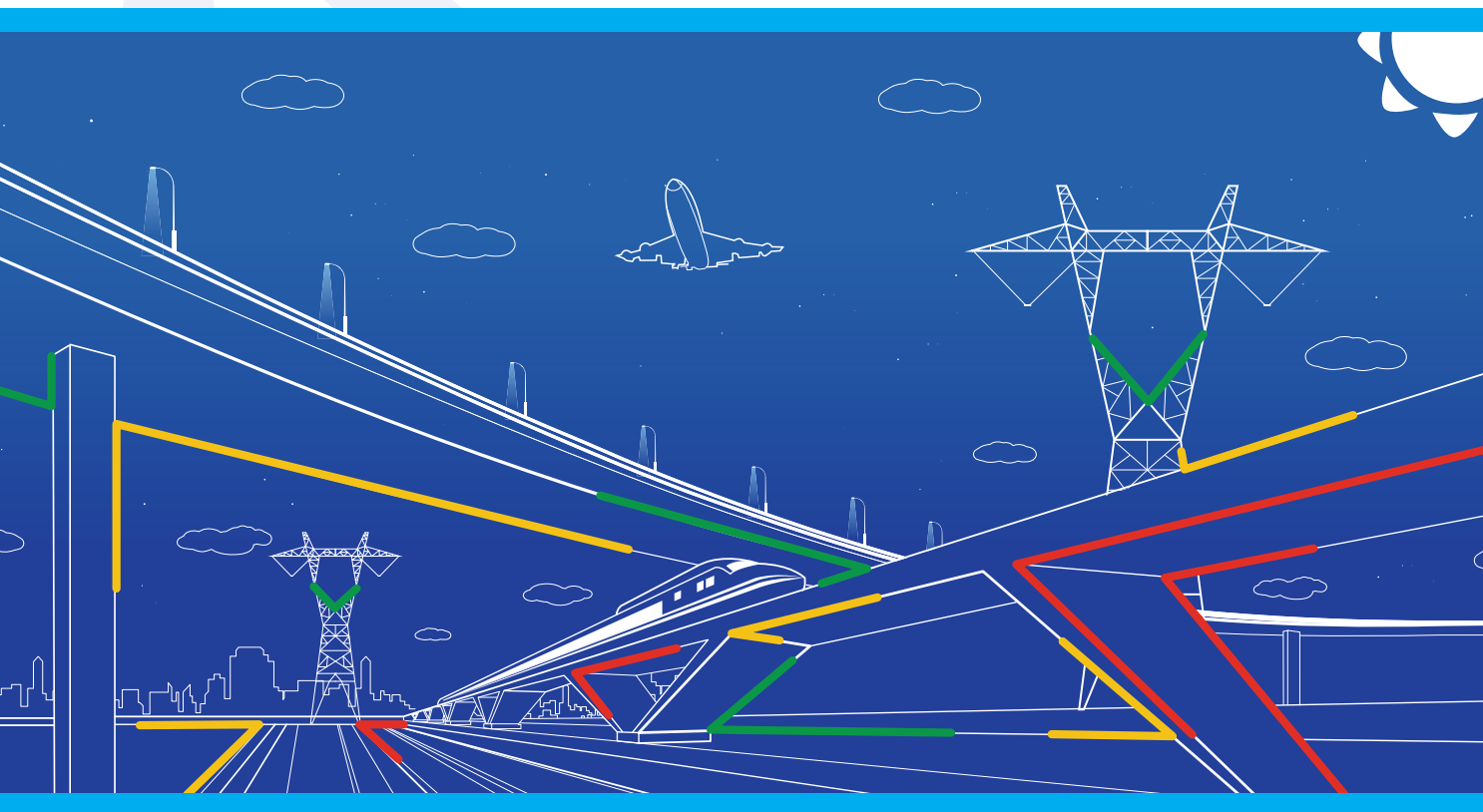


# FINANCING FOR DEVELOPMENT: PROGRESS AND PROSPECTS

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



United Nations

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United Nations  
New York, 2017

United Nations publication  
Sales no. E.17.I.5  
ISBN 978-92-1-101363-4

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## Chapter I.

# The challenge of the global economic situation<sup>1</sup>

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

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

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

Agenda, which provides a broad framework for such cooperation, is therefore more important than ever.

