Agenda also underscores the importance of monitoring the impact of financial regulation on incentives for financial inclusion and investment in sustainable development. Work is under way, particularly at the Financial Stability Board (FSB), to develop a framework for the post-implementation evaluation of the effects and any unintended consequences of financial regulatory reforms that will guide analyses of whether the reforms are achieving their intended outcomes. At the same time, efforts to include all dimensions of sustainable development into the financial reform agenda are still in their infancy. ***Member States may wish to endorse FSB efforts to evaluate the effects of agreed post-crisis reforms on the resilience of the global financial system. Member States may also consider a broader examination of the extent to which all incentives in the financial system are aligned with sustainable development, and balance the goals of access to finance, sustainability and stability.***

Finally, governance of global systems should reflect changes in the global economy and be responsive to the risks faced in all parts of the world. In the Addis Agenda, Member States recommitted to increasing the voice of developing countries in international economic decision-making and norm-setting processes, including at the Basel Committee on Banking Supervision (BCBS) and other main international regulatory standard-setting bodies. The existing regular reviews of governance at the World Bank and International Monetary Fund (IMF) are meant to address this. Other international organizations are also implementing reforms, although progress is uneven. ***Periodic processes to examine governance structures at global and regional organizations, with the goal of strengthening the voice of developing countries, would help meet commitments***.

2. Institutional and policy coherence

The Financing for Development outcomes recognize that institutional silos should be broken down in order to promote cross-fertilization of ideas and more effective coordination of actions at both the national and international levels. They stress the importance of enhancing coherence, governance and consistency of the international monetary, financial and trading systems, and the need to expand the coherence agenda to take into account economic, social and environmental challenges.

2.1 Policy coherence at international institutions

In response to the development of the Addis Agenda and the 2030 Agenda for Sustainable Development, the international financial institutions have stepped up efforts at joint work. In July 2015, six multilateral development banks (MDBs)[1] and the IMF issued a joint commitment to provide financial support of $400 billion dollars in the subsequent three years; a subsequent joint statement from them welcomed the adoption of the 2030 Agenda for Sustainable Development. In April 2016, all the MDBs met to promote coherence in infrastructure finance at the first Global Infrastructure Forum. In October 2016, the six MDBs and the IMF were joined by four other development banks[2] to announce that they were stepping up efforts, within their respective mandates and governance structures, to enhance the effectiveness of their lending, knowledge-sharing and technical assistance.[3]

1 World Bank, African Development Bank, Asian Development Bank, European Investment Bank, European Bank for Reconstruction and Development and Inter-American Development Bank.

2 Asian Infrastructure Investment Bank, International Finance Corporation, Islamic Development Bank and New Development Bank.

3 See http://www.worldbank.org/en/news/press-release/2016/10/09/delivering-on-the-2030-agenda-statement.

The World Bank Group and the IMF outlined plans for adapting to the 2030 Agenda for Sustainable Development at their annual meetings in 2015, which were welcomed by a ministerial communiqué. In 2016, the World Bank Group also prepared a document entitled "Forward Look – A Vision for the World Bank Group in 2030," which seeks to shape a common view among shareholders on how the World Bank Group can best support the development agenda for 2030 while staying focused on its own corporate goals. Meanwhile, work is under way at the IMF to review its progress in supporting the 2030 Agenda for Sustainable Development.

A number of the regional development banks are also adapting their work to support sustainable development. The Asian Development Bank (ADB) is preparing a new strategy, which will include information on how the ADB aligns with the SDGs and the Paris Agreement on climate change. The African Development Bank has created the High 5s Agenda to respond to the 2030 Agenda for Sustainable Development. The Inter-American Development Bank has updated its Corporate Results Framework to identify the most closely aligned SDGs, as well as its guidelines for preparing country strategies.

The United Nations General Assembly adopted a Quadrennial Comprehensive Policy Review resolution in December 2016, the tool for guiding, assessing and monitoring United Nations system-wide coherence (see chapter III.C for a further discussion).

2.2 Policy coherence in migration

An important emerging area for policy coherence highlighted in the Addis Agenda is migration. Instability, crime, climate change, disasters or drastic poverty and inequality have the potential to drive irregular migration, with strong cross-border implications. In the Addis Agenda, ensuring safe, orderly and regular migration is an agreed goal. This requires effective implementation of policies and systems, access to regular channels for migration, well-administered visa and entry schemes, and effective identity management practices.

On 19 September 2016, the General Assembly-mandated high-level summit on addressing large movements of refugees and migrants was a watershed moment for strengthening governance of international migration and an opportunity for creating a more responsible, predictable system for responding to large movements of refugees and migrants. All 193 Member States signed up to the plan for addressing large movements of refugees and migrants — the New York Declaration,[4] which expresses the political will of world leaders to save lives, protect rights and share responsibility on a global scale. In the declaration, Member States stated their commitment to protect the safety, dignity and human rights and fundamental freedoms of all migrants, regardless of their migratory status, at all times. The year 2018 will witness an international conference on migration; the adoption of a global compact for safe, orderly and regular migration; and the adoption of a global compact on refugees. As Member States develop the global compacts on refugees and migrants, they should work to ensure coherence with the Addis Agenda and the 2030 Agenda for Sustainable Development.

3. Macroeconomic stability and financial regulation

A stable global macroeconomic environment is needed to support countries' ability to equitably and sustainably grow and implement other policies that contribute to sustainable development. Past financial crises have highlighted the cost of major failures in the financial sector as well as failures of financial regulation and supervision. As noted in the Addis Agenda, national financial stability faces risks from spillovers from financial systems in other countries. The Addis Agenda emphasizes the importance of strengthening regulatory frameworks at all levels, and addressing gaps and misaligned incentives in the international financial system to foster stability, safety and sustainability, while also promoting access to finance and sustainable development across its three dimensions.

3.1. International monetary system and global financial safety net

The design and functioning of the international monetary system is a critical factor in global macroeconomic stability. While national policy choices

4 A/RES/71/1.

related to exchange rate regimes and foreign reserve accumulation have responded to the evolution of global financial markets, there has not been a fundamental change in the structure of the international monetary system since the 1970s. Nonetheless, there have been important reforms to the global financial system since the 2008 world financial and economic crisis aimed at improving its functioning, stability and resilience, including by strengthening the global financial safety net (GFSN) and introducing new coordination mechanisms. A number of international organizations that are members of the Task Force undertake global economic monitoring in order to sound early warnings about potential risks in the economic and financial system.

There are various ongoing work streams that address the call in the Addis Agenda for the "need to pursue further reforms of the international financial and monetary system".[5] The IMF is continuing work on the role of the special drawing right (SDR), which saw the inclusion of the Chinese renminbi in its basket of currencies, which was approved in 2015 and operationalized in 2016. In July 2016, IMF staff prepared a note for the G20 outlining initial considerations on whether a greater role for the SDR could contribute to the smooth functioning of the international monetary system.[6] In October 2016, a high-level external advisory group, consisting of prominent academics, former policymakers and market practitioners, was convened to advise on this issue.[7] The IMF will continue exploring whether a broader role for the SDR could contribute to the smooth functioning of the international monetary system. This work will seek to identify gaps and market failures that the SDR could help to address in the light of the structural shifts in the international monetary system.

The GFSN has expanded since the global financial crisis, including through a large increase in IMF lending capacity, development of bilateral swap lines and creation or strengthening of regional financial arrangements. Nonetheless, as noted in a recent IMF paper, the GFSN has become more fragmented, has uneven coverage with sizeable gaps (especially with regard to access to financing for systemic emerging markets and those markets that can act as transmitters of shocks) and remains too costly, unreliable and conducive to moral hazard. In essence, there is insufficient liquidity for many countries when they face crises or shocks. While bilateral swap lines across central banks have helped some, they reach only a small number of countries. The IMF is currently working on reviewing and modifying its lending facilities and improving its cooperation with regional financial arrangements.

3.2. Financial regulatory reform

A strong financial system should effectively intermediate private financial flows in line with sustainable development objectives. Ongoing work on financial regulatory reform can be broken down into four main components: resilience of financial institutions, solving the too-big-to-fail problem, making derivatives safer, and transforming shadow banking. This work is coordinated through the FSB, which promotes international financial stability through information exchange, cooperation of national financial authorities and international standard-setting bodies, such as the BCBS, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

The 2016 report of the FSB to the G20 Summit on the implementation and effects of financial regulatory reforms concluded that implementation progress remains steady but uneven, and that strengthened resilience due to the reforms has assisted in the smoother operation of the global financial system. Banks continue to build capital and liquidity buffers to meet the new Basel III capital adequacy standards, with the estimated capital shortfall nearly zero and capital ratios at new highs (figures 1.a and 1.b).

5 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 105. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

6 See http://www.imf.org/external/np/pp/eng/2016/072416.pdf.

7 See https://www.imf.org/en/News/Articles/2016/10/31/PR16474-IMF-Launches-Consultations-on-Role-of-Special-Drawing-Right-with-External-Advisory-Group.

