Preparatory Process for the Third International Conference on Financing for Development

Substantive informal session: "Trade, technology and capacity building and other non-financial means of implementation"

10 December 2014, United Nations, New York

The Monterrey Consensus recognized international trade as an engine for development, and committed Member States to place the needs and interests of developing countries at the heart of multilateral trade negotiations. Since Monterrey, the share of developing countries' exports in the value of total world exports has increased, however, progress has been uneven. Global trade continues to grow, albeit at a much slower pace than before the international financial and economic crisis. In the absence of strong global demand growth prospects for renewed trade growth appear weak. Thus while trade flows continue to assume importance for resource mobilization in many developing countries, the extent to which export-led growth models offer the same development prospects as before the crisis has come in to question. The structure of trade in goods has also changed, with the rise of long global value chains in manufacturing changing the developmental prospects of trade and foreign direct investment.

Moreover, global negotiations on strengthening international trade rules have been stymied for many years. Progress in the implementation of the Bali package stalled over food security policies such as public cereal stockholdings. While this seems to have been resolved at end November 2014, the work programme for tackling the rest of the core issues in the Doha Development Agenda as mandated by ministers in Bali, must still be elaborated. The mandate of the Doha Round of the WTO negotiations also includes issues relevant to sustainable development, such as the liberalization of trade in environmental goods and services, and the implementation of duty-free, quota-free market access for all LDCs. The changes in the trade landscape, when compared to global human development, suggest that the efficiency gains derived from trade integration still have not been translated into broad-based development, with concerns on environmental sustainability not taken into account.

The alternative to progress in advancing a multilateral trade agenda is the continued proliferation of bilateral, regional and interregional free trade and investment agreements, which have increased dramatically since the early 1990s. Developing countries find it increasingly difficult to navigate a highly fragmented international investment regime. Global FDI flows are regulated by a multi-faceted, multi-layered network of more than 3,200 international investment agreements (IIAs). The proliferation of bilateral investment treaties and other trade agreements covering investment issues, including capital flows policies risks curtailing policy space for host countries and renders the mainstreaming of sustainable development in investment regimes more difficult. The balance between foreign investor rights and the sovereign capacity for recipient states to regulate within areas of public interest needs to be examined.

Science, technology and innovation (STI) are of pivotal importance in addressing sustainable development challenges in many areas, including sustainable economic growth and industrial development, poverty eradication, gender equality, health, education, food and agriculture, water, energy, and many others. Technological innovation is at the heart of sustainable development, and building technological capacities can help developing countries "catch up" with developed countries. There have been major advances in this area, for example in the area of information and communication technologies (ICTs). At the same time, access to technology remains uneven and unequally distributed, and a technology gap persists. Addressing these gaps will require additional policy actions – both national and international – in the areas of financing for technology, capacity building and technology transfer.

Programme

10 December 2014, United Nations, New York

Co-Chairs:

- H.E. Mr. George Wilfred Talbot (Guyana)
- H.E. Mr. Geir O. Pedersen (Norway)

Panel 1: 10:00 a.m. to 11:30 a.m. - Fostering science, technology and innovation
Trusteeship Council Chamber

Moderator: Mr. David O'Connor, Division for Sustainable Development, UN DESA

Speakers

- Ms. Xiaolan Fu, Founding Director of the Technology and Management Centre for Development; Professor of Technology and International Development and Fellow of Green Templeton College, University of Oxford
- Mr. William Lazonick, Professor and Director of the University of Massachusetts Center for Industrial Competitiveness; President of The Academic-Industry Research Network
- Mr. Khalil Rahman, Secretary, UN S-G's High Level Panel on the Technology Bank for the LDCs, UN-OHRLLS

Panel 2: 11:30 am to 1:00 pm – Investment regimes for sustainable development
Trusteeship Council Chamber

Moderator: Mr. Richard Kozul-Wright, Director, Division on Globalization and Development Strategies, UNCTAD

Speakers

- Mr. Jeswald Salacuse, Henry J. Braker Professor of Law, Tufts University and President, International Arbitration Tribunal, ICSID
- Ms. Sarah Anderson, Fellow, Institute for Policy Studies; Investment Subcommittee of the U.S. State Department's Advisory Committee on International Economic Policy
- Ms. Elisabeth Tuerk, Chief, International Investment Agreements Section, UNCTAD

