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Coherence, coordination and cooperation in the context of financing for development

Note by the Secretary-General*

Summary

The present note provides background information and suggested points for reflection to inform discussion on the following selected themes:

(a) Promoting sustained, inclusive and equitable economic growth, job creation, productive investment and trade;

(b) Financing of sustainable development.

* The present note was prepared in consultation with the staff of the major institutional stakeholders involved in the financing for development process. Responsibility for its content, however, is solely that of the United Nations Secretariat.

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I. Promoting sustained, inclusive and equitable economic growth, job creation, productive investment and trade

Current trends and challenges

1. The declining prospects for economic growth, especially in the developed countries, continue to threaten the fragile recovery from the world financial and economic crisis. At the same time, global labour markets showed little improvement in 2011. Whereas unemployment remained elevated in most developed economies in 2011, it has been particularly high in the countries facing debt distress and limited fiscal space. Youth unemployment rates are exceptionally high worldwide. Many workers in developing countries continue to face social challenges such as unemployment, poor pay, vulnerable job conditions and lack of access to any form of social security. Overall, according to estimates by the International Labour Organization (ILO), the world must create 600 million jobs over the next decade to compensate for jobs lost during the crisis and meet the needs of a larger global population.[1]

Strengthening domestic resource mobilization for sustained growth and employment

2. To move towards a more robust, balanced and sustainable recovery, coordinated policy actions are needed, especially in terms of short-term stimulus, debt resolution and orientation towards jobs creation. The right mix of monetary and fiscal policies can promote sustained growth and employment through support for aggregate demand, particularly in the short run. Demand could be supported indirectly through taxes or income subsidies or directly through public investment in infrastructure and new technologies in support of job creation.[2] Fiscal consolidation remains critical in the long run to maintain investor confidence through credible programmes to reduce fiscal deficits and the overall debt in a sustainable manner. However, with high unemployment and weak private demand, a premature fiscal tightening may lead to further worsening, rather than improvement, of fiscal balances.[3]

3. Timely and appropriate policy interventions and reformed regulatory frameworks help to support public and private investment in job creation. Public spending measures, in the form of both active and passive labour market policies can be very effective, including the extension of unemployment benefits and work sharing programmes, wage subsidies and enhancing public employment services, public works programmes and entrepreneurship incentives.[1]

4. Modernized, equitable and effective tax systems can help to maximize government revenue for growth and employment-promoting investment. However, non-compliance, weak revenue administrations, low taxpayer morale, shallow use of financial institutions and heavy reliance on volatile receipts from multinational enterprises, as well as pressures on revenue from trade liberalization and from intensifying international tax competition, pose significant challenges for many

[1] ILO, *Global Employment Trends 2012: Preventing a deeper jobs crisis* (Geneva, 2012).
[2] *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2).
[3] UNCTAD, *Trade and Development Report, 2011* (United Nations publication, Sales No. E.11.II.D.3).

developing countries. Despite these challenges, many countries have significantly improved their tax performance over relatively short periods. For instance, limiting incentives and opportunities for rent seeking, eliminating exemptions, strengthening and broadening the tax base and developing capacity for tax expenditure and wider policy analysis have helped to promote modernized, transparent and equitable tax systems in developing countries.[4]

5. A deep, diversified and well-regulated financial sector remains essential for the effective mobilization and channelling of domestic resources to productive activities. Financial depth, measured as the ratio of deposit money bank assets to gross domestic product (GDP), has grown markedly over the past decade in all country income groups.[5] However, domestic credit to the private sector remains low in the poorest countries and challenges remain in channelling capital into employment generating activities. For a number of middle-income countries a significant portion of domestic savings are held up in international reserves. Reforms of the international payments and reserve system that would curb global market volatility and reduce the need for reserve accumulation could liberate substantial resources for long-term finance.[6]

6. More than one third of the world population — about 2.7 billion people — lack access to basic financial services, such as services for savings, loans, insurance and more. Financial inclusion calls for a financial sector that imparts universal access to a wide range of financial services, provided by a variety of sound and sustainable institutions. Inclusive finance represents an opportunity for households and entrepreneurs to generate income, smooth consumption patterns, invest and strengthen their resilience to setbacks.[7] In its recent report to the Group of Twenty (G20) summit in Cannes, France, the Global Partnership for Financial Inclusion encouraged developed and developing countries to commit to further implementation of the nine Principles for Innovative Financial Inclusion.[8]

Some questions for discussion

1. **What type of coordinated policy actions are needed to sustain the fragile global economic recovery and promote job creation?**

2. **What policy interventions and regulatory frameworks could support public and private investment in job creation?**

Enhancing the impact of private investment on growth and employment

7. The development of an effective and well-functioning domestic private sector would serve to generate an increase in investment, incomes and employment in developing countries. In particular, small and medium-size enterprises are responsible for most employment and income generation opportunities. An enabling

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[4] International Monetary Fund, Fiscal Affairs Department, "Revenue mobilization in developing countries" (March, 2011).

[5] World Bank, Financial structure dataset, 2011.

[6] *World Economic and Social Survey 2011: The Great Green Technological Transformation* (United Nations publication, Sales No. E.11.II.C.1), p. xxiii (Overview).

[7] Special Advocate of the Secretary-General for Inclusive Finance for Development, Annual report to the Secretary-General (September, 2011).

[8] Global Partnership for Financial Inclusion, "Report to the leaders", G20 Leaders Summit, Cannes, France (5 November 2011).

business environment is an important factor in maximizing their impact on growth and employment.

