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Mobilizing investment for development:

Contribution of UNCTAD in the
context of financing for development

Mobilizing investment for sustainable development: Background information and considerations pertinent to the Third International Conference on Financing for Development

Note by the UNCTAD secretariat

Executive Summary

This note provides background facts and information on crucial aspects to be considered in the preparation of the Third International Conference on Financing for Development, to be held in July 2015.

In principle, a vibrant national business sector and domestic private investment are the basis of growth in any economy. In practice, however, many developing countries and countries with economies in transition face shortages in domestic resources and therefore seek to mobilize external funds for economic growth, including for sustainable development.

Foreign portfolio investments have been the largest source of external development finance at the global level, but foreign direct investment (FDI) accounts for the majority in developing countries and countries with economies in transition. In addition to FDI and portfolio investments, other external sources such as commercial bank lending, official development assistance (ODA) and remittances can potentially be drawn upon.

In order to increase the absolute level of investment funds directed to sectors related to sustainable development goals and multiply their effectiveness and impact, partnerships between different external and internal sources of development finance and investment are desirable, to benefit from and synergize their unique attributes. Some combinations of funds and sources might be more effective for specific activities related to sustainable development goals (or sectors or projects related to such goals). An important aspect of partnerships is that they are not only about financing; each partner has unique

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characteristics and attributes, including technological assets, managerial and professional skills or knowledge of the relevant sector or project.

To achieve scale and scope, existing and innovative financial instruments and funding mechanisms to raise resources for investment in sustainable development goals need to be supported, adapted to purpose and scaled up as appropriate. Beyond policies for financing, consideration should be given to encouraging the private (and public) sectors, both foreign and domestic, to invest better. For instance, investors expanding the employment of women, minorities and other excluded groups – or boosting their skills through training programmes – support sustainable development through how they invest, and not only by how much.

Introduction

1. Attracting increased investment to sectors that are essential for economic development (e.g. infrastructure and power), for social impact (e.g. water and sanitation, health, education, food security and social housing) and for environmental sustainability (e.g. climate change mitigation and renewable energy) is at the centre of the current debate on sustainable development goals. The amounts needed go well beyond the reach of both ODA and domestic public sector resources in many countries, especially in the least developed countries (LDCs), and increased private investment is required to complement public investment. An overall policy framework that is conducive to attracting and benefiting from private investment is an essential prerequisite for investment-led inclusive and sustainable development, as re-emphasized by the Ministerial Round Table held during the 2014 World Investment Forum, organized by UNCTAD in October.

2. One of the important milestones in the work on financing for sustainable development that will be shared by all members of the international community is the upcoming Third International Conference on Financing for Development, to be held in Addis Ababa, Ethiopia, from 13 to 16 July 2015. The conference will bring together high-level political representatives, including Heads of State and Government, as well as relevant institutional stakeholders, non-governmental organizations and business sector entities. The outcome of this conference should constitute an important contribution to, and support the implementation of, the post-2015 development agenda. UNCTAD, as a development partner, will be fully engaged in this milestone activity, and the Investment, Enterprise and Development Commission is testimony to this. This note is intended to facilitate the Commission's discussions.

3. The International Conference on Financing for Development will set "an agreed and ambitious course for sustainable development financing beyond 2015".¹ The synthesis report of the United Nations Secretary-General on the post-2015 sustainable development agenda states: "Urgent action is needed to mobilize, redirect and unlock the transformative power of trillions of dollars of private resources to deliver on sustainable development objectives. Long-term investments, including FDI, are needed in critical sectors, especially in developing countries."²

4. Investors may finance projects through a range of financial instruments (e.g. international capital flows such as FDI, portfolio investment and commercial bank loans, as well as domestic sources). As each type of flow alone cannot meet the critical needs for the envisaged sustainable development goals, it is vital to leverage combinations of them to maximize their development impact. This note discusses various mechanisms for finance and the development implications of various modalities and forms of investments. Each type has different motivations and accordingly behaves differently and, moreover, the development impact and implications may also vary. It is therefore necessary to review each instrument, as well as the potential synergies between them. In addition, different motivations, characteristics and responses lead different groups of investors to investment projects, including foreign private investors (individuals, including those in diaspora, and more commonly, enterprises, funds and other entities), foreign public investors (e.g. State-owned enterprises and sovereign wealth funds (SWFs), ODA donors and other official financial institutions) and domestic private investors and public entities.

¹ A/69/700.

² Ibid.

I. External sources of development finance

5. Although foreign portfolio investments have been the largest source of development finance at the global level, FDI accounts for the majority of capital inflows to developing countries and countries with economies in transition. In principle, a vibrant national business sector and domestic private investment are the basis of growth in any economy. In practice, however, many developing and transition economies face shortages in domestic resources and therefore seek to mobilize external funds for economic development as a major aspect of development strategies. Various external sources – FDI, portfolio investments, commercial bank lending, ODA and remittances – have varied in their relative significance in the past decades. The right combination of such resources can, and has often, delivered good results in developing economies. However, with the onset of the global crisis in 2008, policymakers once again voiced concerns about the vulnerability of countries with foreign sources of development finance, especially because of the potential for their abrupt reduction or the reversal of portfolio investment. Financial crises can be accompanied by large swings in commercial bank lending and portfolio investments.

6. ODA is less prone to fluctuations, but has grown slowly. Failure to meet ODA objectives has led to some scepticism from a number of donor countries about the effectiveness of ODA in addressing the core development needs of beneficiary countries. The financial crisis affecting donor countries themselves is another reason for the slow growth of ODA. Nevertheless, ODA is undisputedly required by developing countries, in particular LDCs. The synthesis report of the Secretary-General recommends the following: “All developed countries should meet the target of 0.7 per cent of gross national income for ODA to developing countries and agree to concrete timetables to meet ODA commitments, including the Istanbul commitments to the LDCs of 0.15 per cent of gross national income by 2015”.³ ODA should be better targeted, more efficient, more transparent and, where possible, used to leverage additional resources.