## 1. Inadequate growth of global demand and income

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

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

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

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

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

## 2. Investment

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

In developed economies, private non-residential investment growth has been exceptionally weak in recent years. Data shows that most major developed economies experienced a contraction in private non-residential investment in the first half of 2016. Despite some recovery in recent quarters, the public

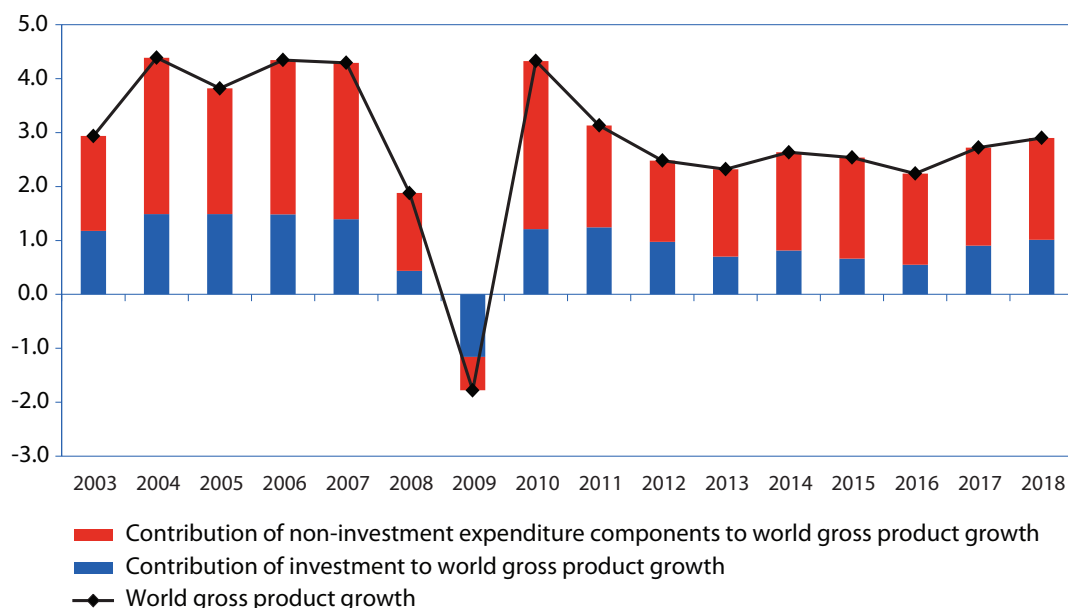
investment-to-gross-domestic-product (GDP) ratio also remains low in many developed economies. This reflects a continuation of fiscal adjustment policies adopted by Governments since 2010, following a bounce back in growth due to the coordinated monetary easing and temporary fiscal stimulus agreed by the Group of 20. The reluctance to increase public sector investment arose despite record-low and often negative government bond yields.

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

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

Figure 1

### Contributions to world gross product growth, 2003–2018 (Percentage)



Source: UN/DESA based on United Nations Statistics Division National Accounts Main Aggregates Database and UN/DESA forecasts.

Note: Data for 2016 are partially estimated; data for 2017–2018 are forecasts.

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

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

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

The slowdown in private investment growth also raises some concerns over corporate debt, particularly in many developing economies, as it suggests that the significant increase in corporate debt burdens in emerging market economies has failed to translate into a commensurate increase in pro-

ductive capital stock. Indeed, disaggregated sectoral data shows that 75 per cent of the increases in developing countries’ corporate debt during 2010-2014 can be attributed to very few sectors, including oil and gas, electricity, and construction and materials, that are not at the technological frontier and do not have the greatest potential to contribute to overall productivity growth. As high debt burdens continue to accumulate, it could begin to restrain access to finance or prompt firms to deleverage and perpetuate the deceleration in investment growth.

### 3. International trade and trade policy

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

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

<sup>3</sup> IEA (2016). *World Energy Investment 2016*.

<sup>4</sup> UNCTAD (2016). *Trade and Development Report (TDR)*, 2016, Chapter V.

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

<sup>6</sup> WTO (2016). *World Trade Statistical Review*. At publication of this report, the most recent year with comprehensive trade data is 2015.

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

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

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

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

#### 4. Impacts on sustainable development prospects

Weak investment and trade have played a significant role in the decline of labour productivity growth since the 2008 crisis. In developed countries, the