8. Establishing an effective legal and regulatory framework is critical, especially in terms of the ease with which businesses can be started and unwound, the cost and efficiency of registering property, and effective enforcement of contracts and the protection of creditor rights (see A/59/800). Moreover, reforms in these areas would require a well-functioning court system. According to the World Bank, 125 countries implemented 245 regulatory and institutional reforms in the period 2010-2011 that would make it easier for businesses to operate in their jurisdictions. While reforms pertaining to regulatory processes such as starting a business or registering property are still most common, an increasing number of countries are also embarking on measures to strengthen their legal institutions and enhance legal protection of investors and property rights.[9]

9. However, the ease with which aspects of the legal and regulatory environment can be applied, enforced and reformed may vary between countries and regions in line with their historical experience, culture, politics and capacities. Moreover, it is important that legal and regulatory reforms do not compromise the broader social and environmental goals of regulation, including the need to ensure adequate social protection for workers.

10. Efforts to put in place an enabling legal and regulatory framework in developing countries should be accompanied by equally critical measures to strengthen the availability of finance, especially to small and medium-sized enterprises, to fund an effective physical infrastructure and to more directly promote entrepreneurship through investing in education, skills and research in key sectors of the economy. Consideration should also be given to measures to support specialized institutions providing finance to small and medium-sized enterprises through, for example, reducing the barriers to entry that they sometimes confront. Initiatives in these areas would in many instances require assistance from the international community.

11. Longer-term private investment from overseas, especially foreign direct investment (FDI), can also play an important role in furthering development. Risk mitigation and capacity-building, as well as measures to improve the enabling business environment, can also serve to expand the distribution of FDI to a greater number of developing countries and development-enhancing sectors such as human resources, transport, energy, communications and information technology.

12. In practice, the impact of FDI on development is likely to depend on the motivation and strategy of the foreign corporation and the policies and characteristics of the recipient country. For instance, FDI in new plant equipment is more likely to add to productive capacity than FDI arising from mergers and acquisitions. Similarly, the creation of linkages between foreign affiliates and local firms and the extent to which FDI can be a channel to diffuse skills, knowledge and technology, are often a function of regulation and conditions in the host country. Linkage promotion policies have already been adopted in a number of countries and need to be combined with broader measures to strengthen the quality of entrepreneurship in the local economy, since a key factor in inducing foreign

[9] World Bank, *Doing Business 2012: Doing Business in a More Transparent World* (Washington, D.C., 2012).

affiliates to form beneficial linkages depends on the availability, cost and quality of domestic suppliers.

13. The increasing volatility and vulnerability of short-term private capital flows both during the crisis and in its aftermath has rendered important the adoption of measures to mitigate their potential destabilizing impact. Apart from appropriate prudential regulation, greater consideration should be given to measures to better manage international capital mobility, such as international taxes or national capital controls, as a means of reducing the negative impact of excessive capital flows. In addition, there is a need for consideration of measures to mitigate the inherent procyclicality of private capital flows. This would include examining the scope for countercyclical regulations, as well as financial instruments, such as bonds linked to GDP and commodity prices, which should help to mitigate some of the risks associated with procyclical foreign private capital flows (see A/66/329).

Some questions for discussion

1. **What are effective ways to facilitate the flow of long-term foreign investment to developing countries?**

2. **What are the possibilities for putting in place a system of industrial relations that serves to promote investment and productivity while also ensuring decent working conditions?**

3. **What policy measures could strengthen the availability of finance, especially to small and medium-sized enterprises, promote investment in infrastructure and foster entrepreneurship?**

Building a trade-employment nexus

14. Exports open opportunities for job creation in dynamic sectors and for employment relocation in traditional sectors. National Governments can shape and strengthen the trade and employment nexus by providing appropriate incentives, as well as support measures.[10] Depending on the circumstances of each country, a balance of economic, productive, labour market, education and social policies can help to maximize the contribution that trade can make to employment and growth.

15. To adapt to competition, national Governments should provide temporary support for those affected. This includes unemployment benefits and focused training and retraining programmes and is consistent with the emerging consensus that open economies should be characterized by strong social protection systems.[11] Successful experience with tripartite industrial relation systems should also be reviewed.

16. Developing countries should use available policy space to create dynamic comparative advantages, as well as invest in long-term support of science, technology and languages in formal and informal education, together with infrastructure development. Export promotion, not necessarily at odds with World

[10] Organization for Economic Cooperation and Development, ILO, World Bank and World Trade Organization, “Seizing the benefits of trade for employment and growth”, report prepared for the G20 summit, Seoul (November 2010).

[11] ILO, *Trade and Employment: from Myths to Facts*, Marion Jansen, Ralf Peters and José Manuel Salazar-Xirinachs, eds., (Geneva, 2011).

Trade Organization (WTO) rules, can also play a useful role, in particular if it is targeted towards overcoming problems associated with taking collective action and assists firms in reaping the benefits of agglomeration externalities that appear to be inherent to exports. In some cases, an industrial policy geared towards a transition to a low-carbon economy[12] could pave the way for export diversification and also result in increased employment, as green investments are generally more employment intensive.[13]

17. Global value chains have, in both developed and developing countries, affected the bargaining power of workers, already in decline owing to the rise of the service sector and the associated decline in unionization, as well as the effects of finance-driven globalization.[14] They have also provided employment opportunities, especially for unskilled labour, although, in many cases, these have not been conducive to stable and decent jobs.