7. In contrast, FDI has proved to be less volatile and more resilient to crises than other forms of external financing. The relative stability of FDI flows can be statistically shown by their lower standard deviation compared to other external resource flows (see table 1), though they have become more volatile in recent years, as detailed in this chapter. More importantly, FDI flows have implications for a host country’s balance of payments, savings, investment, export–import gap and overall macroeconomic management. FDI flows are also seen as a principal channel for the transfer of technology to developing countries, technology spillovers and as a boost to economic growth through employment creation, integration in value chains and enhancement of production and export capacities.

Table 1
Relative standard deviation in capital flows by type during the period 1990–2013
 (Deviation value)

<i>Type of flow</i>	<i>World</i>	<i>Developed countries</i>	<i>Developing countries</i>	<i>Countries with economies in transition</i>
FDI	0.637	0.640	0.760	1.138
Portfolio investment	0.651	0.664	1.037	2.323
Other investment	1.445	1.583	1.590	1.511
Total	0.752	0.811	0.917	1.142

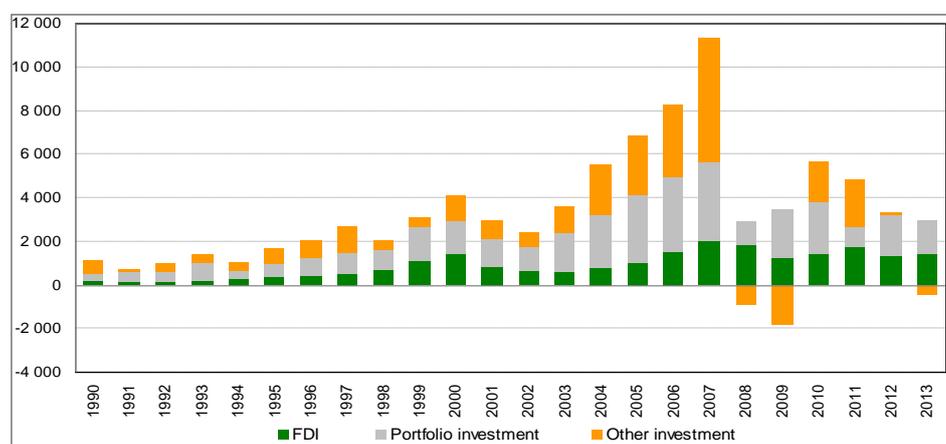
Note: Other investment includes loans from commercial banks, official loans and trade credits.

Source: UNCTAD secretariat calculations, based on data on FDI from UNCTADStat, available at <http://unctadstat/EN/Index.html>, and on portfolio investment and other investment from the international financial statistics database of the International Monetary Fund, available at <http://www.imf.org/external/data.htm>.

³ Ibid.

8. Total global external capital flows (FDI, portfolio investment and other investment) declined in 2013 to \$2.4 trillion, one quarter of the pre-crisis level during the period 2006–2007 and less than 20 per cent of all domestic and foreign investments. A sharp fall during the period 2008–2009 reflected the global financial and economic crisis, while the rise of external capital flows before this period was explained by rapid growth in gross domestic product in both developed and developing countries and by financial liberalization. At the global level, portfolio investment has been larger in absolute values than any other capital flow in most years, while other investments (i.e. international bank loans) grew more rapidly until 2007 (see figure 1). Although all components of private capital flows declined sharply during the period 2008–2009, the most dramatic fall took place in other investments (i.e. bank loans), reflecting the broader crisis of confidence during that period. The year 2010 brought a rise in capital flows, due to the reversal of this investment component (i.e. bank loans). However, the current crisis – reinforced in 2012, in particular in Europe – caused another dip in capital flows. It is essentially bank loans that contribute to dampening the level of capital flows. This type of investment also further lowered total external capital flows in 2013 because of negative flows (i.e. more loan payments than new loans).

Figure 1
Global external capital flows, 1990–2013
 (Billions of dollars)

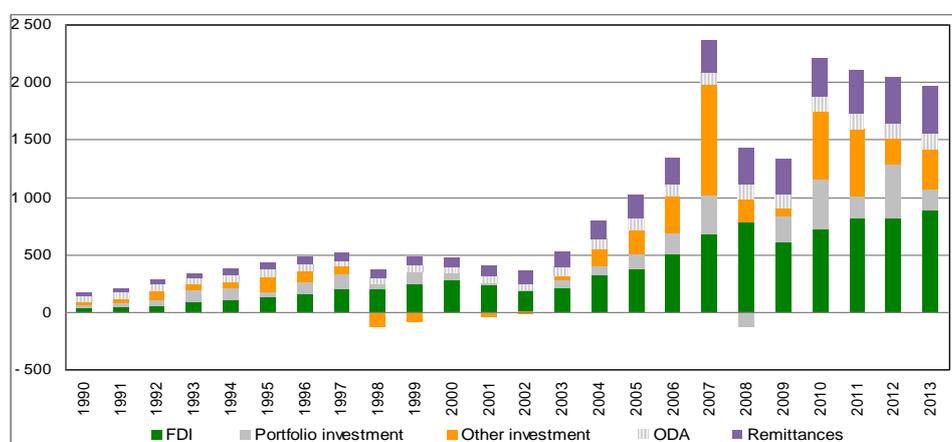


Note: Data are shown in the standard balance of payments presentation, i.e. on a net basis.

Source: UNCTAD secretariat calculations, based on data on FDI from UNCTADStat and on portfolio investment and other investment from the International Monetary Fund.

9. Developing countries and countries with economies in transition differ from developed countries in the dynamics of their external sources of finance. The composition of external financing in developing countries has fluctuated substantially in the past 15 years, although FDI accounted for the bulk of the total in most years (see figure 2). All private capital flows fluctuated, following closely the booms and busts of the economy in general. Including ODA and remittances, development finance to these regions amounted to \$2 trillion in 2013.

