FINANCING FOR DEVELOPMENT: PROGRESS AND PROSPECTS

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

United Nations
FINANCING FOR DEVELOPMENT: PROGRESS AND PROSPECTS

Report of the Inter-agency Task Force on Financing for Development 2017
Chapter II. Financing investment and social protection

1. Introduction

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

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

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

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

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

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

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

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

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

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

<table>
<thead>
<tr>
<th>Source</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic government budgets</td>
<td>67–72</td>
</tr>
<tr>
<td>Private sector</td>
<td>20 – 30</td>
</tr>
<tr>
<td>Aid and multilateral development bank financing</td>
<td>5 – 8</td>
</tr>
<tr>
<td>Other developing-country Governments</td>
<td>3</td>
</tr>
</tbody>
</table>


---

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

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


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

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

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

---

**Figure 1.a**

*Estimated infrastructure needs, globally*  
(Percentage of total)

![Diagram showing infrastructure needs globally]


**Figure 1.b**

*Estimated infrastructure needs, sub-Saharan Africa*  
(Percentage of total)

![Diagram showing infrastructure needs in sub-Saharan Africa]

**Source:** G20 Development Working Group, 2014.
All projects, independently of how they are financed, should be considered as part of an overall infrastructure investment plan and prioritized accordingly, with cost-benefit analysis at the project level and debt sustainability at the macro level, as called for in the Addis Agenda. While the sectoral breakdowns indicate an important role for government in infrastructure investment going forward, whether through public private partnerships (PPPs), incentives, or direct investment, the breakdown of public and private finance across sectors and countries will ultimately depend on a host of factors, including government priorities expressed in the overall infrastructure investment plan, and policy frameworks. Nonetheless, the scope of financing needs makes it imperative to seek an increase in private and public SDG-related investment.

2.1 Private investment in infrastructure

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

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

Figure 2

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


Note: Includes the total value of projects, not just the share attributable to the private sector, in current dollars. Infrastructure includes investments in energy, ICT, transport, water and sewerage.
are also commitments to provide technical support for countries in translating infrastructure plans into concrete project pipelines, to complete feasibility studies, to negotiate complex contracts, to expand project management, and to use investment promotion and other relevant agencies to strengthen project preparation.

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

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

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

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

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

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

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

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

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

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

---


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

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

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

### 2.3 Public-private partnerships and blended finance

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

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

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

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

---


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

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

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

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

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

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

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

As infrastructure projects often profoundly impact local communities, stakeholder participation in decision-making on PPPs is critical to ensuring accountability and project effectiveness. The Addis Agenda also calls for PPPs to meet social and environmental standards, and for all investment flows to be aligned with sustainable development. This represents a shift in thinking, from “doing no harm” through safeguards, to
addressing adverse impacts and generating positive impacts in all three dimensions of sustainable development (similar to impact investing, discussed in chapter III.B).

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

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

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

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

---

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

3. **Investment promotion for the LDCs**

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

FDI flows to developing countries have been on an upward trend since 2000, but have registered lower levels in recent years (see chapters I and III.B). In LDCs, the bulk of FDI is associated with capital-intensive extractive industries. While FDI to LDCs as a group increased in 2015 to $35 billion on a gross basis (or 5 per cent of gross FDI to developing countries), this upturn was largely due to investment in one country—Angola, where over three-quarters of FDI was in the form of loans provided by foreign parent firms to their Angolan affiliates.

Structural change in global production processes through the rise of global value chains (GVCs) has also impacted these trends. GVC participation requires specialized production capabilities at a demanding level of quality and quantity, and within tight timelines. These demands largely confine LDC participation in value

---

22 Ibid., para. 46.
chains to upstream activities such as raw material provision. Nonetheless, GVCs have spawned strong growth in investment into LDCs in Southeast Asia and some South Asian LDCs. East and Southern Africa have also enjoyed increased FDI flows through GVC integration.

3.1 Obstacles to FDI in LDCs

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

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

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

3.2 Investment promotion

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

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

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

---

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

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

More broadly, the UNCTAD Investment Policy Framework for Sustainable Development helps countries, in particular LDCs, to formulate investment policy and investment agreements to enhance the sustainable development dimension of both local and foreign investment. It is critical that investment policy is embedded in a broader industrial and sustainable development strategy so that investment contributes to SDGs.