Panel 3: 3 pm to 6:00 pm – Trade regimes for sustainable development
ECOSOC Chamber

Moderator: Mr. William Milberg, Dean, New School for Social Research

Speakers

- Mr. Guillermo Valles, Director, Division on International trade and commodities, UNCTAD
- Ms. Jennifer Bair, Assistant Professor, University of Colorado
- Mr. Joaquim Tres, Regional Instruments Coordinator, Integration and Trade Sector, IADB
- Mr. Paulo Correa, Lead Economist, World Bank
- Ms. Deborah James, Director of International Programs, Center for Economic and Policy Research

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Briefing Note

International trade for sustainable development

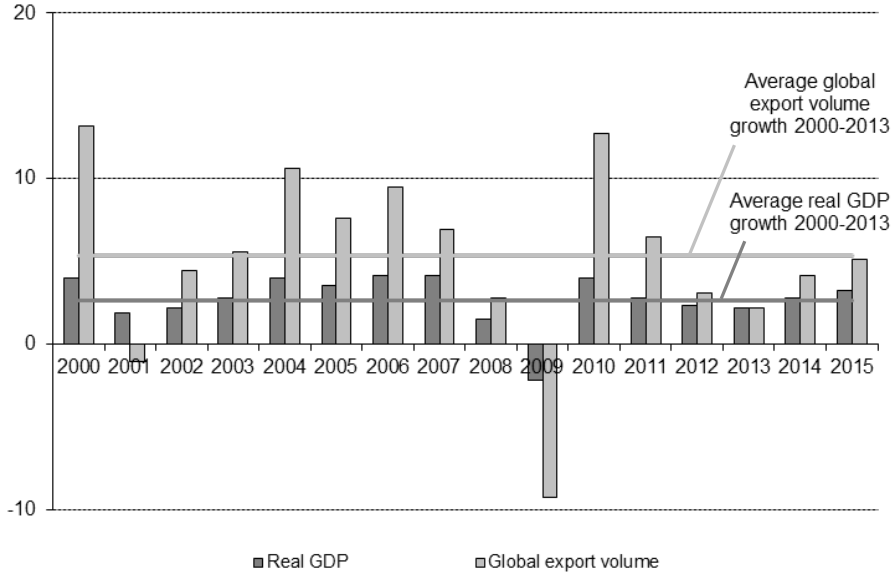
During the past decades there has been a dynamic expansion of world trade driven by technical advances, falling trade costs, a generally open trading environment and global value chains. The volume of world trade in goods and services increased five-fold from 1990 to 2013. The increased participation of developing countries in world trade has driven this global trend: their share in world merchandise exports climbed from 24 per cent in 1990 to 32 per cent in 2000 and then to 45 per cent in 2013. Developing countries in Asia alone have come to represent 36 per cent of the world's merchandise exports in 2013. Trade growth is forecast to accelerate in 2014 and continue into 2015.

However, trade has yet to regain the dynamism and the rapid growth trajectories of the years preceding the global economic crisis. In 2013, international trade in goods and services expanded at a modest pace of 2.2 per cent in volume terms, with developing countries' exports expanding at a faster pace (3.2 per cent) than those of developed countries (1.6 per cent). While trade flows continue to assume importance for resource mobilization in many developing countries, the extent to which export-led growth models offer the same development prospects as before the crisis has come in to question.

There is also a substantial variation in trade performance across countries, which is heavily skewed towards a handful of economies. The largest 20 exporters, most of which are from the developed countries and Asian regions, represent 70 per cent of world merchandise exports. Least developed countries' (LDC's) trade was strongly impacted by the global economic slowdown and their share in world trade in goods and commercial services remains low at 1.14 per cent of world trade.