18. Developing countries should enhance their insertion in global value chains by generating incentives for technology transfer and assimilation, complementary productive capacity and infrastructure development. In this regard, support should be provided to developing countries by development partners through the Aid for Trade Initiative, whose theme and focus of work for the next biennium is “unlocking global value chains”. In general, international coordination, including but not limited to tax coordination, and other policies to avoid “race to the bottom” strategies, should become integral to the monitoring and regulation of large transnational corporations and global value chains.[15]

19. Since a high share of employment is in the informal economy in developing countries, Governments can, directly and indirectly (for example through private-sector associations), enable informal firms to benefit from trade by providing business services, access to capital,[11] training and marketing support, and by promoting better linkages between flagship exporting firms and local suppliers in the value chains.

20. To maximize the trade-employment nexus, countries should also pay special attention to the potential trade-off between securing gains in immediate commercial interests and losing policy space over time in key areas such as intellectual property rights, capital account management[16] and debt restructuring,[17] through regional and bilateral trade and investment agreements. Completing the Doha Development Agenda could bring better long-term dividends, especially if countries could maximize the policy space available for development strategies by properly

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[12] United Nations Environment Programme (UNEP), *Towards a Green Economy: Pathways to Sustainable Development and Poverty Eradication* (Nairobi, 2011), p. 554.

[13] “The Transition to a Green Economy: Benefits, Challenges and Risks from a Sustainable Development Perspective”, report by a panel of experts to the second meeting of the Preparatory Committee for the United Nations Conference on Sustainable Development.

[14] Report of the Secretary-General of UNCTAD to UNCTAD XIII, “Development-led globalization: Towards sustainable and inclusive development paths” document UNCTAD (XIII)/1.

[15] UNCTAD, *World Investment Report 2011* (United Nations publication, Sales No. E.11.II.D.2).

[16] Kevin P. Gallagher, “Policy space to prevent and mitigate financial crises in trade and investment agreements”, G-24 discussion paper No. 58 (UNCTAD, May 2010).

[17] Kevin P. Gallagher, “The new vulture culture: sovereign debt restructuring and trade and investment treaties”, IDEAs working paper series No. 02/2011 (New Delhi, International Development Economics Associates, 2011).

sequencing their participation in areas such as services and intellectual property, as they did in the General Agreement on Tariffs and Trade.

Some questions for discussion

1. **How can the international community enhance the role of transnational corporations and global value chains in job creation and stability?**

2. **What global technology policies could enhance the trade and employment nexus through transfer and capacity-building?**

Strengthening of international financial cooperation in support of sustained growth and job creation

21. Stable, predictable and durable long-term development financing remains a binding constraint on sustainable growth and employment in many developing countries. Even though the last decade has seen an overall decline in the relative importance of official development assistance (ODA), aid continues to be of critical importance in many poor developing countries which rely mainly on official financing to meet their development needs. There are shortfalls in meeting aid commitments and selectivity and volatility in aid delivery. There is a need to ensure that ODA better complements national resource mobilization efforts, helping to fill the gap between domestic saving and the volume of investment required to meet national development goals, including the Millennium Development Goals. ODA should function as a catalyst for other financial flows in some countries and specific areas for the "right" kind of development. A more systematic inclusion of sustainable development considerations into development cooperation will have to be translated into systematic policies, actions and institutional structures.

22. Since the mid-1990s, the international aid community has given much higher priority to poverty reduction objectives in developing countries in their ODA programmes. This has sometimes overlooked the role which policy interventions that are not obviously connected to poverty reduction can contribute to that objective by supporting productive capacity-building. ODA, like other sources of development finance, needs to be tied closely to developmental priorities of recipient countries such as infrastructure and agricultural financing, as agreed in the Istanbul Programme of Action for the Least Developed Countries for the Decade 2011-2020.[18] There is a growing recognition that aid should be channelled through the budget, using country systems for aid delivery, and that it should be part of a comprehensive fiscal and financing package supporting the implementation of national programmes and priorities. This shift would reinforce the ownership of national policies and programmes and improve the accountability of Governments to their national constituencies.

23. Policy coherence and coordination is central to the achievement of development goals. In the current aid architecture, there is incoherence in policies and policy coordination across institutions and stakeholders because of the lack of focus on common goals. There is also incoherence between principles of aid effectiveness and ground realities such as the misalignment between the need for stable flows for development and the procyclical nature of ODA flows. Moreover,

[18] *Report of the Fourth United Nations Conference on the Least Developed Countries, Istanbul, Turkey, 9-13 May 2011* (United Nations publication, Sales No. E.11.II.A.I, chap. II).

non-aid policies of development partners, particularly within the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD), are at odds with the declared objectives of their aid policies. There is a growing tension between "results based" delivery of resources and delivery based on "needs" assessments to support "national ownership" and "policy space". A complex and fragmented development finance architecture is emerging with a multitude of actors and new public-private partnerships setting up new delivery and monitoring approaches and conditions for delivery. Many donor agencies are announcing their own selection of countries and sectors for their aid allocations. The ensuing lack of coordination further takes away focus from common goals and the flow of aid to the neediest countries. It also has significant implications for the capacity of recipient countries to deal with the fragmented development architecture.

24. The Fourth High-level Forum on Aid Effectiveness, held in Busan, Republic of Korea, from 29 November to 1 December 2011 signalled important changes in the approach to development cooperation with a renewed emphasis on development effectiveness and the global partnership for development. While recognizing the growing importance of the role of new actors such as civil society and the private sector and the evolving role of South-South cooperation, it accepted that North-South cooperation remains the main form of development cooperation. South-South cooperation was recognized as being different in nature, modalities and responsibilities from North-South cooperation. However, there was agreement that the principles discussed in Busan would be a reference point for South-South cooperation on a voluntary basis. In light of the changing development cooperation environment, the preparatory process for the Economic and Social Council Development Cooperation Forum to be held in July 2012 will address the following priorities: (a) sustainable development and development cooperation; (b) South-South cooperation; (c) mutual accountability, transparency and results; and (d) coherence and allocations.