Figure 2
External development finance to developing countries and countries with economies in transition, 1990–2013
 (Billions of dollars)



Note: Data are shown in the standard balance-of-payments presentation, i.e. on a net basis.

Source: UNCTAD secretariat calculations, based on data on FDI from UNCTADStat, on portfolio investment and other investment from the International Monetary Fund, on ODA from the Organization for Economic Cooperation and Development and on remittances from the World Bank database, available at <http://data.worldbank.org/>.

10. Global economic growth and the pursuit of sound economic policies by many developing and transition economies generated record levels of private capital flows until 2007. Transnational corporations from developed countries diversified their foreign assets to developing and transition economies, capital market investors expanded their presence in emerging economies and commercial banks also refocused their activities on developing and transition economies.

11. The global economic slowdown that started in 2008, accentuated by the financial crisis, dampened all foreign capital flows to developing and transition economies during the period 2008–2009. However, there were hopes that these regions would prove relatively immune to the global turmoil, and flows recovered, even approaching the 2007 peak, before falling again in 2012. The fall during the period 2012–2013 raised concerns, as the decline of capital flows slowed progress towards the attainment of the Millennium Development Goals in many countries, especially LDCs. It also tempered discussion of finance needs for sustainable development goals during the period 2013–2015, leading to the Third International Conference on Financing for Development.

12. However, the impact of the financial crisis on various capital flows in developing and transition economies differed. Portfolio investment was most affected, as large amounts of such investments were wiped out by plunging share prices and the collapse in the market capitalization of stock exchanges. Because FDI was less affected, its share in external financing for developing and transition economies grew, from 34 per cent during the period 2003–2007, before the crisis, to 42 per cent during the period 2008–2013, after the crisis, and to 53 per cent during the period 2008–2009, the two years immediately after the crisis. Developing and transition economies are today leading the recovery of global FDI, thanks to their relatively quick economic recovery and burgeoning South-South linkages.

13. FDI inflows, together with other external development finance (including portfolio investment, other investment, ODA and remittances), make important contributions to the financing needs of developing countries (see figure 2). In recent years and during the period of financial and economic crisis, FDI inflows remained the most important and stable source of external financing for developing countries.

14. FDI inflows to developing countries have risen without interruption in recent years, except in 2009, with net inflows as reported in the balance of payments reaching a high of \$780 billion in 2013. Reflecting quantitative easing in developed countries, net flows of portfolio capital also rose during the period 2012–2013. In contrast, other investments, including bank loans, and official transfers to developing countries such as ODA, remain at lower levels.

15. The steady increase of FDI to developing countries in the past decades has not only changed the structure of external financing for their economies but also raised the importance of FDI in overall capital formation. Long-term forces in host countries attracting FDI, such as positive and relatively high economic growth rates and growing middle-income populations, as well as established networks of international production in the developing world, counteract and exceed short-term forces such as low export demand and low commodity prices, which exert a downward influence on FDI flows. The relative resilience of FDI flows is also due to supply factors such as the following: long-term nature of FDI projects, which means they are less affected by short-term considerations; ability of transnational corporations to raise financial resources outside the financial sector, including in-house; need to consolidate the industries most affected, such as finance, consumer products, etc.; and business opportunities in niche industries, such as certain parts of information and communications technology and business services, that continue to attract increased FDI.

16. However, despite the importance of FDI as a source of financing for development, concerns about its overall rising volatility remain, as more liquid subcomponents assume a greater share of FDI flows compared to equity. Although it is much less volatile than portfolio and other investments, such as commercial loans and trade credits, as shown in table 1, FDI has become more volatile in recent years for several reasons, including the following:

- FDI flows do not necessarily translate into an equivalent expansion of productive capacity. For example, a focus on mergers and acquisitions may increase amounts of cash reserves rather than capital expenditures in new productive capacity in foreign affiliates. Similarly, direct investments in new greenfield investment projects may be reduced. There can be considerable differences between FDI flows and capital expenditures by foreign affiliates. For example, in 2010, United States of America FDI outflows were some \$300 billion, but capital expenditures by United States foreign affiliates were only \$167 billion, just half of total FDI flows.
- The relative share of equity investment has declined in the last 10 years, especially in developed countries. Some of the decline is structural, for example due to a reduced need for parent financing in the presence of alternatives such as local financing, the availability of investment funds, etc.
- FDI composition is changing, with a shift from equity to debt components and reinvestment of earnings. For some 20 developed countries, equity investment accounted for less than one quarter of total FDI outflows in 2013, compared with nearly half until 2011.
- In contrast to equity, the debt and reinvestment components of FDI are potentially more volatile. Thus, while FDI overall tends to be more constant and long term in orientation, the short-term nature of intracompany loans and reinvested earnings may lead to FDI behaving to some extent in a manner similar to portfolio investment.
- Investments in special-purpose entities and tax havens are normally transitional in nature. For instance, tax havens in the Caribbean alone accounted for 7 to 8 per cent of global FDI inflows in 2013. In addition, in part connected to the drying up of quantitative easing policies, portfolio capital and other hot money has been flowing

out of large emerging economies, contributing to exchange-rate depreciation, which may discourage new FDI or dissuade existing investors from repatriating capital.