However, substantial work remains in implementing the policies designed to address the too-big-to-fail problem — for example, achieving effective resolution regimes and operationalizing plans for systemically important banks and non-bank financial institutions. Given the gaps in implementation of financial regulatory reforms, efforts to implement the already agreed reforms must be speed up and strengthened. Effective implementation will require further cross-border cooperation and the addressing of legal, data and capacity constraints.

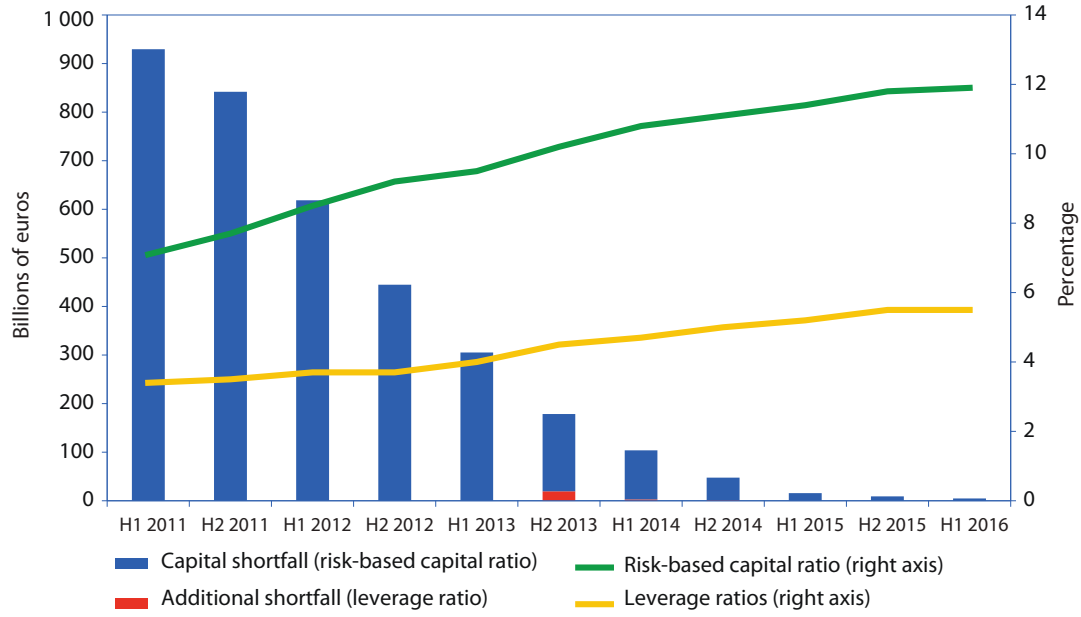
There are some concerns, however, that existing reforms do not fully address the systemic risks in the financial system or the too-big-to-fail problem. Additionally, the efficacy of these reforms has not yet been tested. Some members of the Task Force feel that the stronger capital adequacy requirements still allow banks to maintain high leverage ratios that pose systemic risks. At the same time, there is pressure in some countries to ease or repeal the rules.

The Addis Agenda emphasizes the importance of ensuring that incentives underlying financial market regulations are aligned with sustainable development. All regulatory frameworks create incentives. Regulations could have unintended consequences and spillovers by reducing incentives to lend to sectors, enterprise types, or countries where financing is critical to achieving the SDGs. To date, emerging market and developing economies have not reported major unintended consequences from implementing the reforms.

There is anecdotal evidence on how countries are addressing these impacts. Some measures to boost long-term investment were discussed in the thematic chapter, and better design of regulations can address unintended consequences and spillovers. European Union countries have included carve-outs

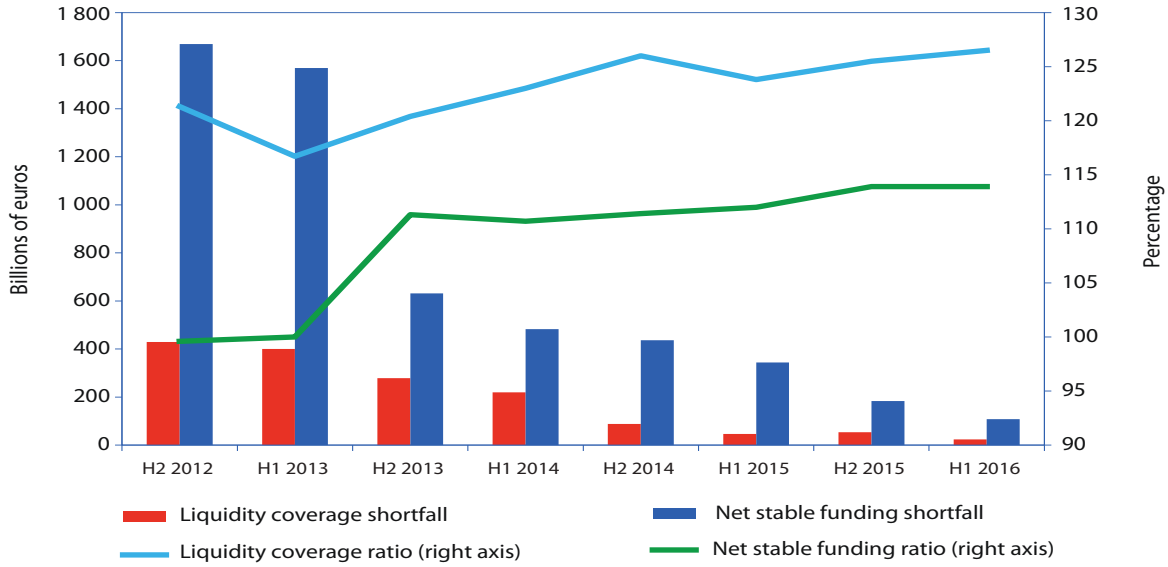
Figure 1
Evolution of banks' regulatory capital and liquidity ratios, 2011 – 2016

Figure 1.a
Risk-based capital and leverage ratios, 2011 – 2016



Source: BCBS Basel III Monitoring Report, March 2017.
Note: The graph shows data for banks that have Tier 1 capital of more than €3 billion and are internationally active (Group 1 banks). The ratios are weighted by risk-weighted assets. Total capital shortfall for banks to reach the fully phased-in 2019 Common Equity Tier 1 (CET1) target ratio of 7 per cent plus bank-specific G-SIB surcharges if applicable, and the respective target levels (and G-SIB surcharges) for Tier 1 and total capital ratios. Additional total capital shortfall to meet the fully phased-in leverage ratio (on top of the target risk-based capital ratios), assuming a 3 per cent calibration as per BCBS (2014).

Figure 1.b
Aggregate liquidity shortfalls, 2012–2016



Source: BCBS Basel III Monitoring Report, March 2017.
Note: The graph shows data for banks that have Tier 1 capital of more than €3 billion and are internationally active ("Group 1 banks"). The liquidity ratios are weighted by CET1 capital.

to the implementation of the Basel III capital adequacy framework that allow lower risk weights for exposure to sovereign debt and loans to small and medium-sized enterprises. These carve-outs attempt to ensure sufficient access to credit in these areas, although this has led to them being judged materially non-compliant with the Basel III standard in peer reviews.

3.3. Financial spillover prevention and capital flow management

As discussed in chapter I, net capital flows continue to exhibit volatility. The Addis Agenda notes that "when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported by macroprudential and, as appropriate, capital flow management measures".[8] In 2016, to help countries better understand and address the impact of cross-border capital flows, the IMF reviewed countries' experiences with capital flows from 2013 to 2016 and their policy responses through the lens of the IMF institutional view on capital flows.[9] In the sample, most countries facing challenges of capital flow reversals relied on macroeconomic policies, although eight countries also used capital flow management measures on outflows. The measures were used mainly in crisis circumstances or when a crisis was considered imminent and as part of a broad policy package, at the same time, some countries used them in circumstances that posed particular challenges. The IMF Executive Board considered that the IMF institutional view on capital flows, adopted in 2012, "remains relevant in the current environment and does not need substantive adjustment at this point", but "would need to remain flexible and evolve over time to incorporate new exprience and insights".[10] They also agreed that further clarification or elaboration was warranted in a few areas, including how the institutional view can serve as a framework for greater multilateral con-

8 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 105. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.
9 See http://www.imf.org/external/np/pp/eng/2016/110416a.pdf.
10 See http://www.imf.org/en/News/Articles/2016/12/20/PR16573-Review-of-Experience-with-the-Institutional-View-on-Capital-Flows.

sistency in the design of policies for dealing with capital flows. The review of experiences showed that countries have relied on a combination of policies in response to capital flows, including the use of macroprudential policies to contain risks from financial cycles. Further IMF staff analysis of how macroprudential policies can contribute to increasing resilience to large and volatile capital flows is expected to be discussed by the IMF Executive Board in June 2017.