25. The potential of innovative sources of finance should be explored to find additional resources required to meet development needs, and their delivery and allocation mechanisms should be streamlined into the overall development architecture. South-South and triangular cooperation is a growing part of development cooperation and priority needs to be given to maximize its advantages.

Some questions for discussion

1. **What steps are needed to reform the development architecture and strengthen international financial cooperation to better meet development challenges?**

2. **How can the international community enhance policy coherence and coordination among institutional stakeholders?**

Enhancing the role of external debt for growth and employment creation

26. In order to enhance the role of foreign borrowing in financing growth and employment, a renewed focus must be given to the conditions under which external debt can contribute to these desired objectives. The link between how debt accumulation can contribute to capital formation is weakened when foreign borrowing is not utilized to finance a build-up of productive capacity that is capable

of producing additional revenues for its servicing. This happens because debt may be contracted to finance current spending and transfers, including interest payments. In addition, debt may also be contracted to prevent or manage the effects of external economic and financial instability and to build-up international reserves as self-insurance against crises. Access to capital markets and new borrowing can enable a country to remain current on its debt service obligations, but in the absence of an increase in primary surpluses in the future, new borrowing will build up the stock of debt and may portend debt problems in the not so distant horizon.

27. Policy intervention is needed to strengthen the nexus between external borrowing and capital formation and avoid external borrowing to finance consumption booms and to fuel asset bubbles. Appropriate cost-benefit analysis of debt-financed growth-oriented projects is the way forward for debt management and borrowing decisions. High levels of debt in relation to GDP and exports are to be avoided as they may decrease the net contribution of new borrowing to growth. Increasing attention needs to be given to the Principles of Responsible Borrowing and Lending that were released by the United Nations Conference on Trade and Development (UNCTAD) in May 2011 as part of an overall effort globally towards strengthening the nexus between debt, trade, investment and growth.

28. A great deal of debt is contracted in foreign currency; thus export revenue is important for debt servicing so as to maintain debt sustainability. A "pull-back" by commercial institutions in 2008 and 2009 had a negative effect on world trade and put the issue of availability of trade finance in a credit crunch and the cost of trade finance on the policy agenda. Nearly 80 to 90 per cent of trade transactions involve some form of credit, and mainly in foreign currency. This crisis further showed that debt sustainability is also a fiscal issue, since some developing countries take recourse to domestic debt financing. The situation was eased by the G20 leaders adopting a wider package for injecting additional liquidity and public guarantees in 2009, but access to trade finance by the smaller traders became significantly more expensive or had simply disappeared.[19] Looking into the future, ensuring debt sustainability would also involve ensuring liquid trade finance markets and improving the regulatory environment for trade credit. In the poorest countries, "aid for trade" can provide trade finance, as identified by the World Trade Organization Task Force on Aid for Trade.

29. Multilateral monitoring of debt markets and debt sustainability in individual countries combined with monitoring of policy spillovers in a global context are essential in order to maintain global financial stability and keep countries on sustainable growth paths. The Bretton Woods institutions are working on revised frameworks to assess debt sustainability and now attempt to include the investment-growth nexus and improve early warning signals of debt distress and policy advice to countries to keep debt sustainable. Credit rating agencies need to be better governed and reformed, as they failed to pick up the biggest disaster in debt markets in recent history leading to huge costs in terms of growth and employment.

30. Debt distress and defaults have a detrimental effect on growth and employment as borne out by the history of debt crises and are costly for both debtors and creditors. It is reasonable to look for a balance among new resources, breathing

[19] Marc Auboin, "Restoring trade finance during a period of financial crisis: stock-taking of recent initiatives", staff working paper ERSD-2009-16 (WTO, 2009).

space and debt restructuring through various tools of crisis prevention and management. The present approaches to official and private debt restructuring do not provide countries with a fresh start after a default, except for countries that benefited from debt relief under the heavily indebted poor countries initiative. The International Monetary Fund (IMF) proposal for a sovereign debt restructuring mechanism may not have been politically feasible when proposed, but had some positive features that should not be forgotten. Due to the ongoing debt problems in the Euro zone, rules and proposals are being floated for a European debt restructuring mechanism. Countries need to agree on a set of principles for resolving debt crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors.

Some questions for discussion

1. **What measures can be taken to enhance the nexus between debt and growth at the national and international levels and keep debt sustainable?**

2. **How can the international community promote a fair burden-sharing in resolving debt crises and debt sustainability?**

Addressing systemic issues to promote growth and job creation

31. Global economic growth and job creation continue to be hampered by shortcomings in the international financial and monetary system. Therefore, a number of policy challenges need to be addressed at the systemic level. Strengthening international economic policy coordination and coping with debt crises are considered to be the most pressing issues in this regard. Further reform is also needed in other areas of the international financial and monetary system.[20] In addition, strengthening global economic governance would enhance multilateral policymaking in support of growth and employment.

32. In the face of weakening global growth, more internationally concerted short-term fiscal stimulus is necessary to prevent sliding back into recession.[21] It is suggested that additional stimuli focus on job creation, for instance through infrastructure investments. International macroeconomic policy coordination should also ensure that actions of major economies are consistent with the objective of reducing global economic imbalances. In follow-up to the Framework for Strong, Sustainable, and Balanced Growth, launched by the G20 at its summit in Pittsburgh in 2009, G20 leaders adopted the Cannes Action Plan for Growth and Jobs in November 2011. It includes, inter alia, medium-term commitments towards structural reforms to enhance growth and job creation. At the multilateral level, it is also important to continue the ongoing process of strengthening IMF surveillance. In this context, the spillover reports being prepared for the major economies are considered to be a useful tool for international policy coordination.