There have also been large changes in the structure of global trade. World trade has been characterised by a lengthening of global value chains and the intensified transport of goods within such chains. An important aspect of trade in global value chains is that countries are required to import intermediate goods to produce and export processed goods or goods for final consumption. Reflecting the growth in value chains, trade in intermediate goods increased to approximately 55 per cent of world trade in

Annual changes in world real GDP and exports (goods and services), 2000-2015



2011. Dynamic growth in South-South trade, particularly intraregional trade, is in large part a reflection of the rise in trade within global value chains. South-South trade accounted for 59 per cent of developing countries' exports in 2013 and 25 per cent of world merchandise exports.

Overall growth in services trade has been faster and less volatile than trade in goods, but remains fairly stable as a share of total trade, at about 20 per cent. Tourism and transport services remain the main sectors for services trade. From 2000 to 2013, developing countries' share in world services exports rose from 23 to 30 per cent. In 2012, services represented 14 per cent of the total export of goods and services for developing countries and 51 per cent of their GDP.

Trade policies also have differential impacts on men and women, depending on a number of factors, including existing gender patterns within the division of labour, inequalities in the ownership of assets, educational level and entitlements, and the traditional pattern of gender roles. Because trade policies have strong redistributive effects both across economic sectors and among individuals, assessing the impact of trade policies on the wellbeing of men and women, separately, and ultimately on households can be helpful. Such an assessment can help with the design and implementation of policies to boost women's economic empowerment.

Multilateral trade policy

Global negotiations on strengthening international trade rules have been hindered for many years, despite repeated commitments by Member States to bring them to a conclusion. The Doha Round was launched in 2001 with a broad-based agenda, giving priority to developing countries' issues with implementation and to special and differential treatment to redress the imbalances left over from the previous Uruguay Round, as well as to agriculture and services. However, prolonged negotiations and recurrent setbacks delayed an agreement.

In a WTO ministerial conference in Bali, Indonesia in December 2013, a package of agreements was made. The "Bali package" contains 10 ministerial decisions, aimed at reducing trade transaction costs, addressing certain developing-country trade concerns in agriculture, enhancing LDC trade and establishing a mechanism to monitor the functioning of existing development provisions in WTO agreements. Yet, progress in the implementation of the Bali package stalled over food security policies such as public cereal stockholdings. While this seems to have been resolved at end November 2014, the work programme for tackling the rest of the core issues in the Doha Development Agenda as mandated by ministers in Bali, must still be elaborated.

Aid for trade, the category of official development assistance (ODA) that supports developing countries (particularly LDCs) in addressing trade-related constraints and in strengthening their capacity, increased in 2012, after declining in 2011, according to preliminary figures presented by OECD. However, the share of the LDCs of total aid-for-trade flows fell 2 per cent in 2012 to $13.1 billion, or 24 per cent of the total, as the large increase in aid for trade was directed to middle-income countries, mainly in the form of loans.

Regional trade and the multilateral system

One of the most significant challenges to the multilateral trading system since the Monterrey agreement is the increased prevalence of regional trade agreements, which risk fragmenting trade rules and undermining the consistency of the multilateral system. As of June 2014, some 585 notifications of regional trade agreements were received by GATT/WTO, of which 379 were in force. The last two years have seen an expansion of negotiations for 'mega-regional trade agreements' agreements amongst groups of countries, such as the Trans-Pacific Partnership (TPP), the EU–United States Transatlantic Trade and Investment Partnership (TTIP) and the Canada–EU Comprehensive Economic and Trade Agreement (CETA). Twenty-first century regional trade agreements differ qualitatively from previous regional trade agreements. They are generally oriented towards a deeper and more comprehensive integration. In addition to promoting fully open markets, such agreements now encompass a range of behind-the-border

regulatory measures, including investment, competition policy, capital movement, intellectual property rights and government procurement. Once concluded, these are likely to have a major impact on global trade and investment patterns.

Negotiations for mega-regional agreements have become increasingly prominent in the public debate, attracting considerable attention – support and criticism alike – from different stakeholders. Primary concerns relate to their likely impact on Contracting Parties' regulatory space and sustainable development (see below). In addition, these agreements are not negotiated under a development mandate and thus may not adequately consider the sustainable development implications of their provisions.

Regional trade agreements often incorporate provisions on intellectual property rights going beyond the Agreement in Trade-Related Aspects of Intellectual Property Rights that affect various public policies, ranging from health to innovation. Regional trade agreements have also had an effect on liberalization of government procurement, a market representing 10-15 per cent of GDP. Negotiations have also sought to address the potentially anti-competitive effect of State-owned enterprises.