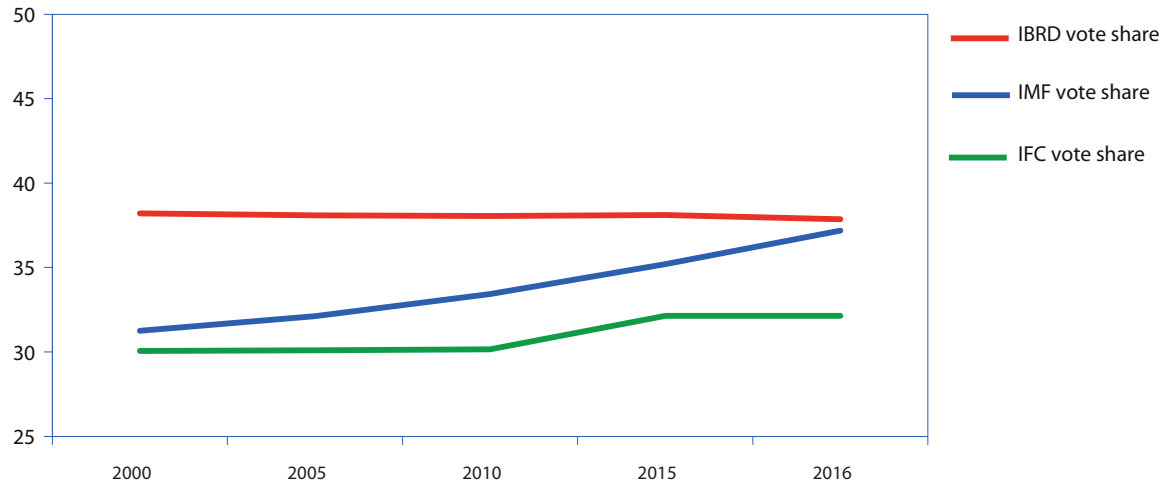
4. Global economic governance

The Addis Agenda welcomes recent reforms to the international financial architecture, and calls for additional measures to ensure that international mechanisms and institutions keep pace with the increased complexity of the world, and respond to the imperatives of sustainable development. Governance reforms to ensure a more inclusive and representative international architecture are being implemented gradually but unevenly across international organizations.

4.1. International financial institutions

As reported in the 2016 Task Force report, the IMF quota and governance reforms agreed to in 2010 became effective in January 2016, doubling the quota resources, increasing the aggregate voting rights of developing countries, as well as improving their representation on the IMF board. The World Bank Group and IMF are currently discussing further reforms to their governance and voting rights. In October 2015, the governors of the World Bank Group agreed to consider realignment of International Bank for Reconstruction and Development and International Finance Corporation shareholding alongside consideration of a capital increase in 2017. An IMF general review of quotas—its fifteenth—had also been due for conclusion in the autumn of 2017; but, in October 2016, the governors of the IMF agreed to reset the timetable for completing the review to the Spring Meetings of 2019 and no later than the Annual Meetings of 2019, subject to adoption by the Board of Governors, in order to provide adequate time to build the necessary broad consensus. For both institutions, the last agreed reforms occurred in 2010. At the IMF, final implementation of the 2010 reform is largely complete, while at the World Bank implementation is still underway, as Member States subscribe to the additional shares agreed to be created. As shown in figure 2, the uneven speed of take up of new shares at the World Bank has resulted in countries in developed regions actually gaining voting rights. The IMF

Figure 2
Share of voting rights at IFIs of countries in developing regions, 2000 – 2016 (*Percentage*)



Source: United Nations Statistics Division database.

reforms have increased the share of votes held by countries in developing regions.[11]

4.2. International regulatory standard-setting bodies

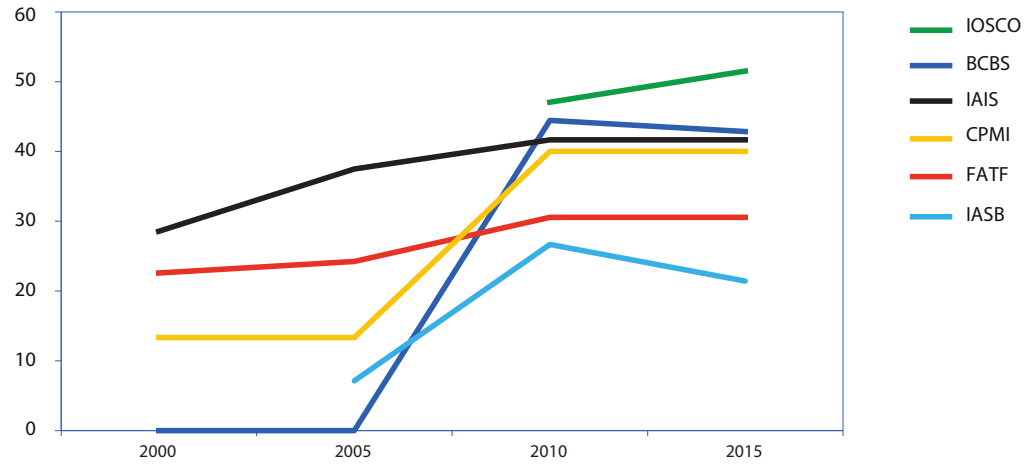
A number of public and private bodies set international standards for financial regulation and supervision that countries may adopt into national frameworks. Members of international regulatory standard-setting boards (SSBs) are usually national regulators. The main international SSBs include the following:

- the Financial Stability Board (FSB), an international body founded in 2009 to coordinate national financial authorities and other SSBs, including the BCBS, IAIS, IOSCO, IASB, CPMI, and the BIS Committee on the Global Financial System
- the Basel Committee on Banking Supervision (BCBS) for standards on banking regulation
- the Basel Committee on Payments and Market Infrastructure (CPMI) for standards on payment, clearing, settlement systems and related arrangements
- the International Organization of Securities Commissions (IOSCO) for standards on securities regulation
- the Financial Action Task Force (FATF) for standards on combating money laundering and terrorist financing
- the International Accounting Standards Board (IASB) for accounting standards
- the International Association of Insurance Supervisors (IAIS) for standards on insurance industry regulation and supervision

These institutions were generally set up by developed countries. As shown in figure 3, following the 2008 world financial and economic crisis, a number of SSBs implemented governance reforms to give developing countries greater voice, although they lack a process for regular governance reviews. Other standard-setting bodies are developing ways for developing countries to have more input into, but not necessarily a vote on, norm setting and/or implementation discussions. This is often accomplished through regional consultative committees.

Figure 3

Share of countries in developing regions in the governance of international regulatory standard-setting bodies, 2000 – 2015 (*Percentage*)



Source: UN/DESA.

11 There is no established convention for the designation of "developed" and "developing" countries or areas in the United Nations system. In common practice, Japan in Asia, Canada and the United States in northern America, Australia and New Zealand in Oceania, and Europe are considered "developed" regions or areas. Until a definition of developing countries is agreed, data under this SDG indicator provisionally aggregates all countries located in "developing regions" according to the M49 statistical standard for the purposes of monitoring the voting share of "developing countries".

Chapter III.G

Science, technology, innovation and capacity-building

1. Key messages and recommendations

Technology and innovation are at the heart of economic, environmental and social development. Over the past several decades, there has been important progress in access to many technologies, particularly in information and communications technology (ICT). Nonetheless, two years after the adoption of the Addis Ababa Action Agenda, access remains uneven within and between countries, with the greatest growth in technology investments occurring mainly in developed regions and some developing countries. Substantial divides in access rates to certain technologies—the Internet, for example—persist between men and women as well as between urban and rural areas.[1]

Knowledge and technology transfer from developed to developing countries is a necessary part of ensuring access to technology, since many technologies are initially developed in industrialized countries. However, the conventional view that technology is developed in the North and simply transferred to the South is misleading. Technology transfer involves more than the importation of hardware: it involves the complex process of sharing knowledge and adapting technologies to meet local conditions. The science, technology and innovation (STI) performance of a country, as well as the economic and social impact of STI, are affected by the quality and level of interactions and flows of knowledge between agents in the innovation system — such as firms, universities, research centres, public agencies and intermediate organizations. These interactions are enabled by infrastructure, market forces and public policies. The systemic nature of the innovation process underlines the need to incorporate scientific and technological knowledge into national development strategies and plans in order to make effective use of innovation.

The Addis Agenda thus speaks both to building domestic capacities for innovation and to the role of international cooperation and support. Building an innovative economy is based on a range of actions — including interactive learning, information exchange, timely availability of finance and other resources, and effective collaboration among the private sector, universities, research centres, policymakers and other actors — as well as improved governance. ***Countries should work to develop national strategies for STI comprising policy, regulatory and institutional frameworks that strengthen the enabling environment and enhance interactive learning, while also strategically allocating resources and providing adequate infrastructure.***

In response to the subdued and somewhat procyclical nature of public spending for research and development (R&D) in some countries, ***Governments should introduce policies to ensure that government spending on R&D remains stable and long-term oriented. At the same time, they should use a variety of tools to incentivize greater private investment.*** Some progress has been made on the Addis Agenda commitment to consider setting up innovation funds where appropriate. ***More efforts in this area are encouraged at the subnational, national, regional and global levels.***

1 ITU (2016). *ICT Facts and Figures 2016*. Available from http://www.itu.int/en/ITU-D/Statistics/Documents/facts/ICTFactsFigures2016.pdf.