33. Amid rising global financial instabilities,[22] there is an urgent need to resolve the debt crisis in a number of advanced economies, particularly in the euro area. The

[20] UNCTAD, *Trade and Development Report 2011*.

[21] *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. E.12.II.C.2).

[22] IMF, *Global Financial Stability Report: Grappling with Crisis Legacies* (Washington, D.C., September 2011).

focus should be to prevent contagion to larger economies and to the banking sector. European leaders have agreed on assistance facilities and intend to establish a compact to enhance fiscal discipline. There is also a need to pursue fiscal consolidation in major advanced economies over the medium and long term, while sustaining necessary stimulus in the short run. A factor hampering resolution of the crisis is the absence of an international debt workout mechanism. Moreover, it has been proposed to further strengthen the global financial safety net, including through reinforcing IMF resources.

34. Major steps in the continuing effort to strengthen international financial regulation have been the introduction of the Basel III framework and progress on the regulation of systemically important financial institutions and the shadow banking system. While the foreseen higher capital and liquidity requirements in principle support systemic stability, the view has been expressed that they remain too small to sufficiently improve the crisis resilience of the financial system. Besides, there are challenges regarding the implementation of regulatory reforms, including the consistent transposition into national laws and prolonged time periods until their full implementation.

35. In recent years, the question of how to manage volatile cross-border capital flows has received increased attention. Capital inflows in excess of an economy's absorptive capacity carry risks for financial stability, growth and employment. Indeed some countries recently introduced capital controls to contain the surge in short-term capital flows. Despite potential multilateral repercussions, however, there is largely a lack of international guidelines on capital flow management. To address this issue, IMF is working to develop a framework for the effective management of capital flows, including both capital inflows and outflows.

36. The need for reforming the international reserve system has gained wide recognition. Many developing countries rely on reserve accumulation as a mechanism of self-insurance against liquidity crises. Despite some diversification, the majority of reported international foreign exchange reserves continue to be held in United States dollars. Therefore, there are proposals to gradually strengthen the role of special drawing rights as a reserve asset in combination with a range of nationally supplied reserve assets.

37. There is a need to strengthen the framework of global economic governance in support of growth and employment. This includes enhanced coordination, cooperation and coherence across the United Nations system. Efforts should also be made to ensure that there continues to be adequate engagement between the G20 and the United Nations and complementarity of policy efforts between the United Nations, IMF, the G20 and other multilateral stakeholders. Moreover, regional institutions should be better incorporated into global economic governance mechanisms.

Some questions for discussion

1. **What policy measures are critical at the systemic level to promote growth and employment? What should be the short-term and long-term priorities?**

2. **How can the international community ensure complementarity of efforts among the United Nations, the Bretton Woods institutions, the G20 and other multilateral stakeholders?**

II. Financing of sustainable development

Major challenges and funding gaps

38. Promoting sustainable development represents a key policy priority. There is a continuing need to ensure a balance among economic development, social development and environmental protection as interdependent and mutually reinforcing pillars of sustainable development. The objective of the United Nations Conference on Sustainable Development (Rio+20), to be held from 20 to 22 June 2012, is to secure renewed political commitment for sustainable development, assess the progress to date and the remaining gaps in the implementation of the outcomes of the major summits on sustainable development, and address new and emerging challenges. The Conference will focus on two themes: (a) a green economy in the context of sustainable development and poverty eradication; and (b) the institutional framework for sustainable development. As expressed by the General Assembly in its resolution 64/236, the objective remains to strengthen sustainable development and the implementation of Agenda 21, "including through the mobilization of financial and technological resources, as well as capacity-building programmes, in particular for developing countries".

39. In the context of sustainable development, the concept of greening the economy has gained traction and is viewed as a means to achieve sustainable development. A green economy enables economic growth and investment while increasing environmental quality and social inclusiveness. As such, a green economy contributes to meeting key goals, including poverty eradication, food security, protecting and enhancing the natural resource base, increasing resource efficiency, and promoting low-carbon development. The existing challenges in financing the transition to the green economy as well as the measures and policies that are needed to scale up financing are discussed below.

40. Transitioning to a green economy requires major structural and technological changes in a number of key sectors such as infrastructure, industry, agriculture, housing, transportation and energy. A wide range of policy measures can be used by countries to initiate, encourage and support this move to a sustainable development path. Relevant public policies, including on taxation, subsidies, procurement and investment, can go a long way to foster sustainable development. One important element is mobilizing sufficient financial resources, which may involve redirecting available resources as well as raising new and additional financing.

41. In developing countries, the particular challenge within the transition process lies in reconciling development goals with the increasing adoption of sustainable practices. Technology sharing, capacity-building and finance are critical to support and accelerate developing countries' sustainable development. Developed countries, on the other hand, should take the lead in changing their production and consumption patterns. Moreover, transition efforts need to be embedded in a supportive and enabling international environment, including a coherently reformed trade, monetary and financial system, in particular to avoid the proliferation of unilateral measures and subsequent retaliations.