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

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

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

#### 5. Employment, inequality and social protection

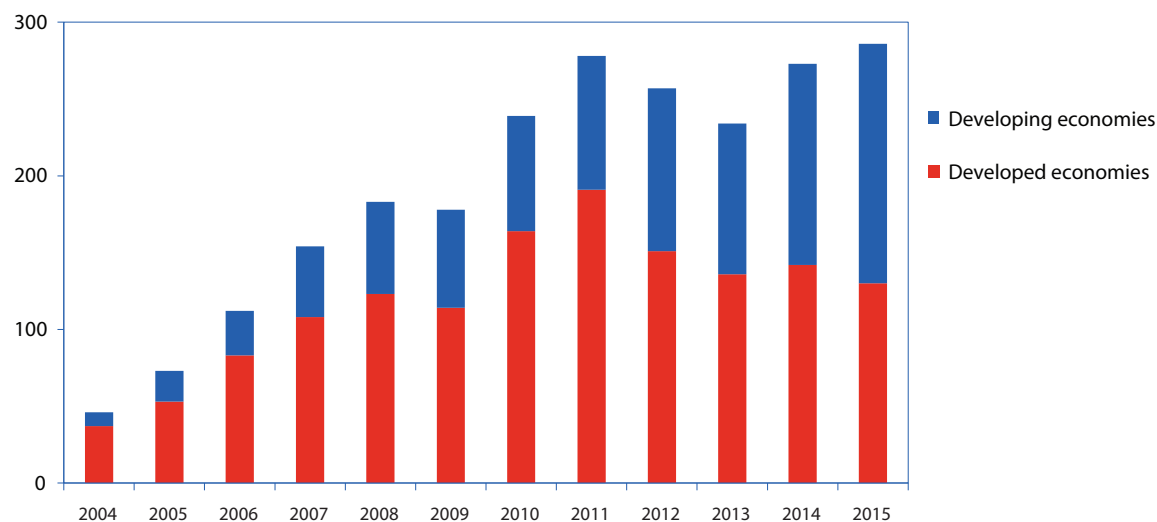
The social consequences of the economic growth trend delineated here are profound. The International Labour Organization (ILO) estimates that over 200 million people are expected to be unem-

<sup>8</sup> IMF (2016). *World Economic Outlook, October 2016*.

<sup>9</sup> The data exclude large hydroelectric projects.

<sup>10</sup> United Nations (2017), *World Economic Situation and Prospects, 2017*, p. 29.

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



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

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

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

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

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

<sup>11</sup> ILO (2017), *World Employment and Social Outlook: Trends 2017*, Geneva.

<sup>12</sup> Fiszbein, Kanbur and Yemtsov (2013). Social Protection, Poverty and the post-2015 Agenda. Policy Research Working Paper 6469. World Bank.

<sup>13</sup> United Nations (2017). *World Economic Situation and Prospects, 2017*, p. 5.



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

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

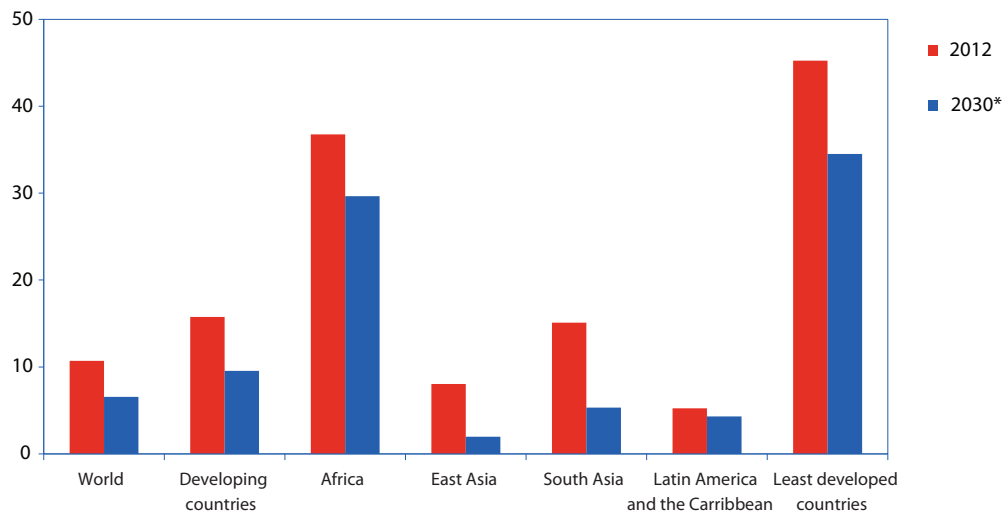
## 6. From a vicious to virtuous cycle

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

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

Figure 3

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



Source: UN/DESA.

Note: \* Forecast; see Holland and Jayadev (2016) for detailed discussion of the forecast models.<sup>16</sup>

<sup>14</sup> Ibid., pp. 25-27.

<sup>15</sup> ILO (2017), op. cit., p. 9.

<sup>16</sup> Holland, Dawn and Arjun Jayadev (2016). Linking inequality and poverty in macroeconomic models. Presentation at Project LINK Meeting 2016, Toronto, October. Available from <http://www.rotman.utoronto.ca/FacultyAndResearch/ResearchCentres/ProjectLINK/LINKconferences/LINK-2016-Agenda>.