At the international level, United Nations Member States committed to supporting the efforts of developing countries to strengthen their scientific, technological and innovative capacity. Official development assistance (ODA) for research and development to African countries, least developed countries (LDCs) and landlocked developing countries (LLDCs) has increased modestly since the financial crisis. There is also scope to strengthen and leverage South-South cooperation in promoting STI development. In 2016, the United Nations held the first Multi-stakeholder Forum on Science, Technology and Innovation for the Sustainable Development Goals as one element of the Technology Facilitation Mechanism and established the Technology Bank for LDCs. ***For the Technology Bank, it will be critical to establish the financial base as soon as possible to ensure that all LDCs can benefit from the new institution.***

Capacity-building is an integral part of the global partnership for sustainable development. The data on international funds for financial and technical assistance to African countries, LDCs, LLDCs and small island developing States (SIDS) indicates a recent decline in disbursements for capacity-building to all four country groups. ***ODA providers should aim to step up their contributions for capacity-building in the context of fulfilling their overall commitments. Efforts at peer learning should also be increased.***

2. National and international trends in science, technology and innovation

Science, technology and innovation play a central role in the implementation of the 2030 Agenda for Sustainable Development across all Sustainable Development Goals (SDGs). For example, ICT can be used to map the needs of the poor in support of development initiatives to eradicate poverty, or to ensure last-mile delivery of food, drugs and other disaster relief. There is, however, concern that the benefits of technology may not be available to all. Ensuring that STI is inclusive and beneficial to all will depend on sound policy and regulatory frameworks, the strategic allocation of resources, adequate infrastructure, and international cooperation and support for those most in need.

Innovation is at the basis of technological development. However, innovation is not limited to new breakthroughs: most innovation involves incremental improvements and adaptations of existing technologies, processes and organizational structures. China and India, in particular, have become global leaders in some sustainable technologies, such as solar and wind technology, and electric and hybrid-electric vehicles, in part because they were able to improve existing technologies and production processes. Some LDCs have also begun to develop domestic technological capacities and successfully build new industries, such as the solar photovoltaic industry in Bangladesh.

An example of a technology that is rapidly evolving is Blockchain, which records information and shares it via a peer-to-peer network using state-of-the-art cryptography. This technology makes transactions possible without an intermediary and thus has the potential to reduce service costs and increase financial inclusion. However, it is important to note that blockchain services are still in early stages and a number of issues, including data and privacy protection, regulatory oversight, and the overall contribution to sustainable development need further discussion, especially at the international level due to their cross-border nature.

2.1 Global expenditure for research and development

Since 2000, total (public and private) spending on R&D as a proportion of GDP has grown in all country categories, although the global distribution of spending remains uneven, with five economies accounting for 59 per cent of global public R&D spending in 2014 and 25 economies accounting for 90 per cent.[2]

The 2008 world financial and economic crisis in 2008 did not have a significant immediate impact on global spending for R&D. Global spending on R&D as a percentage of gross domestic product

2 OECD (2016). OECD Science, *Technology and Innovation Outlook 2016*. Available from http://dx.doi.org/10.1787/sti_in_outlook-2016-en.

Box 1
Social innovation

In addition to technological, process and structural innovation, United Nations Member States agreed in the Addis Ababa Action Agenda to promote social innovation that supports societal well-being and sustainable livelihoods. In the absence of both an agreed definition of social innovation and indicators to measure how social innovation contributes to social well-being and sustainable livelihoods, case studies can illustrate some recent developments of innovations aimed at improving human well-being. These approaches have the potential to address the needs, interests and perspectives of poorer, marginalized communities, and serve non-market and environmental goals, which can be relevant for countries with low levels of innovation capabilities to realize the Sustainable Development Goals.

For instance, in response to the Ebola outbreak in 2014, the United States Agency for International Development (USAID) collected more than 1500 ideas for combating the disease. The Agency then identified 14 of these ideas for their potential effectiveness and some are already being implemented. Other examples of pro-poor and inclusive innovation include the Mitticool low-cost refrigerator created in India that can be easily and inexpensively built (at about $30 to $50), and collaborative initiatives, such as the Unilever Shakti initiative, aimed at strengthening women's empowerment and capacity-building in poor communities. Several countries and international organizations are also implementing social innovations, such as organic farming by smallholder farmers (Thailand) and women's information and communications technology-enabled entrepreneurship (UN Women).[a]

a United Nations Commission on Science and Technology for Development.

(GDP) increased from 1.56 per cent in 2007 to 1.64 per cent in 2009,[3] partly because R&D spending was included in stimulus packages by some countries.[4] However, from 2010 to 2015, public spending on R&D in many developed countries as well as some emerging economies contracted. Growth rates in total R&D expenditure were largely supported by private investment. In contrast, in developing countries, public spending on R&D continued to increase. As a result, LDCs, LLDCs, SIDS[5] and middle-income countries witnessed an incremental increase in their total spending on R&D (figure 1). Nonetheless, other than middle-income countries, the growth in spending was still below growth in developed countries, meaning that the gap between developed and most developing countries continued to grow.

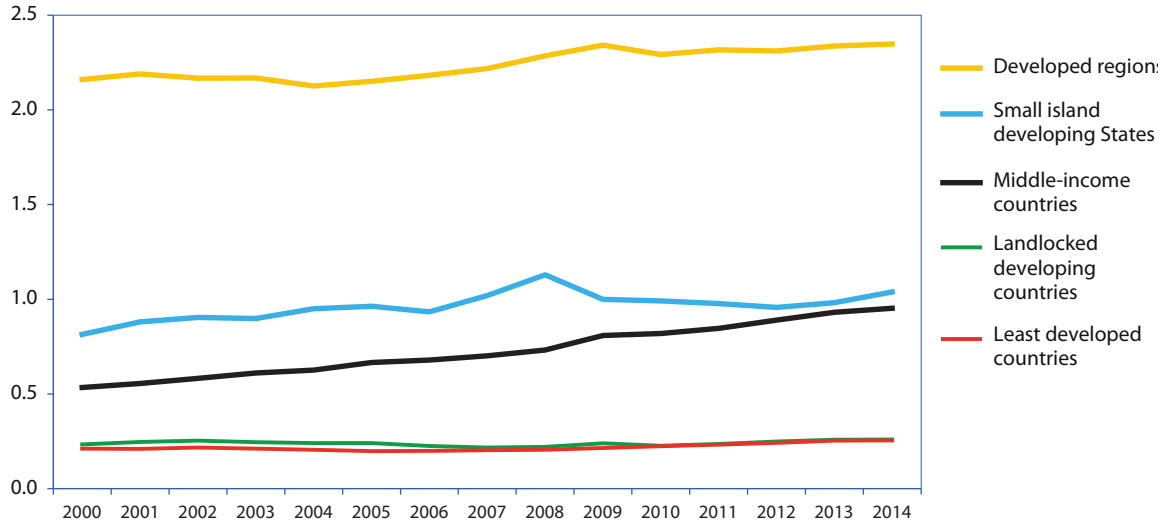
The decline in public spending on R&D in developed countries following the global economic and financial crisis has led to fears of fluctuations and procyclical behaviour in investment, with R&D declining during periods of economic slowdowns. Based on these developments, one recommendation is for Governments to introduce policies to ensure that government spending on R&D remains stable and long-term oriented, in contrast to the R&D expenditure incurred as part of short-term stimulus packages directly after the financial crisis.

2.2 Facilitating the innovation process through National Innovation Strategies[6]

Both public and private actors contribute to the innovation process, which is generally composed of four interdependent phases: research, development, demonstration and diffusion. In addition, market formation can be added for new markets, such as for some clean technologies that do not automatically develop after the diffusion stage. The government is often the main actor in basic research, through funding for universities or public research laboratories. Development and demonstration, which are based on entrepreneurial experimentation, generally take place within firms. However, financing for these advanced stages of product development is gener-

3 UNESCO Institute for Statistics.
4 UNESCO (2015). *UNESCO Science Report: towards 2030*. Available from http://unesdoc.unesco.org/images/0023/002354/235406e.pdf.
5 The data for SIDS are dominated by a single country that spends more than any other member of the country group.
6 United Nations (2011). *The great green technological transformation*, World Economic and Social Survey 2011.

Figure 1
Research and development expenditures, 2000 – 2014 (*Percentage of GDP*)



Source: UNESCO Institute for Statistics.

ally limited, particularly in the so-called valley of death, during which the investment risk is still high but government financing often limited. Funding for this stage often comes from entrepreneurs' own savings or from family members. Venture capitalists tend to fund projects that have already been demonstrated in the marketplace, although they have been hesitant to take risks associated with some investments in some new technologies, especially in developing countries. Thus, the development phase of many new technologies—and particularly sustainable technologies—often needs to be supplemented by government policies.