42. In the current landscape of financing for sustainable development, resources are already being channelled to sustainable uses from a number of sources and

through a variety of mechanisms.[23] Some indications show that the bulk of current financing for sustainable development is from private sources. The private sector has indeed started to provide resources for the green economy transition through domestic and cross-border investment. For instance, a certain proportion of FDI to developing countries is targeted towards sustainable economy investments. The public sector is estimated to provide a smaller yet indispensable part of sustainable development financing. Funding through domestic budgets plays an important role in this regard. ODA has been critical in addressing sustainable development challenges in developing countries. Mixed sources of financing, such as sovereign wealth funds, are of increasing importance. In addition, innovative financing mechanisms and facilities supporting the implementation of multilateral environmental policies and agreements have been instrumental in providing funds for sustainable development purposes. These include major mechanisms such as carbon emissions trading under the clean development mechanism of the Kyoto Protocol, the Global Environment Facility (GEF), the initiative on reducing emissions from deforestation and forest degradation (REDD-plus) and Climate Investment Funds.

43. While there is no complete estimate of funds needed to green the entire global economy, there are attempts to assess the approximate scope of financing requirements. The Department of Economic and Social Affairs of the Secretariat estimates the annual incremental investment requirements for achieving sustainable development objectives across a number of key sectors at about 3 per cent of gross world product up to 2050 (equal to over $1.9 trillion in 2010). Much of the incremental investment in green technology will need to take place in developing countries. Assuming a share of 60 per cent of global investment is needed for developing countries, at least $1.1 trillion will be needed per year for incremental investments in green technology in developing countries.[24]

44. In comparison, the total amount of net ODA and FDI to developing countries in 2010 was $429 billion (see A/66/167). Innovative mechanisms of financing for development raised about $57 billion from 2000 to 2008, according to a World Bank estimate (see A/66/334). Notwithstanding caveats and uncertainties of estimates of total financing requirements, it is therefore fair to conclude that financial flows from current sources are clearly insufficient to meet the substantial additional requirements. Given the magnitude of financing requirements for a sustainable economy transition, financial resources need to be raised from the entire range of private, public and mixed sources, and through multiple channels and instruments. This also includes redirecting existing investment and subsidies to green uses. Against this backdrop, the key policy challenge is to create the necessary domestic and international conditions to unlock substantial amounts of new and additional financing.

45. Given current financing patterns, the private sector is likely to provide the vast majority of resources needed to move towards the green economy. For the private sector, this would involve seizing economic opportunities represented by green

[23] UNEP, *Towards a Green Economy: Pathways to Sustainable Development and Poverty Eradication* (Nairobi, 2011).

[24] *World Economic and Social Survey 2011*. UNEP puts the required increase in green economy investments at an average of 2 per cent of global GDP annually up to 2050 — $1.3 trillion in 2010 (UNEP, *Towards a Green Economy*).

economy transitions, and responding to policy reforms and price signals through higher levels of financing and investment. There is potential for long-term investors and the financial sector to scale up engagement in sustainable development. This includes a wide range of financial actors and institutions, including traditional capital markets, the insurance industry and providers of venture capital, as well as other financial institutions, such as local banks and financial cooperatives. Microfinance has also been identified as an important tool at the community level for poverty eradication[25] and increasing the poor's resilience to risk.

46. In order to support the three pillars of sustainable development, it remains important to implement major international commitments regarding financial flows to developing countries. It is imperative to fulfil the commitment to provide 0.7 per cent of donor country gross national product in ODA to developing countries, with at least 0.15 per cent to 0.20 per cent to least developed countries. The Copenhagen Accord adopted at the fifteenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change foresees a need to provide $100 billion per annum in climate change finance for developing countries by 2020.

47. The public sector will remain crucial to increase investments in sustainable development. One important function of public funding is to leverage private sources and to kick-start green economy investments. A strategic approach would therefore be to use public funds in part to steer and leverage private sector finance with appropriate instruments, such as guarantees, insurances and other instruments to mitigate private risks. Innovative mechanisms of financing sustainable development are also considered to have significant potential to raise additional resources. Moreover, further strengthening targeted facilities and programmes of multilateral, regional, subregional and national development banks would enhance the financing of the green economy transition.

Some questions for discussion

1. **What are the main challenges in financing the transition to a green economy in various countries?**

2. **How should the private and the public sectors work together to mobilize the necessary resources for sustainable development?**

Measures at the national level to scale up financing for sustainable development

48. Government policies are important in scaling up financing of sustainable development. Technologies that promote sustainable development or "green technologies" are often not cost-competitive with established technologies, whose externalities (like greenhouse gas emissions and other environmental risks) have not been reflected in market prices. Yet, traditional measures to internalize these externalities like carbon taxes or "cap and trade" schemes, as well strong intellectual property rights for green technologies come at a cost. Higher energy prices due to carbon taxes can impede economic development in poor countries, and strong property rights can slow down knowledge transfer and inhibit innovation.[26]

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[25] High-level Panel of the Secretary-General on Global Sustainability, *Resilient people, resilient planet: a future worth choosing* (United Nations, document A/66/700).

[26] *World Economic and Social Survey 2011.*

49. More broadly, the national innovation system approach emphasizes the importance for an innovative economy that is based on interactive learning, information exchange and coordination among firms, universities, research centres, policymakers and other actors. A green sustainability-oriented national innovation system would integrate the public-goods nature of many green technologies into the national innovation system framework and is particularly useful for innovation policymaking in the context of long-term sustainable development.[27]

50. Green technologies should be treated as infant industries, with appropriate support, including public sector investments in infrastructure, subsidies and access to credit. Governments can help leverage private investments into green technology through targeted credit enhancement measures that help boost returns through subsidies, risk mitigating measures, altering payback periods (i.e., bringing forward returns) and reducing the volume of financing required through co-investing. Consumer-targeted measures can play an important complementary role to encourage demand for green technologies. For example, green stickers and labelling systems for food and consumer products (Ecolabels) make it easier for consumers to take environmental concerns into account.