More broadly, the proliferation and deepening of regional and bilateral trade agreements raises concerns of their coherence with the multilateral trading system. Member States may want to consider processes to ensure an optimal mixture of arrangements, as well as coherence among processes, to create an environment that facilitates sustainable development. There have been suggestions for strong multilateral oversight, including by setting minimum standards for regional regulatory provisions. Member States may wish to consider policies to ensure that the special and differential treatment and the policy space available under the multilateral trading system is not eroded by regional trade agreements.

Guiding questions

1. *Do regional trade agreements and preferential agreements undermine the multilateral trading system, and how can this be avoided?*
2. *How can sustainable-development-oriented progress be made at the WTO?*
3. *How will benefits for LDCs, such as duty-free and quota-free access, be delivered in a timely fashion?*

International investment regimes for sustainable development

Investors are unlikely to invest long term in countries where they have concerns about policy and regulatory regimes.[1] At the same time, investment regimes need to adequately balance investors' preferences with the needs of residents of the countries in which they operate. Two issues are prominent – the use of investment incentives and the impact of investor-State dispute settlement (ISDS).

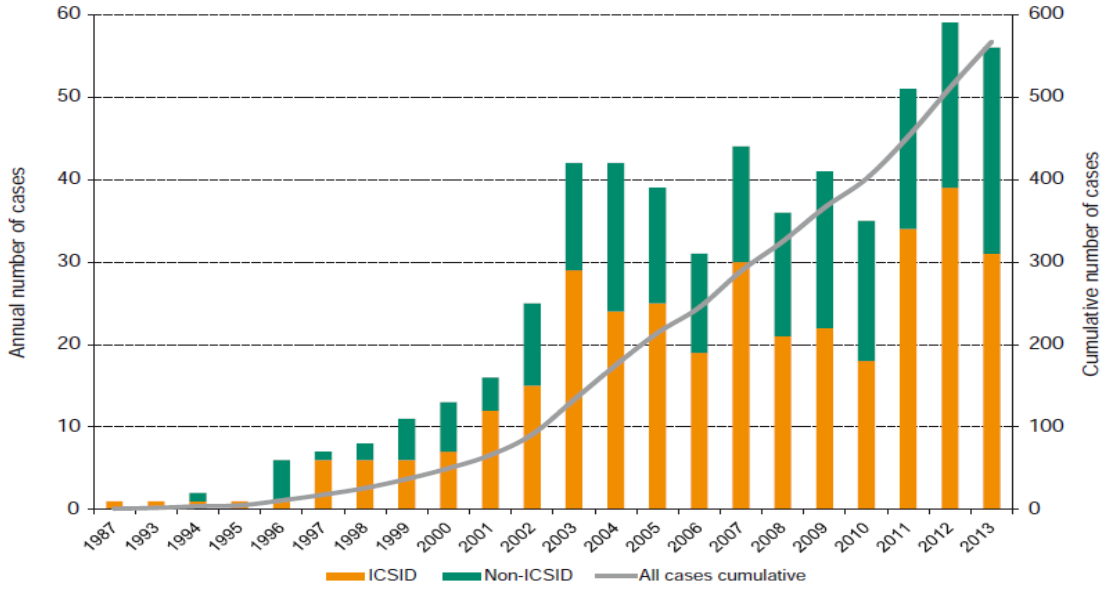
Investment incentives[2]

Policymakers use incentives to stimulate investments in specific industries, activities or disadvantaged regions. Incentives can be offered by national, regional and local governments, and come in three types: financial, fiscal and regulatory. Investment incentives are usually conditioned on the fulfilment by the investor of certain performance requirements, typically job creation, technology and skill transfer, minimum investment, locational decisions, and export requirements.

[1] Data on the volume of foreign direct investment was provided in a background note in November 2014. Please see http://www.un.org/esa/ffd/third-conference-ffd/13November_PrivateFinance.pdf.

[2] This section draws upon *World Investment Report 2014*, UNCTAD.