At the national level, the impact of STI on sustainable development is closely linked to the quality of policy frameworks, innovation strategies and supporting infrastructure, ranging from roads to Internet access. Spending on R&D needs to be linked to policies that create an enabling environment for innovation and support entrepreneurship to ensure that innovations can be deployed for sustainable development. Policies should be designed in an integrated manner as part of the innovation system, to encourage interaction and knowledge-sharing among domestic and international firms, research institutes, universities, policymakers and other actors. Furthermore, STI policies should be coherent with other development policies—trade, foreign direct investment (FDI), and education, for example. For developing countries, initiatives to enhance absorption capacity and facilitate the diffusion of innovation deserve special attention.

Countries have a variety of options for providing incentives for the promotion of STI. They can utilize the tax system or other incentives to nudge the private sector to invest in STI. National innovation funds are one instrument identified in the Addis Agenda that countries can use to allocate resources for R&D.

2.3 Innovation funds

In the Addis Agenda, Governments committed to "consider setting up innovation funds where appropriate, on an open, competitive basis to support innovative enterprises, particularly during research, development and demonstration phases".[7] As noted in the Agenda, such funds create diversified portfolios, which spread risk across multiple investments,

7 Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda) (United Nations publication, Sales. E.16.I.7), para. 118. Available from http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf.

so that gains from winning investments compensate for losses from failures.

Innovation funds have been established to support innovative enterprises or public institutions, particularly during research, development and demonstration phases, as defined by national strategies. In combination with the distribution of funds to STI activities, public and/or closed-end innovation funds can also act countercyclically, providing resources for STI during economic slowdowns. Innovation funds can also stimulate competition among potential fund beneficiaries. Furthermore, they can foster collaboration by linking STI actors and stakeholders across different sectors. Different types of innovation funds would allocate resources differently, with some sectors needing financing for basic research, while others might have a greater need for financing during later phases, such as development or demonstration. Innovation funds should also be inclusive and support diverse sources of knowledge.

The United Nations Educational, Scientific and Cultural Organization (UNESCO) Science Report from 2015[8] provides a baseline snapshot of more than 35 innovation funds globally. The list includes 6 innovation funds from developed countries and more than 29 funds from developing countries, including some LDCs and LLDCs. Some of the funds were set up as early as the 1990s, but most were established in the last ten years. Total financial resources reported for these funds are several hundred million dollars. Most funds are endowed with domestic public resources. In some cases, this includes earmarked revenues, such as taxes on the profits of mining or energy companies. Some funds also utilize private investment; although, to date, co-mingled investment by public and for-profit private actors has been limited.

Existing national innovation funds support activities across various sectors and different stages of the innovation process, with a concentration in general science and technology as well as sectors such as clean energy and health. Several innovation funds in developing countries also focus on agriculture. While most funds concentrate on the provision of financial resources, some also offer technical advice.

In addition to national funds, there are international innovation funds. The Global Innovation Fund (GIF), for example, was established by the Governments of Australia, Sweden, the United Kingdom of Great Britain and Northern Ireland, and the United States of America, in partnership with Omidyar Network. The GIF invests in a range of innovations in developing countries, which have potential for social impact on a large scale, with innovation broadly defined to include new business models, policy practices, technologies, behavioural insights, or ways of delivering products and services that benefit the poor.

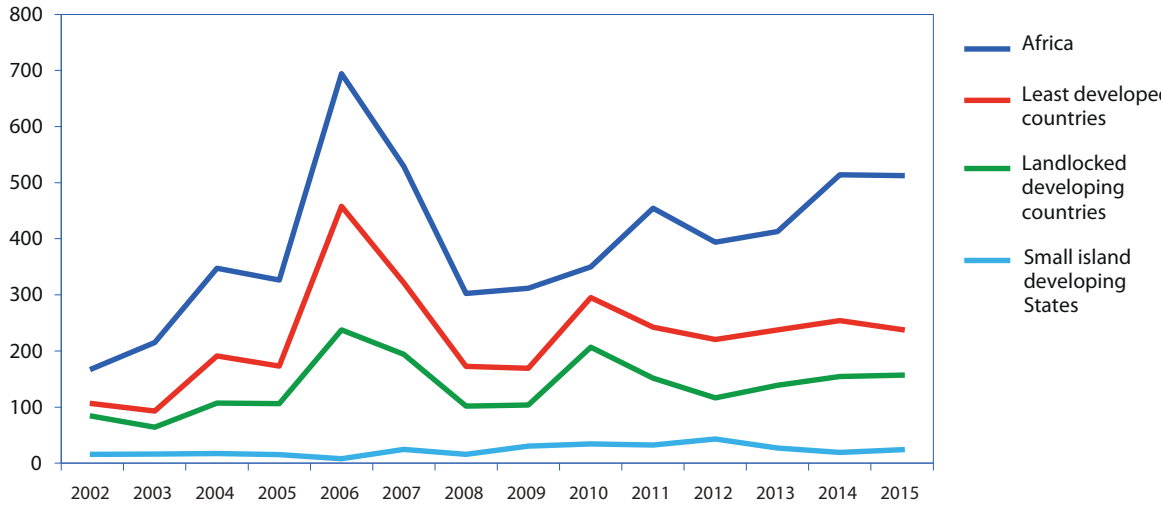
2.4 International cooperation for STI

In addition to national efforts, international cooperation plays an important part in strengthening science, technology and innovation. ODA for R&D in areas such as education, medical, energy, agriculture, forestry, fishery, technology and environmental, as well as research and scientific institutions, peaked in 2006 as a result of a strong increase in one-time contributions from some bilateral donors in certain sectors. A low point was reached during the financial crisis (figure 2). Since then, only a modest increase was observed in LDCs and LLDCs, although ODA to African countries recovered to some extent. The share going to SIDS remained relatively low.

The Development Cooperation Forum (DCF) has underscored how development cooperation modalities and instruments—such as technical and financial support, capacity-building, and policy change support—if carefully deployed, country-owned, and delivered through effective channels can facilitate innovation to achieve the 2030 Agenda for Sustainable Development. To deliver on such a challenging promise, development cooperation providers and recipients will have to share a common understanding of what constitutes successful technology innovation at different stages of the technology cycle. Furthermore, donors need to provide long-term capacity-building and bring together resources, actors and actions that respond

8 UNESCO (2015). *UNESCO Science Report: towards 2030*. Available from http://unesdoc.unesco.org/images/0023/002354/235406e.pdf.

Figure 2
Official development assistance for scientific, technological and innovative capacity, 2002–2015
(*Millions of constant 2014 United States dollars*)



Source: OECD Creditor Reporting System and UN DESA calculations.
Note: These official development assistance flows include flows to the areas of education, medical, energy, agricultural, forestry, fishery, technological, environmental, and research and scientific institutions.

to development needs and the specific social, economic, political and institutional contexts. Such a careful approach, supported by dedicated analysis and policy dialogue at the global level, can help propel technology innovation and ensure that STI supports national and global development priorities, including the 2030 Agenda for Sustainable Development.[9]

Regarding R&D for vaccines and medicines, at the end of 2015, the Global Alliance for Vaccines and Immunizations (GAVI) initiative had secured full funding for its 2011-2015 strategic period, with cumulative funds totalling $12 billion since its inception in 2000. As a result, GAVI exceeded its goal to immunize an additional 243 million children between 2011 and 2015. GAVI is funded through a mix of contributions from Governments and philanthropy, as well as by innovative finance mechanisms such as the International Finance Facility for Immunisation (IFFIm), which frontloads aid payments.[10]

South-South cooperation on STI could potentially make an important contribution by providing access to complementary knowledge, offering context-specific solutions and overall STI capacity-building. However, the limited available data suggests that, as of now, technology-driven FDI among developing countries is still relatively small. Furthermore, South-South technology-driven FDI is dominated by flows from a few countries and with a heavy focus on ICT (47 per cent of total South-South technology-driven FDI) and design, development and testing (DDT) (36 per cent). Pure R&D investments only account for about 10 per cent. While countries in Asia—where the technology-driven FDI growth rate is 1 per cent—continue to receive the highest total amount, inward South-South technology-driven FDI growth is higher in Africa

9 This section highlights findings of the 2016 Development Cooperation Forum Policy brief entitled "International Development Cooperation to Promote Technology Facilitation and Capacity-building for the 2030 Agenda". Available from http://www.un.org/en/ecosoc/newfunct/pdf15/dcfuganda_policy_brief_tech2.pdf.

10 For certain vaccination programmes to be effective in serving public-health goals, such as containing the spread of contagious diseases, it is important that a certain level of coverage will be quickly reached. Thus, the International Finance Facility for Immunisation restructures existing financing by issuing bonds backed by long-term official development assistance pledges from donor countries with the objective of generating upfront financing.

(15 per cent) and Latin America and the Caribbean (14 per cent). Outward technology-driven FDI is growing, especially from Africa (20 per cent, particularly from Mauritius and South Africa) and Latin America and the Caribbean (14 per cent, particularly from Argentina, Brazil and Mexico), although from a low base. It is important to note that the growth is caused predominantly by flows going to countries in the same region.[11]

3. Actions by the United Nations system

Progress was made on a range of actions by the United Nations system in order to strengthen overall cooperation and support on science, technology and innovation.