51. A well-designed domestic regulatory framework can spur green investment. Command and control measures may offer the lowest-cost solution and may be easier to administrate and implement where market-based instruments prove not to be effective. Technical standards can be developed and implemented to place requirements on products and/or processes and production methods that aim at enhancing energy efficiency. Full cost pricing (e.g., the removal of subsidies on fossil fuels) can help level the playing field to allow alternative energies to compete on price. Through sustainable public procurement practices, Governments can create high-volume and long-term demand for green goods and services and therefore promote longer-term investments in innovation and encourage producers to realize economies of scale, lowering costs. In turn, this can lead to the wider commercialization of green goods and services, promoting sustainable consumption.[28]

52. Significant attention has recently been directed towards the potential of institutional investors, particularly pension funds, for investment in green infrastructure. With their $28 trillion in assets, and long-term investment and portfolio diversification needs, pension funds could possibly generate significant benefits from investing part of their assets into green growth initiatives. However, due to lack of appropriate investment vehicles and market liquidity, scale issues, regulatory disincentives and a lack of expertise among pension funds in this field, only a few assets have been allocated to green investments. Governments in general, and regulatory and supervisory authorities in particular, can promote green investment by pension funds through supportive environmental policy backdrops; proper investment vehicles; liquid markets; reduced investment barriers; education and guidance to investors; and improved pension fund governance.[29]

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[27] Ibid.
[28] UNEP, *Towards a green economy*.
[29] Raffaele Della Croce, Christopher Kaminker and Fiona Stewart, “The role of pension funds in financing green growth initiatives”, OECD working papers on finance, insurance and private pensions, No. 10 (OECD, 2011).

53. The contribution of the private sector is essential for raising the resources required for a transition to a green economy and, in particular, for enabling the necessary investments in climate-change adaptation and mitigation in developing countries. In order to attract larger flows of private capital into the green economy, greater efforts should be made to provide stronger incentives for private sector involvement in sustainable development activities. This can be achieved through a combination of taxation, emissions trading and regulation.[30]

54. These efforts need to be complemented with efforts by the public sector to provide effective risk-mitigation or revenue-enhancing instruments to attract private investment into activities that they may not otherwise find commercially viable.[31] Effective public investment in greater capacity-building related to climate-change adaptation and mitigation efforts can also serve to attract private finance. In this respect, there is considerable scope for Governments and multilateral institutions to use their own resources to leverage financial flows from the private sector.[32]

55. Attention is also being given to ways to encourage foreign investment that generates and disseminates technologies that mitigate greenhouse gas emissions, also referred to as low-carbon FDI. UNCTAD proposes a global partnership that will, among other things, galvanize low-carbon investment for sustainable growth and development. Elements of this partnership would include establishing clean investment promotion strategies; enabling the dissemination of clean technology; securing the contribution of international investment agreements to climate change mitigation; and setting up an international low-carbon assistance centre to leverage expertise, including from multilateral agencies.[33] However, while low-carbon FDI can make a valuable contribution to the response of developing countries to climate change, policymakers in developing countries need to be cognizant of possible disadvantages, including the crowding out of domestic companies, technological dependency and higher costs for essential goods and services, and should weigh these against the benefits. Moreover, for FDI to be effective in generating knowledge spillovers that mitigate greenhouse gas emissions, it needs to be supplemented by domestic policies designed to encourage knowledge spillovers, such as, for example, the imposition of training requirements.[34]

56. Other ways of tapping into the private sector have included the setting up of portfolio "green funds". However, these funds have tended to be procyclical, increasing during booms and redeeming funds during downturns, and they need to be regarded with caution.[35] Microfinance could be an avenue for raising private finance for sustainable development, with several institutions already extending loans for clean energy products. Considerable scaling up is nevertheless required with, among other things, the need for significant investment in human capital and infrastructure. Looking ahead, there is also a need to consider ways in which public-private partnerships can provide meaningful support to stimulating private financing

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[30] *World Economic and Social Survey 2009: Promoting Development, Saving the Planet* (United Nations publication, Sales No. E.09.II.C.1).

[31] *Report of the Secretary-General's High-level Advisory Group on Climate Change Financing* (United Nations, 2010).

[32] UNEP, *Towards a Green Economy*.

[33] UNCTAD, *World Investment Report 2010: Investing in a Low-carbon Economy* (United Nations publication, Sales No. E.10.II.D.2).

[34] *World Economic and Social Survey 2011*.

[35] Ibid.

in green economy projects, including through mechanisms that facilitate the sharing of risks between the official and private sectors.

Some questions for discussion

1. **How can developing countries effectively mainstream green sustainability-oriented national innovation systems into their national development strategies?**

2. **What are the most effective Government policies to "crowd in" private green investment?**

3. **How can Governments and multilateral organizations most effectively leverage private finance into climate change mitigation and adaptation activities?**

Measures at the international level to scale up financing for sustainable development

57. The transition to a green economy in the context of sustainable development requires significant scaling up of financial resources. Massive reductions in global per capita emissions and energy consumption are twin requirements of success. The challenge is how to equitably balance the still enormous energy needs of developing countries with the requirements of planetary sustainability. To this end, global financial efforts should facilitate free or low-cost access to technology, through, for example, global financial technology funds that create knowledge made available as a public good, public sector purchase of relevant technology also made freely available, technical assistance in building technology capabilities and human capital formation.