Known ISDS cases, 1987–2013



Source: UNCTAD, ISDS database.
Note: Due to new information becoming available for 2012 and earlier years the number of known ISDS cases has been revised.

Incentives are widely used by governments as a policy instrument for attracting investment, despite persistent criticism that they are economically inefficient and lead to misallocations of public funds. In 2013, 59 countries adopted 87 policy measures affecting foreign investment, including 61 related to liberalization, promotion and facilitation of investment, and 23 related to new restrictions or regulations on investment. Around half policy measures applied to industry-specific measures, particularly in services. Facilitation measures concentrated on simplifying business registration. A number of countries introduced special economic zones (SEZs) or revised policies related to existing SEZs.

As of yet, sustainable development is not among the most prominent objectives of incentive policies. Despite the fact that investment incentives have not been a major determinant of FDI and that their cost-effectiveness can be questioned, policymakers continue to use incentives as an important policy instrument for attracting FDI. Suggestions have been made to link investment incentives schemes to sustainable development goals to make them a more effective policy tool to remedy market failures.

Investment treaties and ISDS[3]

The global investment policy landscape has seen an increasing participation rate in negotiating treaties, and an expansion of the substance of agreements. However, there is a growing dichotomy in investment policies over the last few years, which has manifested itself in simultaneous moves by countries to expand the global IIA regime and to disengage from it.

In 2013, 44 international investment agreements (IIAs), 30 bilateral investment treaties, or BITs, and 14 “other IIAs” were negotiated, bringing the total number of agreements to 3,236 (2,902 BITs and 334 “other IIAs”). At the same time, several countries terminated BITs including because of concerns that they were unbalanced or constraining policy space. At least 40 countries and 4 regional organizations are currently revising or have recently revised their model IIAs.

The total number of known investor-State dispute settlement (ISDS) cases reached 568 by the end of 2013, although since most arbitration forums do not have a public registry the total number of cases is

[3] This section draws upon Recent Developments in Investor-State Dispute Settlement (ISDS), UNCTAD, 6 April 2014.

likely higher. At least 98 governments have been respondents to one or more investment treaty arbitration. About three-quarters of known cases were brought against developing countries, although in 2013 almost half of all new cases were brought against developed countries. Around 85 per cent of ISDS claims have been brought by investors from developed countries.

The growing number of ISDS cases and the broad range of policy issues they raise have turned ISDS into arguably the most controversial issue in international investment policy. A number of recent ISDS cases have raised questions about the coherence of ISDS with sustainable development goals. In El Salvador a mining company brought a claim against the State after it refused to issue a mining permit; the government has sought tighter restrictions on all mining due to concerns about water pollution. Tobacco companies have brought claims against several states that have introduced regulations on tobacco packaging aimed at bolstering public health. Government policies aimed at resolving financial crises have also been the basis for claims in numerous countries.

Transparency is also an issue of concern. From 2006, the International Centre for Settlement of Investment Disputes (ICSID), a World Bank arm for ISDS, is required to make public, information on the registration of requests for and the termination of all conciliation or arbitration proceedings. In addition, ICSID could publish excerpts of the legal reasoning of the arbitral tribunal when the parties did not consent to publication of the award. Provided consent of both disputing parties, ICSID publishes the full awards. In April 2014 new UNCITRAL rules on transparency in investor-State arbitration came into effect, giving the public broad access to dispute-related documents. However, in relation to treaties concluded before 1 April 2014, parties to a dispute or treaty must agree to the application of the new rules.

Guiding questions

1. *What can be done to minimize the challenges that IIAs, existing and future, may pose for countries' sustainable development goals?*
2. *What are the key areas and pressing issues in IIAs and investment dispute settlement that need to be addressed?*
3. *What can be learnt from the most recent experience with UNCITRAL rules?*

Fostering science, technology and innovation

Science, technology and innovation (STI) are of pivotal importance in addressing sustainable development challenges in many areas, including sustainable economic growth and industrial development, poverty eradication, gender equality, health, education, food and agriculture, water, energy, and many others. Technological innovation is at the heart of sustainable development, and building technological capacities can help developing countries “catch up” with developed countries. There have been major advances in this area, for example in the area of information and communication technology (ICT). ICT is widely seen as the key general-purpose technology of the globalization age, driving technological progress in a wide range of sectors. ICTs have made the diffusion of information easier, and have facilitated better access by developing countries to the global knowledge pool.