3.1 Establishment of the Technology Bank

The Addis Agenda reiterated the call from the Istanbul Programme of Action for the establishment of a Technology Bank that can help improve scientific research and the innovation base in LDCs, promote networking among researchers and research institutions, and help LDCs access and utilize critical technologies. In May 2016, the Secretary-General appointed the Governing Council for the Technology Bank, which elaborated its draft charter[12] and prepared a three-year Strategic Plan[13] for the new institution. The General Assembly formally established the Technology Bank[14] in December 2016, to commence operation in 2017, with headquarters located in Gebze, Turkey.

The main objective of the Technology Bank, as set out in its charter, is to support LDCs in building the STI capacities required for the transformation of their economies, eradication of poverty and fostering sustainable development. The Technology Bank will (i) strengthen the capacity to identify, absorb, develop, integrate and scale up the deployment of technologies and innovations, including indigenous ones, as well as the capacity to address and manage intellectual property rights (IPRs) issues; (ii) promote the development and implementation of national and regional STI strategies; (iii) strengthen partnerships among STI-related public entities and with the private sector; (iv) promote cooperation among all stakeholders involved in STI, including researchers, research institutions, public entities within and between LDCs, as well as with their counterparts in other countries; (v) promote and facilitate the identification, utilization and access of appropriate technologies by LDCs, as well as their transfer to the LDCs, while respecting IPRs and fostering the national and regional capacity of LDCs for the effective utilization of technology to bring about transformative change.

As operational units, the bank will comprise a Science, Technology and Innovation Supporting and Enabling Mechanism (STIM) and an Intellectual Property (IP) Bank. The STIM is expected to strengthen STI capacities of LDC Governments and other stakeholders. This would be achieved through the promotion of national and regional innovation ecosystems that can attract outside technology, stimulate domestic research and innovation, and help resulting products reach the market stage. The IP Bank is intended to support LDCs in building domestic and regional capacities in the areas of IPRs and technology-related regulations. Furthermore, the IP Bank is set up to facilitate technology transfer on voluntary and mutually agreed terms and conditions and, as part of the process, help accelerate LDC beneficial integration into the global IP system and technology markets. Thus, the IP Bank will act as a conduit between IP holders and relevant actors in the LDCs to facilitate access and use of appropriate IPRs covering desired technologies. Finally, the IP Bank will also help LDC stakeholders identify,

11 WIPO (2016). The *Global Innovation Index 2016: Winning with Global Innovation*. Available from http://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2016.pdf.

12 United Nations (2016). *Technology Bank for the Least Developed Countries*. Note by the Secretary-General, A/71/363. Available from http://undocs.org/A/71/363.

13 See http://unohrlls.org/custom-content/uploads/2017/01/Strategic-Plan-of-the-Technology-Bank-for-the-LDCs-8-August.pdf.

14 United Nations (2016). *Establishment of the Technology Bank for the Least Developed Countries*. Resolution adopted by the General Assembly, A/RES/71/251. Available from http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/71/251.

access and use appropriate technologies no longer covered by IPRs protections.

The Technology Bank will be financed by voluntary contributions from Member States and other stakeholders, including the private sector and foundations, to a dedicated trust. It is estimated that the Technology Bank will require an annual budget of $35 million to $40 million to have an impact in all LDCs. Therefore, during the initial phase of the Technology Bank, it will be critical to establish the financial base of the new institution.

3.2 The Technology Facilitation Mechanism

The Technology Facilitation Mechanism (TFM) consists of a United Nations Inter-agency Task Team on Science, Technology and Innovation for the Sustainable Development Goals (IATT-STI), a collaborative Multi-stakeholder Forum on Science, Technology and Innovation for the Sustainable Development Goals (STI Forum) convened by the President of the United Nations Economic and Social Council (ECOSOC), and an online platform to serve as an information gateway to STI initiatives within and beyond the United Nations.

The IATT-STI was established in September 2015 under the chairmanship of the United Nations Department of Economic and Social Affairs and the United Nations Environment Programme. Its membership comprises 31 organizations of the United Nations system. In January 2016, the Secretary-General appointed a 10-Member Group to Support the Technology Facilitation Mechanism (10-MG), which consists of ten high-level representatives of academia, civil society and the private sector, to support the IATT-STI and the President of ECOSOC on the STI Forum.

The first STI Forum was convened on 6-7 June 2016.[15] It was attended by more than 600 participants representing 81 Governments and more than 350 scientists, innovators, technology specialists, entrepreneurs and civil society representatives. Participants discussed the mobilization of science, technology and innovation for the SDGs; options for strengthening science, technology and innovation capacity; literacy; policy coherence; and the role of international cooperation in strengthening science, technology and innovation, in addition to other issues. Going forward, the STI Forum should continue to strengthen the dialogue between Governments and all stakeholders to facilitate the exchange of ideas and building of new partnerships.

The TFM online platform will establish a comprehensive mapping of and gateway to information on existing STI initiatives, mechanisms and programs at the United Nations and beyond. Second, it will provide access to information and experiences, including best practices and lessons learned, related to STI facilitation initiatives and policies. Third, it will support the global dissemination of relevant open-access scientific publications. In response to the mandate from the 2030 Agenda for Sustainable Development, an independent technical assessment for the development of the online platform is underway and scheduled to be presented at the 2017 STI Forum (15-16 May 2017). The IATT-STI and the 10-MG have initiated consultations and developed terms of reference for the independent technical assessment. It will include sections on (i) architecture, functional requirements and user groups; (ii) stocktaking, benchmarking, best practices, and lessons learned from existing relevant online platforms, within and beyond the United Nations system; (iii) recommendations on management and governance structure and regular quality control of the platform; and (iv) an assessment of the benefits and potential financial costs. The online platform will also include a preliminary collection of existing technology applications and initiatives that address sustainable development challenges.

4. Capacity-building

Support to capacity-building is an integral part of the global partnership for sustainable development. The Organization for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) data on international funds for financial and technical assistance to African countries, LDCs, LLDCs and SIDS (SDG Indicator 17.9.1) show that

15 United Nations (2016). *Multi-stakeholder forum on science, technology and innovation for the Sustainable Development Goals: summary by the Co-Chairs*. Note by the President of the Economic and Social Council, E/HLPF/2016/6. Available from http://www.un.org/ga/search/view_doc.asp?symbol=E/HLPF/2016/6&Lang=E.

after a substantial increase between 2005 and 2010, disbursements to all four country groups declined again between 2010 and 2014 (figure 3).[16] While the OECD DAC statistics may underreport the amount for technical assistance because they do not include the value of donor expertise provided as part of projects, the decline in disbursements is still a concerning trend.

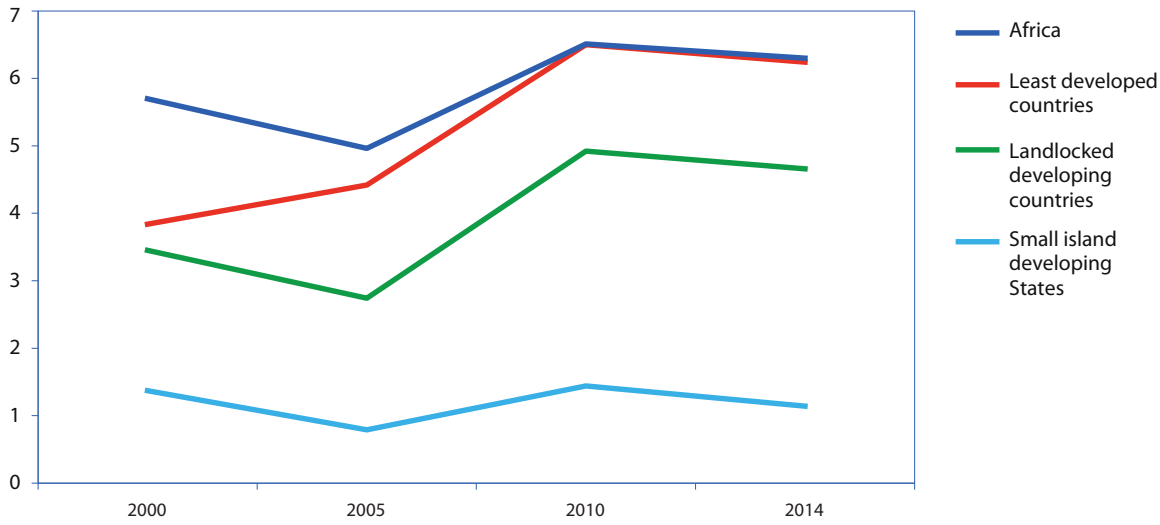
Capacity-building and peer learning are important components of South-South cooperation, although it is not possible to measure detailed financial and technical contributions. Several organizations of the United Nations system have served as brokers for initiatives to support South-South cooperation that are designed to build human and institutional capacities for the implementation of national plans and strategies in developing countries.[17]

Measures to strengthen the effectiveness of capacity-building are ongoing. For example, a joint initiative by the United Nations, International Monetary Fund, World Bank Group and OECD presented a report to the Group of Twenty on how to enhance the effectiveness of external support in building tax capacity in developing countries.[18] The initiative aims to better coordinate capacity-building support to developing countries, deliver joint outputs and strengthen the interactions between standard-setting, capacity-building and technical cooperation. However, more needs to be done by both providers of international support and recipient countries. Capacity-building can also be supply-driven or, in some cases, influence national policies, resulting in country ownership being undermined by donor priorities. From the recipient perspective, it is often a lack of capacity itself that can make it difficult to take ownership in the relationship with international donors.