58. Overall, global investment in clean energy rose from $50 billion in 2004 to $240 billion in 2010.[36] By some optimistic estimates, the volume of climate finance may already be as high as $96.9 billion per year, with on average $55 billion provided by the private sector, while at least $21 billion is provided by public budgets in various forms, including concessional loans ($13 billion) and various forms of grants ($8 billion).[37] Although some 80 per cent of the needed investment funding has to come from the business sector, public financing is indispensable in jump-starting and catalysing the flow of private investment towards a green economy.

59. Recent OECD data show that Development Assistance Committee countries allocated up to $22.9 billion, 15 per cent of total ODA, to assistance related to climate change in developing countries in 2010, with one third going to support adaptation and two thirds for mitigation. An analysis of disbursements and commitments of "fast-start" financing for 2010 found that just under $10 billion had been made available by donors.[38] It is to be "additional" to development assistance

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[36] Statement of the Secretary-General of the United Nations at the seventeenth Conference of the Parties to the United Nations Framework Convention on Climate Change, Durban, South Africa, 28 November-9 December 2011.

[37] Submission by Climate Policy Initiative to the sixteenth Conference of the Parties to the United Nations Framework Convention on Climate Change, Cancun, Mexico, 29 November-10 December 2010.

[38] See World Resources Institute, "Summary of developed country fast-start climate finance pledges. Available at http://pdf.wri.org/climate_finance_pledges_2011-11-18.pdf.

and cover the "incremental costs" caused by climate change. Prompt delivery of the pledged funds approaching $30 billion in fast-start finance for 2010-2012, almost all of which is identified in national budgets, is required in a way that generates momentum for actions on the ground.

60. To provide resources on the scale needed, a mix of public finance, carbon market finance and private finance would need to be leveraged by development banks, as well as innovative sources of finance. As a complement, public instruments (e.g., guarantees, risk-sharing instruments, technical assistance or concessional loans) can help to leverage private finance. Multilateral and other development banks can play an important role in broadening the sources of and access to climate finance. They exert a substantial leverage, which goes beyond the purely financial domain, through providing technical assistance as well as financial and sector expertise, alongside funding. They can play a catalysing role in channelling funds from public and private sources to climate investment projects ("crowding-in").

61. Carbon markets offer opportunities for directly financing new technologies in developing countries and for leveraging private investments.[39] Further reform and expansion of existing mechanisms are essential if they are to become the basis for a global carbon market. An international agreement on emissions reductions would provide further incentives to the expansion of this market. Additionally, a number of economies have proposed or implemented cap-and-trade systems, which could link into the larger international trading network. Discussions have also alluded to a global carbon tax on greenhouse gas emissions. However, besides implementation challenges, international agreements on harmonized taxes on greenhouse gas emissions have proven difficult and might not succeed in the time frame required to jump start the green economy and avoid catastrophic consequences of climate change.

62. The Global Environment Facility, has allocated $9.2 billion, supplemented by more than $40 billion in co-financing, for over 2,700 projects in 165 developing economies. Increasing significantly its resources is essential if it is to be transformed into an innovative mechanism for delivering global ecosystem benefits, which can only be accomplished if it can compensate developing countries for land use change and other economic activities that are the cause of ecological degradation worldwide.[40]

63. A number of important sectors of the global economy are currently untaxed, despite the externalities they generate.[41] Key sectors in this regard are the international maritime and aviation sectors. Other promising ways to scale up financing could involve some form of intervention in the global financial sector, either a financial transaction tax, a currency transaction tax or an international financial facility. This last approach has already been applied to the International Financial Facility for Immunization (see A/66/334). One advantage of the international financial facility approach — in comparison with a currency transaction tax, a financial transaction tax and taxes on airline travel or fuel or the

[39] Report of the Secretary-General's High-level Advisory Group on Climate Change Financing (2010).

[40] See Edward Barbier, "The policy challenges for green economy and sustainable economic development", *Natural Resources Forum*, vol. 35, No. 3 (August, 2011), pp. 233-245.

[41] Report of the High-level Panel of the Secretary-General on Global Sustainability (2012).

arms trade — is that, unlike other potential new sources of global financing or mechanisms, it can be started without the need for an international agreement involving many countries. Yet, given the precarious fiscal situation of some developed economies, innovative options such as special drawing right emissions for green development or taxes on financial transactions could be particularly effective in providing a timely push to the transition to a green economy.

64. In addition, the United Nations deforestation and forest degradation (REDD) and REDD-plus mechanisms need to be scaled up. Yet, monitoring and verifying changes in deforestation rates in developing countries and their impacts on carbon emissions could increase substantially the transaction costs of implementing a REDD scheme on a global scale. There is also concern over the high opportunity costs faced by many developing countries from losses in foregone agricultural and timber benefits. These issues need to be resolved if a REDD financial mechanism is to be implemented on a global scale.

65. In general, the proliferation of financing mechanisms increases the challenges of coordinating and accessing finance. The establishment of the Green Climate Fund under the United Nations Framework Convention on Climate Change raises the question of consolidating some of the existing funds, including the Climate Investment Funds established under the auspices of the World Bank, but with a sunset provision relating to a financial architecture under the Framework Convention. More importantly, the Green Climate Fund should receive sufficient initial capital to allow it to begin work as soon as possible. Likewise, the Cancun Adaptation Framework and its Committee, and the Technology Mechanism and its Climate Technology Centre and Network, should start working as soon as possible.

Some questions for discussion

1. **How can financing be scaled up while at the same time streamlining the financing architecture to maximize its impact?**

2. **How can multilateral development banks and other development financing institutions play a catalysing role in channelling funds from public and private sources into green investment?**