Policy issues for consideration

17. There are a number of potential external sources of development finance for investing in sustainable development goals, although FDI is currently the largest and most stable source in developing countries and countries with economies in transition. In terms of specific sectors related to sustainable development goals, which potential sources of financing and investment are the most appropriate? Relevant factors in considering this question include the following:

- Characteristics of sectors related to sustainable development goals and the sources
- Differences between developing countries, including LDCs, landlocked developing countries and small island developing States
- Trends in flows by source and the relevant characteristics, motivations and propensities of each (further detailed in chapter 2 and chapter 3)
- Degree to which external sources invest directly in developing countries versus supplying finance and other resources to domestic public or private sector investors
- Nature of investment projects, including public–private partnerships (PPPs)

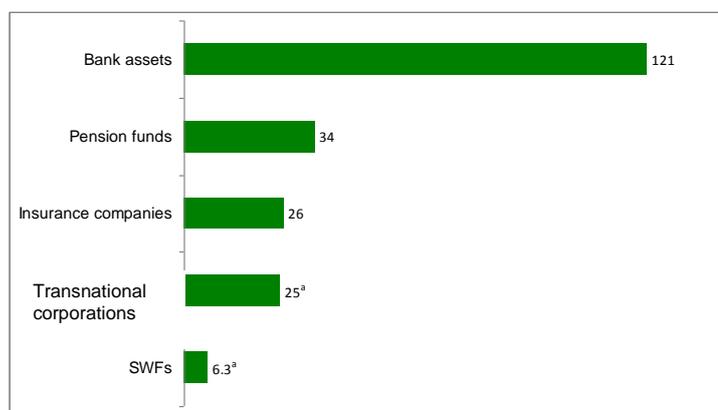
18. Lessons learned from country experiences may guide decisions on the above, including in terms of the following:

- Building an investment climate conducive to financing and investing in sustainable development goals, while safeguarding public interests
- Establishing new incentive schemes and a new generation of investment promotion institutions to effectively harness external sources

II. Mobilizing external sources of financing for sustainable development: The main actors

19. The global financial system, its institutions and actors, can mobilize capital for investment in sustainable development goals. There is a wide range of prospective private sector sources of development finance (see figure 3). The extent to which such finance is made available depends on the propensity of each source to be used for investment and its comparative advantages for specific types of projects, as detailed in this chapter.

Figure 3
Relative sizes of selected potential sources of investment, 2012
 (Value of assets, stocks and loans in trillions of dollars)



Notes: a = 2014 value. This figure is not exhaustive but seeks to list some key actors and sources of finance. The amounts for assets, stocks and loans indicated are not equivalent, in some cases overlap and cannot be added.

Source: UNCTAD, 2014, *World Investment Report 2014 – Investing in the Sustainable Development Goals: An Action Plan* (New York and Geneva, United Nations publication).

Banks

20. Flows of cross-border bank lending to developing countries were roughly \$325 billion in 2013, making international bank lending the third most important source of foreign capital after FDI and remittances. Banks are an important source of project financing that can be used to fund projects relevant to sustainable development goals. The implementation of the Equator Principles – a risk management framework that helps determine, assess and manage environmental and social risk – can also help to ensure that bank lending contributes to sustainable development goals.

21. State-owned banks and similar financial institutions can be effective in targeting specific sectors, for example, infrastructure and public services. Today, State-owned financial institutions account for 25 per cent of total assets in banking systems around the world and the capital available in such institutions in developing countries can be used both for investment in sustainable development goals directly and to leverage funds and investment from the private sector.

Pension funds

22. UNCTAD estimates that pension funds have at least \$1.4 trillion of assets invested in developing markets and the value of developed-country assets invested in the South is growing, in addition to the value of pension funds based in developing countries, which are predominantly invested in each country's own domestic market. Pension funds recognize infrastructure investment as a distinct asset class and there is the potential for future investment by pension funds in more illiquid forms of infrastructure investment. Lessons may be learned from some countries, including Australia and Canada, that have been successful in packaging infrastructure projects specifically to increase investment by pension funds. In both countries, infrastructure investment makes up some 5 per cent of pension fund portfolios.

Insurance companies

23. Insurance companies have long-term liabilities (in the life insurance industry), are less concerned about liquidity and are increasingly prepared to invest in infrastructure, albeit predominantly in developed markets. One study suggests that insurance companies currently allocate an average of 2 per cent of their portfolios to infrastructure, although this

increases to more than 5 per cent in some countries.⁴ Insurers may also invest in areas such as climate change adaptation, which would result in savings from fewer insurance claims and lower insurance premiums in the long term.⁵ The insurance industry is committed to mainstreaming economic, social and governance goals into its activities and raising awareness of the impact of new risks on the industry, for example through the Principles for Sustainable Insurance of the United Nations Environment Programme Finance Initiative.

Transnational corporations

24. With \$7.7 trillion currently invested in developing economies and with some \$5 trillion in cash holdings, transnational corporations offer a significant potential source of finance for investment in sectors related to sustainable development goals in developing countries (further detailed in chapter 3).

Sovereign wealth funds

25. Although 80 per cent of SWF assets are owned by developing countries, more than 70 per cent of direct investments by SWFs are currently in developed markets and a high proportion of their total assets under management may also be invested in developed markets. SWFs can offer a number of advantages for investment in sectors related to sustainable development goals in poor countries, not least because their finance is unleveraged and their investment outlook is often long term. For example, 60 per cent of SWFs already actively invest in infrastructure, in particular in sectors such as water and energy.⁶ Some SWFs and public pension funds have non-profit driven obligations, such as social protection or intergenerational equity; they also represent a form of public capital that could be used for the provision of essential services in low-income communities.

Foundations, endowments and family offices

26. Some estimates put total private wealth at \$46 trillion, although a third of this figure is estimated to be incorporated in other investment vehicles, such as mutual funds.⁷ The private wealth management of family offices stood at \$1.2 trillion and foundations and/or endowment funds at \$1.3 trillion in 2011.⁸ From this source of wealth, it may be possible to mobilize greater philanthropic contributions to long-term investment and investments for sustainable development through the fund management industry. In 2011, the United States alone was home to more than 80,000 foundations with \$662 billion in assets, representing over 20 per cent of estimated global foundations and endowments by assets, although much of this was allocated domestically.

Venture capital

27. The venture capital industry is estimated at \$42 billion.⁹ Investors seeking to allocate finance through venture capital often take an active and direct interest in their investments. In addition, they might provide finance from the start or early stages of a commercial venture and have a long-term investment horizon for the realization of a return on their

⁴ Preqin, 2013, *The 2014 Preqin Sovereign Wealth Fund Review* (London).