As a follow-up to the commitments in the Addis Agenda, several multi-stakeholder partnerships were launched to support capacity-building in the context of financing sustainable development. One example is the Addis Tax Initiative (ATI), which

Figure 3

Financial and technical assistance commitments, selected years, 2000–2014 (*Billions of constant 2014 United States dollars*)



Source: United Nations Statistics Division database.

16 See https://unstats.un.org/sdgs/indicators/database/?indicator=17.9.1.

17 United Nations (2016). *State of South-South cooperation*. Report of the Secretary-General, A/71/208. Available from http://undocs.org/A/71/208.

18 International Monetary Fund (IMF), OECD, United Nations, World Bank Group (2016). *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries*. Available from http://pubdocs.worldbank.org/en/858011469113510187/Enhancing-the-Effectiveness-of-External-Support-in-Building-Tax-Capacity.pdf.

is supported by more than 45 countries along with regional and international organizations that committed to double their support for capacity-building by 2020. To support the achievement of its commitments, the ATI will hold its first conference on tax and development in June 2017. The Initiative Tropical Agriculture Platform, facilitated by the Food and Agricultural Organization, developed and approved a framework on capacity development for agricultural innovation systems.

Chapter IV.

Data, monitoring and follow-up

1. Key messages and recommendations

The final chapter of the Addis Ababa Action Agenda emphasizes the importance of high-quality disaggregated data for policymaking and for accurately monitoring the progress of implementation of the Addis Agenda and the 2030 Agenda for Sustainable Development. The 2016 ECOSOC Forum on Financing for Development follow-up endorsed the Inter-agency Task Force on Financing for Development proposal to develop an online annex to compile and analyse all relevant data in a comprehensive manner. The creation of this annex has been a major undertaking of the Task Force in 2016-17. The annex contains the most up to date data across chapters, with an emphasis on tracking all flows for financing sustainable development. However its coverage remains uneven due to incomplete data.

While there is a rich variety of data sources available for monitoring the Financing for Development (FfD) outcomes, official data sources' coverage of commitments and actions is mixed. In some areas, there is robust tracking of financing flows with clear information on a from-whom-to-whom basis; in other areas, data may be missing, delayed, not comparable or not easily validated, at both national and international levels.

Compared to the Sustainable Development Goals (SDG) indicator process, the elaboration of the monitoring framework for the Addis Agenda and FfD outcomes has been agency driven. This has made the reporting less formalized, but has also meant that the closing of data gaps on FfD follow-up may not be sufficiently prioritized within the global agenda. In the Addis Agenda, Member States recognize the need for strengthening financing and related data, and request the United Nations Statistical Commission (UNSC), working with the relevant international statistical services and forums, to facilitate enhanced tracking of data on all cross-border financing and other economically relevant financial flows. Nonetheless, questions remain about the appropriate framework for dealing with the data challenges related to financing for development. The UNSC promulgates statistical standards and oversees the work of SDG indicator development. It often relies on related forums of experts to undertake the development of statistical standards and measures in specific statistical domains. For example, some of the information and data necessary for follow-up on the Addis Agenda are collected by central banks and other bodies, and not by the national statistical offices (NSOs) that are represented on the UNSC.

The online annex will include boxes on data gaps, which will be consolidated in the data section. ***Member States could consider strengthening support, including funding, to the Task Force to allow it to intensify its work on closing reporting gaps, as well as to provide additional analytical tools to present available data in more accessible or policy-relevant formats***. To go beyond this inter-agency effort, which focuses on compiling and presenting existing data, ***Member States would need to indicate whether they want the framework for data collection and the data gaps related to financing for development to be presented to the UNSC in the near term, and, if so, what the preparatory mechanism would be.***

The Addis Agenda, like the 2030 Agenda for Sustainable Development, prioritizes the development of data and statistical capacity. The Cape Town Global Action Plan for Sustainable Development Data provides a framework for discussion on, and planning and implementation of statistical capacity-building necessary to achieve the scope and intent of the 2030 Agenda. ***Resources invested in data capacity-building and production should be***

strategically allocated to benefit a large number of Member States. On their part, potential recipients of assistance that do not yet have them should develop national statistical plans.

The Addis Agenda emphasises the interoperability of data and standards. ***Countries should consider how to speed-up implementation of the Data Gap Initiatives' recommendations related to national and international sharing of granular data***.

2. Strengthening data and statistical capacities

In March 2016, at its forty-seventh session, the UNSC agreed to a global indicator framework for measuring achievement of the SDGs as a practical starting point, based to the greatest extent possible on comparable and standardized national official statistics.[1] At its forty-eighth session in 2017, the Commission agreed with the revised indicator framework, recognizing that building a robust and high-quality indicator framework will need to develop over time, and that all indicators are not necessarily applicable in all national contexts. Currently, the SDG indicators database, based on the framework developed by the Inter-Agency and Expert Group on Sustainable Development Goal Indicators, includes data for 115 of the 230 SDG indicators agreed in 2016, with almost 500 data series and a total of more than 330,000 data records, disaggregated at country, regional and global levels. The database and reports based on it represent a comprehensive measure of progress.

While much is being done to improve data availability and adequacy, gaps persist in the level and type of disaggregation captured by existing data. The Addis Agenda calls for disaggregation of data by sex, age, geography, income, race, ethnicity, migratory status, disability and other characteristics relevant in national circumstances. However, there remains a significant lack of financial resource allocation for conducting household-level surveys with adequate levels of disaggregation.

There is much work going on to improve the disaggregation of data, but challenges remain. The Evidence and Data for Gender Equality (EDGE) project is a joint initiative of the United Nations Statistics Division and UN Women that seeks to improve the integration of gender issues into the regular production of official statistics for better, evidence-based policies. EDGE has worked for several years to develop and test guidelines to measure asset ownership/control and entrepreneurship from a gender perspective, and is now preparing revised guidelines to be submitted to the next session of the UNSC. As another example, there is a notable lack of disaggregated statistics on persons with disabilities. In response, in 2015 the United Nations Statistics Division and the Washington Group on Disability Statistics[2] started a project aimed at developing international guidelines for the measurement of disability and enhancing the capacity of national statistical systems to collect and generate relevant, quality statistics on persons with disailities based on those guidelines.[3] This project will be completed in March 2019.

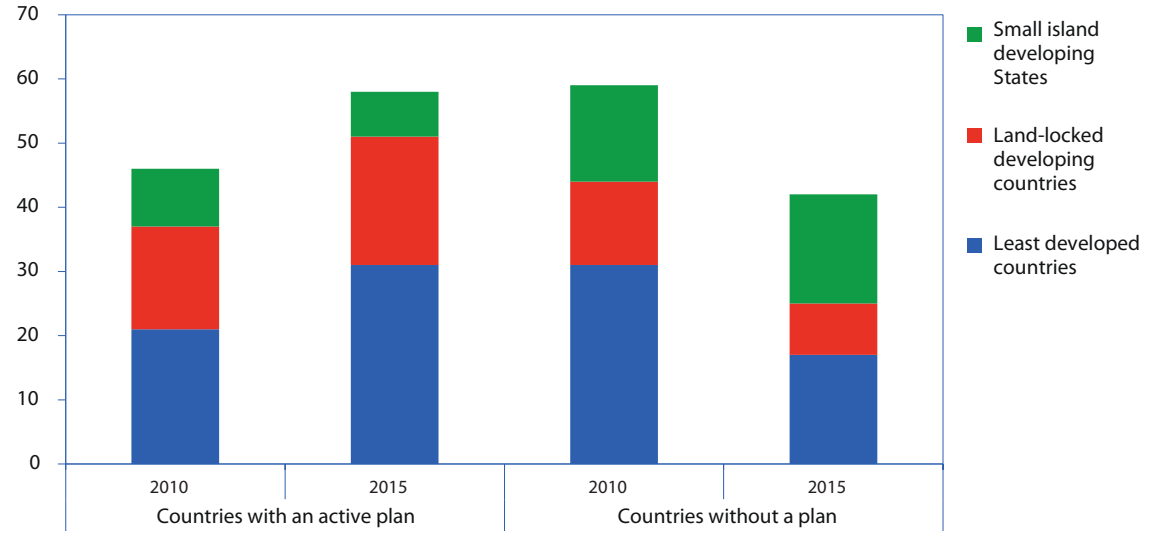
Developing countries need support to improve the availability of high-quality and disaggregated data. The Addis Agenda stresses the importance of country needs assessments for improving their data capacities. The number of least developed countries (LDCs) and landlocked developing countries (LLDCs) with active national statistical plans increased from 21 to 31 and 16 to 21, respectively, between 2010 and 2015 (figure 1). However, many countries do not have national statistical plans, and others need to update their plans. The number of small island developing States (SIDS) with a statistical plan declined from nine to seven over this period, as the time period for some existing plans expired.