Nonetheless, access to technology remains uneven and unequally distributed, and gaps persist. For example, 74 per cent of populations in developed countries use the internet, compared to only 26 per cent in developing countries. Developing countries, LDCs in particular, spend significantly less on research and development and international collaboration in science. Furthermore, of the world’s researchers, only 27 per cent are women, and only 0.5 per cent live in LDCs.[4]

[4] UN Technical Support Team (TST) Issue Brief 16: *Science, technology and innovation, knowledge-sharing and capacity building*, available from

Despite these gaps, the view that technology is developed in the North and simply transferred to the South is misleading. Technology transfer involves more than the importation of hardware; it involves the complex process of sharing knowledge and adapting technologies to meet local conditions. Most innovation involves incremental improvements and adaptations of existing technologies. Innovation, in this sense, is widespread in many developing countries, and firms in middle income countries, in particular, are responsible for a growing share of global research and development spending.[5] For example, China and India have become leaders in some new technologies, in part because they were able to improve and adapt existing technologies and production processes. Some low-income countries have also begun to develop domestic technological capacities, successfully adapt technologies, and build new industries, such as the solar PV industry in Bangladesh. These experiences have underscored the importance of interactive learning, information exchange, and coordination among government, firms, universities, research centres, and other actors in building an innovative economy.

There are also areas where significant breakthroughs in technologies are still needed to meet the ambitious goals of the post-2015 agenda. In view of these needs, current levels of global investments in research and development are insufficient. For example, expenditure on energy R&D is estimated at $ 10 billion annually, but would need to be increased to $40-90 billion, from public and private sources, to meet clean energy R&D needs.[6]

To better innovate and develop, as well as diffuse and adapt technologies for sustainable development, policy actions are needed to **create enabling environments, both at the national and the international level**, and to **strengthen partnerships and collaboration between all stakeholders**. Measures to ensure sufficient financing, capacity building and knowledge, and technology transfer are of particular importance.

At the national level, this includes, among other issues, coherent national science, technology and innovation strategies, an emphasis of education policies on STI, good governance, transparency and open access to scientific information, and policies to foster research and development (R&D). To best harness their potential to contribute to sustainable development for all, these policies also need to integrate a gender perspective. More broadly, a green national innovation strategy (or G-NIS) should be a central part of countries' national sustainable development strategies.[7]

R&D in particular requires sufficient funding for public research. Innovative activity is inherently risky and its returns are uncertain, and private investors are often unlikely to invest in new technologies, particularly the research phase, without public support. The figure below depicts the development phases of the innovation process, along with the type of financing typically available for the different phases.

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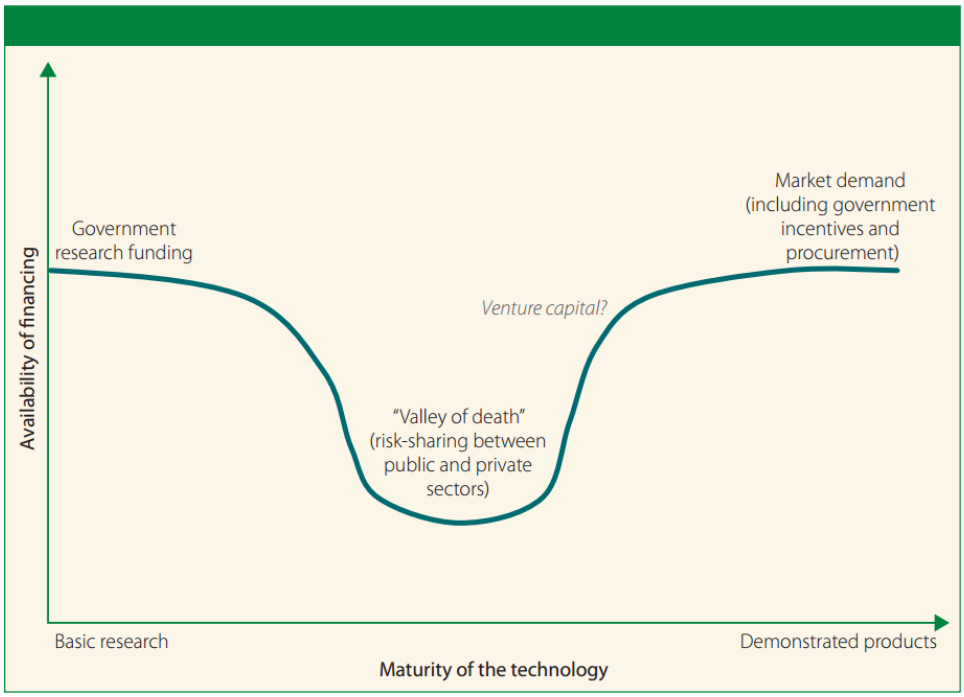
http://sustainabledevelopment.un.org/content/documents/1554TST_compendium_issues_briefs_rev1610.pdf