⁵ Climatewise, Munich Climate Insurance Initiative and United Nations Environment Programme Finance Initiative, 2013, Global insurance industry statement, presented at the Caring for Climate Business Forum at the Conference of the Parties of the United Nations Framework Convention on Climate Change, Warsaw, 19 November, available at <http://www.climatewise.org.uk/global-insurer-statement/> (accessed 29 January 2015).

⁶ Preqin, 2013.

⁷ TheCityUK, 2013, Fund management, available at <http://www.thecityuk.com/research/our-work/reports-list/uk-fund-management-2014/> (accessed 29 January 2015).

⁸ World Economic Forum, 2011, *The Future of Long-term Investing* (New York and Geneva).

⁹ Ernst and Young, 2013, Turning the corner: Global venture capital insights and trends, available at <http://www.ey.com/GL/en/Services/Strategic-Growth-Markets/Global-VC-insights-and-trends-report-2013> (accessed 29 January 2015).

initial capital. This makes venture capital more characteristic of a direct investor than a short-term portfolio investment.

Policy issues for consideration

28. In mobilizing development finance from external sources, the relevant characteristics, motivations and propensities of the principal actors need to be taken into account, including the following among institutional investors:

- Pension funds are attracted to longer term opportunities, such as in infrastructure
- Insurance companies have some incentive to support climate-change mitigation and adaptation projects
- For most portfolio and/or institutional investors, bankable projects are a valuable incentive

29. In this respect, lessons learned from country experiences may support policymaking and guide investors towards specific projects related to sustainable development goals, such as the following:

- Setting up a portfolio of bankable projects
- Developing new rating methodologies for investment in sustainable development goals
- Building and supporting go-to-market channels for investment projects related to sustainable development goals in financial markets

30. At the same time, policies may be required to reorient the propensities and behaviour of sources of finance and investment, such as the following:

- Building or improving pricing mechanisms for externalities
- Realigning incentives in capital markets
- Widening the scope and content of principles to guide investment behaviour
- Establishing effective instruments for measuring and monitoring investments

III. Enhancing partnerships between external and internal sources of finance and investment

31. Mobilizing international resources for development was set as one of the objectives in the Monterrey Consensus¹⁰ to meet the Millennium Development Goals and will be reiterated at the Third International Conference on Financing for Development with an agreed and ambitious course for sustainable development financing to meet the future sustainable development goals. This mobilization will require public and private sectors, both domestic and foreign, to work in partnership and concert.

32. Although private capital flows have an increasingly significant role in financing for development, the public sector is the dominant actor in many sectors related to sustainable development goals. However, the public sector alone cannot attain the level of investment

¹⁰ The Monterrey Consensus was adopted by the First International Conference on Financing for Development, a summit-level meeting sponsored by the United Nations to address key financial and related issues pertaining to global development, held in Mexico in March 2002. Among other things, it called for mobilizing and increasing the effective use of financial resources needed to fulfil internationally agreed development goals in the context of a holistic approach to the challenges of financing for development.

required for the envisaged sustainable development goals. As Governments in developing countries and countries with economies in transition operate on limited budgets, especially in countries experiencing rapid population growth and urbanization, they need to tap into the private sector, both domestic and foreign, for capital, technology and the expertise to finance, develop and manage public-sector projects in infrastructure and other areas. Partnerships between public, private and foreign investors have increasingly been recognized as an effective and appropriate mechanism for managing the complexity of the development challenges facing developing countries and for meeting the Millennium Development Goals. This has also been clearly articulated with regard to all sectors related to sustainable development goals. Significant areas in which such partnerships might be the most effective include promoting infrastructure development, mitigating climate change and increasing agricultural production, as detailed in the box.

Typical sectors related to sustainable development goals that can effectively utilize partnerships among different investors

Infrastructure

A good example of industries in which a close association between foreign and domestic investment – either public or private – can substantially help in meeting local development needs is seen in the infrastructure sector.¹¹ As the investment requirements of developing countries in infrastructure far exceed the amounts that can be financed by the public sector, Governments have opened up infrastructure industries and services to greater participation by the private sector, including transnational corporations. Fiscal space limitations and debt sustainability considerations have led many Governments in developing countries to reassess the potential role of foreign and domestic private-sector financing of current and future public investment needs in infrastructure.

Climate change

There is considerable potential for interaction between public and private investments in mitigating the effects of climate change, especially in such areas as renewable power generation. Given that renewable energy technologies are not yet price-competitive with traditional more carbon-intensive ones, their use by private firms often requires some type of PPP, which can take a number of forms but typically includes assurances by Government of access to the power grid and preferential rates for the electricity produced, in addition to long-term purchase agreements and financing at concessional rates.¹²

Agriculture

The expansion and revitalization of agricultural production is crucial for developing countries, both to meet rising food needs and to lay the foundations for economic diversification and development. Both foreign and domestic investments, public or private, can contribute to the development of the agriculture sector, and there is considerable potential for interaction between the two. There are many successful cases of PPPs in agricultural production in developing countries, especially in areas such as improving agricultural technologies and inputs, research and development and providing extension

¹¹ Examples of PPPs involving foreign and local partners worldwide include, among others, hydropower stations in Cambodia, Port Saïd and Marsa Allam in Egypt and Tangier Méditerranée in Morocco.

PPP's involving public and private partners include the Mbombela water concession in South Africa, the Enfidha-Hammamet Airport Project in Tunisia and the Bujagali Hydropower Project in Uganda.

¹² Examples include a build, own, operate and transfer wind-generation project in Costa Rica with GDF Suez of France. In Brazil, the Brazilian Development Bank approved R\$72 million (\$35 million) in financing for the Pedra do Sal wind farm in cooperation with Ecomenergy International, a subsidiary of GDF Suez.

services to help farmers move from subsistence to market-oriented production.¹³

Foreign and domestic investors, whether companies, individual farmers or public investors, may cooperate in agricultural production and at different stages of the food value chain. For instance, while domestic investors may undertake production, foreign investors may focus on food processing or distribution. Contract farming is a typical component of such cooperation.