Figure 2 illustrates how international development cooperation, including official development assistance (ODA), can provide catalytic support to developing countries to enhance capacity-building in data and statistics. The share of ODA dedicated to statistical capacity-building was only 0.25 per cent in 2014, up just slightly from 0.24 per cent in 2013.

1 E/CN.3/2016/34, decision 47/101.
2 Available from http://www.washingtongroup-disability.com/.
3 E/CN.3/2016/22.

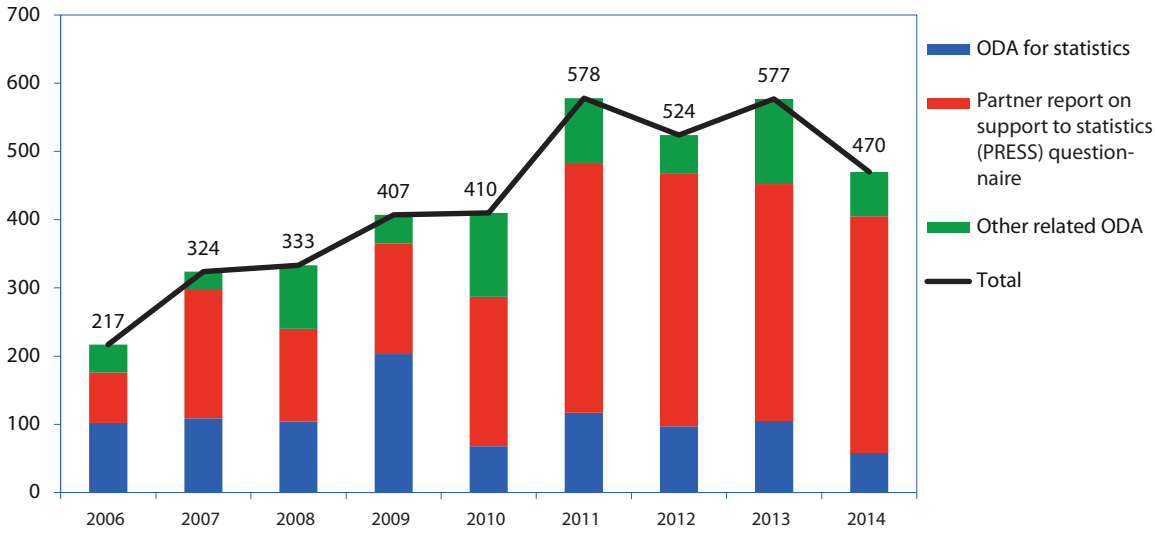
It is also important to note that the small volumes of ODA for statistical capacity-building are concentrated, with the top five recipient countries receiving, on average, 38 per cent of the total from 2011 to 2015. Regional cooperation and South-South cooperation in statistics and monitoring and evaluation could provide capacity support that is relevant, as noted at the 2016 Development Cooperation Forum.

Figure 1
Number of countries with a national statistical plan, 2010 and 2015



Source: United Nations Statistics Division database.

Figure 2
Global funding commitments to statistics, by data source, 2006–2014 (*Millions of United States dollars*)



Source: Partner Report on Support to Statistics (PRESS), 2016.

The first United Nations World Data Forum took place in Cape Town, South Africa, on 15-18 January 2017, hosted by the Government of South Africa and Statistics South Africa, with support from the United Nations Statistics Division acting as secretariat. At its conclusion, the Global Action Plan for Sustainable Development Data was launched.[4] The Plan sets out a framework for member countries to assess, build and strengthen NSO capacity and identifies six strategic areas, with one of them referring to the need for innovation and the modernization of national statistical systems including the application of new technologies and data sources. This plan was adopted by the UNSC during its meeting in March 2017. Implementation of the plan will be evaluated at the second United Nations World Data Forum, which will convene in Dubai, United Arab Emirates, at the end of 2018 or early 2019.

3. Monitoring financial flows

The Addis Agenda includes commitments to improve data availability specifically on resource mobilization, spending and cross-border financing. The data on Goal 17 and the means of implementation of the SDGs are particularly relevant to the FfD follow-up, and are an integral part of the work of the Task Force. In March 2016, the UNSC agreed on indicators covering ODA, foreign direct investment, South-South cooperation, remittances, and the dollar value of financial and technical assistance committed to developing countries overall. However, data for the component of the indicator covering South-South cooperation (17.3.1) is not specified. The online annex of the Task Force clearly highlights relevant SDG indicators and links to the data, and much of this data is reported and included in the chapters of the 2017 Task Force report. Some flows are well covered, but not all relevant flows are being captured (box 1) and improved tracking remains a challenge.

National level macroeconomic, financial and external sector statistics are for the most part compiled by central banks and finance ministries. The International Monetary Fund (IMF) has been a major player in global efforts to assist developing countries in improving their statistics in these areas. In the year to end-April 2016, it sent 563 missions to countries around the world and organized 120 training events reaching thousands of country participants. About half of the technical assistance on statistical issues benefits low-income countries.

In a related effort, the IMF and the Financial Stability Board have been leading the Data Gaps Initiative (DGI)[5] to address gaps in economic and financial data identified after the 2008 world financial and economic crisis. In 2015, the Group of Twenty Finance Ministers and Central Bank Governors endorsed the completion of the first phase and the launch of the second phase of the DGI. In this context, a thematic workshop on data sharing, emphasising economic and financial data, was held during January 31-February 1, 2017. The key outcomes included agreement on a common terminology on data sharing, the identification of main barriers preventing the sharing of disaggregated data and micro data (including cross-border disaggregated data), and discussion on possible approaches to overcome such barriers. The workshop concluded with seven recommendations aimed at providing guidance to national and international authorities and encouraging increased accessibility and sharing of granular data. Such sharing has many important uses relevant to the Addis Agenda. Information sharing on financial market activity is crucial for effective supervision of financial institutions and resolution of failed institutions. National sharing of granular data can better enable law enforcement, including crackdowns on tax avoidance, tax evasion, fraud and other illicit financial flows. Better availability of financial transaction data on a from-whom-to-whom basis would enable much better disaggregated data to be made available on the means of implementation for the 2030 Agenda for Sustainable Development.

4 See https://unstats.un.org/sdgs/hlg/Cape-Town-Global-Action-Plan/.

5 The Inter-Agency Group on Economic and Financial Statistics, chaired by the International Monetary Fund (IMF), has been facilitating the work at the global level.

Box 1

Data gaps and challenges

In addition to the overarching challenges of data availability, disaggregation and timeliness, below are some of the main data gaps identified in each chapter or action area of the Addis Agenda. Data gaps in each action area are also enumerated in the online annex and consolidated in the data section.

Domestic public resources

- Data on illicit financial flows and stolen assets
- Historical data on ODA for domestic revenue mobilization capacity
- Aggregated data on national development bank financing
- Aggregated data on practices in international tax cooperation
- Continuous coverage of fossil fuel subsidy estimates
- Real-time government spending data, with disaggregation by sex and other relevant areas

Private business and finance

- Private cross-border capital flows, on both gross and net bases, for each flow type
- Consistency of FDI data across institutions
- Domestic private investment figures, including sectoral and gender disaggregation
- MDB private investment catalysation
- Unrecorded remittances through informal channels
- Comprehensive coverage of philanthropic flows, including disaggregation

International development cooperation

- Data inconsistencies on lending by multilateral development banks and leveraging of private finance
- Crisis prevention financing and alternative funding mechanisms
- Comparable data and information on South-South cooperation and its contributions to sustainable development
- Capacity gaps in monitoring and review of development cooperation at country level
- Limited tracking of gender-disaggregated expenditures in development cooperation information systems

International trade

- Global agricultural producer support estimates
- Comprehensive information about the distributional implications of trade within countries, for example gender-impact
- Qualitative assessment of coherence questions

Debt and debt sustainability

- Limited data on domestic and private debt as well as contingent liabilities
- Discrepancies in debtor and creditor records
- Different data series on external debt remain difficult to compare

Addressing systemic issues

- Quantitative measurements — as well as, at the least, clear indicators — for policy coherence
- Consistent and aggregated data on migration and transnational crime
- Disagreement about the effectiveness of financial regulatory reforms

Science, technology, innovation and capacity-building

- Data on ICT skills and accessible technology for people with disabilities (disaggregated by gender)
- Data on social innovation and promoting entrepreneurship (national strategies, social entrepreneurship)
- Data on contributions from traditional knowledge, innovations and practices of indigenous peoples and local communities
- Data on public funding to enable critical projects to remain in the public domain and strive for open access to research for publicly funded projects.