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

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

---

25 As of March 2017, see: http://investmentpolicyhub.unctad.org/IIA/IiasByCountry#iiaInnerMenu
addition to technical assistance and measures aimed at improving the investment climate, the plan will use EU grants to mobilize investments, including through guarantees to support private sector projects in risky environments. MDBs and development finance institutions also provide a range of blending instruments, political risk guarantees and technical assistance to promote private sector investments.

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

4. Addressing vulnerabilities

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

The provision of universal social protection floors (SPFs) is included in the 2030 Agenda for Sustainable Development and was also adopted by the member countries of the International Labour Organization (ILO) in 2012.30 SPFs are meant to convey at least minimum benefits to all people at every stage in their life cycle (children, mothers with newborns, support for those without jobs, persons with disabilities, older persons) through nationally designed and owned social protection systems.31 Social protection systems are essential elements of a policy response to address poverty and vulnerability, with a successful track record of quickly reducing poverty in countries across all regions. SPFs also have important economic consequences. They expand nations’ “production possibility frontiers” as SPFs enlarge the stock of healthy, educated and productive citizens who might otherwise be excluded from the main economy. They also economically empower poor people and thereby enlarge their potential contributions to the economy, raising productivity and growth along with their incomes. This ultimately expands tax revenues and the fiscal sustainability of public services. Some components of SPFs act as “automatic stabilizers” that lessen the contraction phase of macroeconomic cycles. Further, SPFs can help prevent social conflict, and support political stability and social cohesion.

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

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

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

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

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

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

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

4.2 International cooperation for strong and reliable social protection floors

As noted above, the Addis Agenda includes a commitment of strong international support for social
Additionally, while national SPFs should generally be financed by national resources, there are times and circumstances—for example, after an economic shock—when it will be difficult for countries to fully meet all the costs of their SPFs and other entitlements and obligations out of their own resources. Some international steps have been taken to assist in such situations. More are under consideration and should be advanced.

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

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

33 ILO Recommendation 202 states “National SPFs should be financed by national resources. Members whose economic and fiscal capacities are insufficient to implement the guarantees may seek international cooperation and support that complement their own efforts.” (para. 12)
34 ILO estimates in 90 developing countries that recurrent resources needed to operate cash transfers and administrative costs amount to 2.9 per cent of GDP, on average.
35 Figures are based on project-level data for members of the OECD Development Assistance Committee in constant 2014 US dollars. Social security systems are covered under code 16010 for social/welfare services.
36 The IMF funds are provided through the Rapid Credit Facility at concessional interest rates for low-income countries and the Rapid Financing Instrument at normal interest rates for all IMF members. The World Bank created the Crisis Response Window, the Immediate Response Mechanism and most recently the Pandemic Emergency Financing Facility, in partnership with the World Health Organization.
Box 2
Investing in gender equality and women’s empowerment

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

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

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

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


\(^b\) http://www.unwomen.org/-/media/headquarters/attachments/sections/news/action%20on%20transformative%20financing%20for%20gender%20equality.pdf?la=en&vs=5346

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

\(^d\) For a more in-depth discussion please see the Report of the Secretary-General on Women in development, A/68/271.
Members of the Task Force are already increasing cooperation on SPFs. The ILO and the World Bank bring together the relevant global, regional and bilateral development institutions through a Global Partnership on Universal Social Protection launched in September 2016. “Working as One” to promote SPFs is an important initiative of the United Nations Development Group and the ILO, launched in 2014. It mobilizes “One UN” national teams, under the Social Protection Floor Initiative, to design and implement social protection systems and floors through national dialogue. In addition, some developing countries have bilateral cooperation initiatives on social protection, and the ILO and the United Nations Special Unit for South-South Cooperation have facilitated peer-to-peer learning, including through events like the China High-level South-South event to achieve the SDGs on Universal Social Protection in September 2016. In sum, many countries are working on enhancing their SPFs and the international community is supporting such efforts; however, more needs to be done to speed implementation of this crucial component of the Addis Agenda.

---


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

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