33. Involvement of the private sector in sectors related to sustainable development goals should be based on a set of guiding principles that include balancing liberalization with the right to regulate, balancing the need for attractive risk-return rates with the need for accessible and affordable services, balancing a push for private investment with the push for public investment and balancing the global scope of sustainable development goals with the need to make a special effort in LDCs.¹⁴

34. Leveraging external sources for investment in local economies provides a viable and useful means for supporting development. However, synergizing different sources of investment is a formidable challenge. Each external source has specific motives and thus reacts to economic situations differently. It is vital to recognize such differences when leveraging potential synergies for development purposes.

35. Used effectively and under the right conditions, other capital (e.g. bank loans) can boost the level of investment by direct investors, both local and foreign, facilitate its operation on a day-to-day basis or do both. However, when not used correctly (for example, if an FDI enterprise becomes overly exposed to debt or derivatives or when banks lend excessively without proper due diligence to domestic public or private enterprises), such capital can provoke or worsen a crisis.

36. Public and private entities directly investing in projects related to sustainable development goals (e.g. in infrastructure), including transnational corporations, can potentially partner with various types of external capital from a wide range of sources, such as the following five, to synergistic effect (see chapter 4 for examples of innovative financing).

Portfolio investment

37. Generally speaking, portfolio investors do not have a day-to-day management interest in how an enterprise is run. Such funds can come and go very quickly. Portfolio equity investors, who hold less than 10 per cent of shares or the equivalent, may keep the investment over the long term. Institutional investors, such as SWFs or pension funds, are typical examples. In their case, the motivation to invest is not simply to make a quick return and move on but, as with FDI, to seek a return over the longer term. In some cases, portfolio investors hold a seat on the board of directors. For instance, Government Pension Fund Global of Norway is considering this kind of arrangement. This type of portfolio investment can thus reinforce the type of long-term investment required to meet the challenge of sustainable development.

Official development assistance

38. ODA can catalyse FDI by improving the conditions needed for direct investments to flourish. This can be done directly by investing in or jointly with enterprises, including

¹³ Examples include a PPP arrangement for vegetable oil production in Uganda with Wilmar International of Singapore. PPPs in China include, with Syngenta of Switzerland, involvement with the Hubei Biopesticide Engineering Research Centre and the Shanghai Institute of Organic Chemistry for the development of crop protection innovations. In India, Syngenta has PPPs that support improvements to farming practices and the livelihoods of poor smallholders.

¹⁴ UNCTAD, 2014.

through FDI, or indirectly by promoting conditions in which such enterprises can thrive. To meet its objectives, ODA must be applied carefully, in order that, for example, increasing FDI crowds in domestic investment rather than crowding it out. ODA, which is motivated primarily by development concerns, rather than the business interests of the donor country, supports foreign investment for development in several ways. At one end of the scale of investment, PPPs are becoming increasingly popular in developing countries, where FDI synergizes with foreign and domestic public and private investment to run large-scale projects that otherwise would not be viable. At the other end of the scale, donors, through development institutions, can behave in a manner similar to FDI investors, especially investors in domestic small and medium-sized enterprises. Their main objective is to provide additional finance as a means to boost investment and cover risk. In this way, they can also facilitate projects that otherwise would not be viable. In such cases, they invest in individual projects. ODA in its many forms can thus boost private investment and promote its synergies with other types and sources of investment and this has beneficial results in helping countries move towards meeting the Millennium Development Goals and future sustainable development goals. Particularly in a climate of budget cuts, linking ODA to FDI is important to enhance synergies between them.

Commercial bank loans

39. Commercial bank loans provide funds directly to an investor to expand a business, purchase new equipment, upgrade existing facilities, boost working capital or grow inventory. An investor might have sufficient internal resources but opt to take out a commercial loan in order to, for example, retain sufficient funds to cover contingencies and reduce taxable income by increasing debt payments. Bank loans can therefore directly promote more direct investment by local or foreign investors by adding to the investment or indirectly by ensuring the smooth operation of an activity. In this respect, the role of commercial banks is critical. When taking a long-term view, banks may sit on the board of directors of an enterprise, exert a direct interest in its management and thus be motivated to ensure its long-term prosperity. This contrasts with a more laissez-faire approach in which banks are primarily interested in a return on their money. Bank loans may thus stabilize finance for enterprises in times of crisis.

Supplier credits

40. Supplier credits are normally provided by partner firms or intermediate banks and are primarily but not always short-term. Such credits are especially important to investing enterprises that engage in trade or depend on importing inputs; the global trading economy has thus relied heavily on them. During the financial crisis, supplier credits took a severe hit, which had a huge impact on trade and the activities of even healthy enterprises directly and indirectly involved in trade. An environment conducive to trade credits is therefore important to sustain investment and economic activity.

Remittances

41. Workers' remittances are payments and transfers from foreign workers to their countries of origin. With some \$370 billion in remittances to labour-sending developing countries and countries with economies in transition in 2013, income transfer has grown to a significant amount: almost half of FDI flows and over three times as high as total ODA received by developing countries. As a source of development finance in labour-sending countries, remittances are still limited because they flow directly to households and are essentially used for consumption. However, their wide distribution throughout the economy means they can have a much broader effect than capital flows and even official flows, where the recipients are targeted, more limited and geographically concentrated. When emigrants return home, they may become important human resources, as they typically acquire technological skills in labour-receiving countries. Furthermore, emigrants and short-term workers also invest directly in their countries of origin (see table 2).

Table 2
Migrant remittances and diaspora acquisitions, 1990–2013
 (Millions of dollars)

Receiving region	Annual average							
	1990–1994	1995–1999	2000–2004	2005–2009	2010	2011	2012	2013
Developing countries	38 855	63 946	111 895	246 192	311 202	348 053	365 619	374 702
Africa	10 368	10 868	14 146	41 414	51 911	56 408	60 851	60 364
Developing Asia	20 215	37 906	66 200	145 704	201 527	230 397	242 957	251 351
South-East Asia	3 793	8 638	14 792	31 398	41 537	44 745	48 327	51 433
Latin America and the Caribbean	8 159	15 062	30 804	57 493	56 050	59 434	59 962	61 124
Countries with economies in transition	1 193	4 777	6 652	24 050	30 319	36 401	37 598	42 152
Developed countries	33 867	43 395	60 329	99 737	111 978	122 111	118 272	125 084
World total	73 915	112 119	178 876	369 978	453 499	506 565	521 489	541 938

Source: UNCTAD secretariat calculations, based on data from the World Bank.

Investments by diaspora

42. Investments by permanent emigrants and refugees range from portfolio investment to FDI and financial investment (e.g. bank deposits) in their countries of origin. As long as emigrants invest in fixed assets over other assets, they make a direct contribution to productive investment. Small enterprises managed by families and relatives typically benefit from such investments. Relatives and others (e.g. friends) in countries of origin may have access to emigrants' bank deposits and turn them into productive investments.¹⁵ Based on data on cross-border mergers and acquisitions by diaspora members in their countries of origin, their investment in developing countries in 2013 is estimated at \$3.1 billion, accounting for 3 per cent of the value of all cross-border mergers and acquisitions in developing countries. The value of investment is still small – one hundredth of all remittances in recent years – but members of diaspora, perhaps more than foreign workers per se, can also contribute technical, managerial and other skills.

Policy issues for consideration

43. In order to increase the absolute level of investment funds for sectors related to sustainable development goals and to multiply their effectiveness and impact, partnerships between different external and internal sources of development finance and investment are desirable, to benefit from and synergize their unique attributes. Some combinations of funds and sources might be more effective for specific sectors or projects related to sustainable development goals. What country experiences may be drawn on to support policymaking with respect to partnerships? Related policies might entail, among others, the following:

- Use of ODA funds as base capital or junior debt in order to share risks or improve risk-return profiles for private-sector funders
- Wider use of PPPs for projects related to sustainable development goals to improve risk-return profiles and address market failures

¹⁵ Such amounts are called personal transfers and are recorded in the income account, not necessarily in the capital account, in a balance of payments.

- Advance market commitments and other mechanisms to provide more stable and reliable markets for sectors related to sustainable development goals
- Use of public development funds (e.g. provided by development or multilateral banks) as seed capital or guarantees to raise further private sector resources in financial markets

44. An important aspect of partnerships is that they are not only about financing; each partner has unique characteristics and attributes, including technological assets, managerial and professional skills or knowledge of the relevant sector or project. These attributes and skills can be quite diffuse, and another area of consideration is thus how to bring such attributes together into a mutually feasible partnership, especially in terms of non-traditional sources of know-how in developed countries (e.g. diaspora members, retired individuals and career-gap volunteers).

IV. Innovative financing mechanisms for sustainable development: Maximizing benefits from development finance

45. Innovative financing solutions to support sustainable development, including new financial instruments, investment funds and financing approaches, have the potential to contribute significantly to the realization of sustainable development goals. To date, however, they have remained relatively small in scale and limited in scope. Sources of innovative finance may operate on the margins of capital markets and, when linked to discretionary donor budgets, are not always stable. Prevalent examples of sources of innovative finance that could be scaled up include the following seven sources.

Green bonds and development impact bonds

46. The current estimated market value of green and/or climate bonds ranges from \$86 billion to 174 billion and various proposed development impact bonds are likely to raise this further.¹⁶ These bonds are appealing because they ensure a safer return for investors, many of which are backed by donors or multilateral banks, and also because they are clearly defined sustainable projects or products. The proceeds are often credited to special accounts that support loan disbursements for projects related to sustainable development goals (e.g. projects related to development or climate change adaptation and mitigation). These instruments were often the domain of multilateral development banks, but more recently, a number of transnational corporations have issued green bonds, such as EDF Energy, Toyota and Unilever.¹⁷

Impact investing

47. Impact investment can be a valuable source of capital, especially to finance the needs of low-income developing countries or for products and services aimed at vulnerable

¹⁶ According to the World Economic Forum, the size of the green bond market is estimated at \$174 billion by HSBC and the Climate Bonds Initiative, under a definition that looks beyond explicitly labelled green and/or climate bonds, while other estimates, including those from the Organization for Economic Cooperation and Development, place the market nearer to \$86 billion (World Economic Forum, 2013, *The Green Investment Report* (Geneva)).

¹⁷ EDF Energy undertook a €1.4 billion issue to finance investment in solar and wind energy, Toyota raised \$1.75 billion for the development of hybrid vehicles and Unilever raised £250 million for projects to reduce greenhouse gas emissions, water usage or waste within its supply chain (S Mulholland, 2014, Toyota said to issue \$1.75 billion of green asset-backed bonds, *Bloomberg*, 11 March; *Reuters*, 2013, Successful launch of EDF's first green bond, 20 November; *The Economist*, 2014, Green bonds: Spring in the air, 22 March; and Unilever, 2014, Unilever issues first ever green sustainability bond, 19 March).

communities. Estimated impact investments presently range from \$40 billion to \$100 billion, depending on which sectors and types of activity are defined as constituting impact investing. Similarly, the estimated future global potential of impact investing varies from the relatively modest to up to \$1 trillion in total.¹⁸ Impact investors include aid agencies, non-governmental organizations, philanthropic foundations and wealthy individuals, as well as banks, institutional investors and other types of firms and funds. A joint study of impact investment by UNCTAD and the United States Department of State in 2012 observed that over 90 per cent of impact investment funds were still invested in the developed world, mostly in social impact and renewable energy projects. In developing regions, the largest recipient of impact investing is Latin America and the Caribbean, followed by Africa and South Asia.¹⁹ This is because there are a number of constraints on the expansion of impact investing in developing countries; some are supply-related constraints, such as the lack of a common understanding of what impact investment entails, while others are demand-related constraints, such as a shortage of high-quality investment opportunities with experience or the lack of innovative structures to accommodate the needs of portfolio investors.²⁰

Vertical funds

48. Vertical, or financial intermediary, funds are dedicated mechanisms that allow multiple stakeholders (e.g. Government, civil society, individuals and the private sector) to provide funding for previously specified purposes, often to underfunded sectors such as disease eradication or climate change mitigation. Funds such as the Global Environment Fund and the Global Fund to Fight AIDS, Tuberculosis and Malaria have now reached a significant size.²¹ Similar funds could be created in alignment with other specific focus areas of sustainable development goals in general. For example, the Africa Enterprise Challenge Fund has been used as a vehicle to provide preferential loans for the purpose of developing inclusive businesses.

Matching funds

49. Matching funds, whereby the public sector commits to contributing an equal or proportionate amount, have been used to incentivize private sector contributions to development initiatives. For example, under the Gavi Matching Fund, the Department for International Development of the United Kingdom of Great Britain and Northern Ireland and the Bill and Melinda Gates Foundation have pledged about \$130 million combined to match contributions from corporations, foundations, customers, members, employees and business partners (see <http://www.gavi.org/funding/give-to-gavi/gavi-matching-fund/>).

¹⁸ N O'Donohoe, C Leijonhufvud and Y Saltuk, 2010, Impact investments: An emerging asset class, J.P. Morgan Global Research, available at <https://www.jpmorgan.com/pages/detail/1290554691462> (accessed 29 January 2015).

¹⁹ R Addis, J. McLeod and A. Raine, 2013, Impact – Australia: Investment for social and economic benefit, Australian Government Department of Education, Employment and Workplace Relations.

²⁰ A number of initiatives are under way to address these constraints and expand impact investment, including the Global Impact Investing Network and the Impact Reporting and Investment Standards catalogue, the Global Impact Economy Forum of the United States Department of State, the Global Impact Investment Ratings System, the United Kingdom Impact Programme for investment in sub-Saharan Africa and South Asia and the Group of 8 Social Impact Investment Task Force.

²¹ The Global Environment Fund – a partnership between 182 countries, international agencies, civil society and private sector – has provided \$11.5 billion in grants since its creation in 1990 and leveraged \$57 billion in co-financing for over 3,215 projects in over 165 countries. The Global Fund to Fight AIDS, Tuberculosis and Malaria has secured pledges of about \$30 billion since its creation in 2002 and over 60 per cent of the pledges have been paid to date (World Bank, 2013, *Financing for Development Post-2015* (Washington, D.C.)).

Front-loading aid

50. In addition to catalysing additional contributions, the public sector can induce private sector actors to use financing mechanisms that change the time profile of development financing, through the front loading of aid disbursements. The International Finance Facility for Immunization issues AAA-rated bonds in capital markets that are backed by long-term pledges by donor Governments. As such, aid flows to developing countries that would normally occur over a period of 20 years are converted to cash immediately upon issuance. For investors, the bonds are attractive due to the credit rating, a market-comparable interest rate and the perceived socially responsible return on investment. The International Finance Facility for Immunization has raised more than \$4.5 billion to date through bond issuances purchased by institutional and retail investors in a range of different mature financial markets (see <http://www.iffim.org>).

Future-flow securitization

51. The front loading of aid is a subset of a broader range of initiatives under the umbrella of future-flow securitization, which allows developing countries to issue marketable financial instruments whose repayments are secured against a relatively stable revenue stream. These can be used to attract a broader class of investors than would otherwise be possible. Other prominent examples are diaspora bonds, whose issuance is secured against migrant remittance flows, and bonds backed by the revenue stream from, for example, natural resources. These instruments allow developing countries to access funding immediately that would normally be received over a protracted period.

Crowdsourcing

52. It is estimated that crowdfunding platforms raised \$2.7 billion globally in 2012 and were forecast to increase 81 per cent in 2013 to \$5.1 billion.²² While currently more prevalent in developed countries, crowdfunding has the potential to fund projects related to sustainable development goals in developing countries. Crowdfunding has been an effective means for entrepreneurs and businesses in developed countries that do not have access to more formal financial markets. Crowdfunding could also help dormant entrepreneurial talent and activity to circumvent traditional capital markets and obtain finance.

53. In dealing with these innovative mechanisms for finance and addressing various challenges in sectors related to sustainable development goals, investing in human resources is critical. Mobilizing resources for entrepreneurship promotion is a viable option, and is addressed in a separate note prepared by the Secretariat (TD/B/C.II/29).

Policy issues for consideration

54. To achieve scale and scope, existing and innovative financial instruments and funding mechanisms to raise resources for investment in sustainable development goals need to be supported, adapted to purpose and scaled up as appropriate. What country experiences can be drawn on to devise appropriate policies and mechanisms for doing so? Among others, consideration may be given to the following:

- Partnerships between outward investment agencies in home countries and investment promotion agencies in host countries
- Facilitation measures to support financial instruments dedicated to sustainable development goals and impact investing initiatives
- Means of implementation of policies, in order to ensure a better use of innovative mechanisms and reduce constraints on investors

²² Massolution, 2013, The crowdfunding industry report, available at <http://www.crowdsourcing.org/editorial/2013cf-the-crowdfunding-industry-report/25107> (accessed 29 January 2015).

55. Beyond policies for financing, consideration should be given to encouraging private and public sectors, both foreign and domestic, to invest better. Achieving sustainable development goals is not only about how much investment is made, but how it is implemented. For instance, investors expanding the employment of women, minorities and other excluded groups – or boosting their skills – support sustainable development through how they invest, and not only by how much.



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**Mobilizing investment for sustainable development:
Background information and considerations pertinent to the
Third International Conference on Financing for
Development**

Note by the UNCTAD secretariat

Corrigendum

The corner notation on document TD/B/C.II/28 should read as above.

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