[5] Castaldi, Carolina, and others, 2009: *Technological Learning, Policy Regimes, and Growth: The Long-Term Patterns and Some Specificities of a 'Globalized' Economy*. In: Industrial Policy and Development. The Political Economy of Capabilities Accumulation, Mario Cimoli, Giovanni Dosi and Joseph Stiglitz, ed. Oxford: OUP

[6] International Energy Agency estimates, cited in: Sachs, Jeffrey and Guido Schmidt-Traub, 2014, *Financing Sustainable Development: Implementing the SDGs through effective investment strategies and partnerships*, Preliminary unedited draft, SDSN

[7] United Nations, 2011, *World Economic and Social Survey, The Great Green Technological Transformation*

G-NIS financing



Sources: UN/DESA

Public agencies have historically provided research funding and early stage capital financing of many new technologies.[8] This is to be expected as early stage basic research activities are inherently risky, and the knowledge gained is a public good. For example, many technological breakthroughs of the past decades, including innovations in aeronautics, electronics, and green technologies, were facilitated or funded by Governments. Additional public resources will be needed to fund breakthroughs needed for sustainable development.

Further along in the technology cycle, when specific products emerge that could yield a return, the risks become lower, and the private sector plays a larger role. Private financing in the form of venture capital, private equity and commercial finance become available at this stage. However, there are financing gaps between different stages of the cycle – at an early stage, when concepts need to be developed into working prototypes, and later during commercialization, when risk capital for early-market exploration is insufficient.[9] It is critical that the financial system is geared toward serving innovation, providing long term and patient capital to bridge potential 'valleys of death'.[10]

Public policy can support and encourage private investment in R&D and innovation, e.g. through tax incentives for R&D and subsidized credit. However, in these structures the government often takes a significant risk, without having the opportunity to share in the upside. This has led to calls for equity linked-financing mechanisms and for innovation funds, which diversify across projects so that gains from successful companies can compensate for losses from others. Indeed, some national development banks have recently shifted from low interest loans to equity-linked financing for innovation projects. In addition, non-financial support for innovation is needed, such as balanced intellectual property rights regimes.[11]

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[8] Lazonick, William, 2011, *The innovative enterprise and the developmental state*

[9] Sagar, Ambuj, and Arun Majumdar, 2014, *Facilitating a sustainability transition in developing countries,* Rio+20 Working Paper No.3, UN DSD

[10] Mazzucato, Mariana, 2013, *Financing innovation: creative destruction vs. destructive creation*, Industrial and Corporate Change, 22 (4).

[11] Report of the Secretary-General on '*Options for facilitating the development, transfer and dissemination of clean and environmentally sound technologies'*, A/68/310

At the international level, development cooperation can contribute to creating well-functioning national STI systems, e.g. through capacity building for innovation and human capital development, and through improving access to infrastructure. Despite current efforts, significant gaps remain, in particular in the earlier stages of the technology cycle and the strengthening of capabilities of developing countries to carry out R&D.[12] There is also an important role for South-South cooperation in sharing knowledge, skills, and expertise.

Knowledge moves across borders either embodied in people, goods or services and embedded in global trade and investment flows, or codified in technical documents and blueprints. Traditional mechanisms for technology transfer have included FDI, imports and licensing. However, experience demonstrates that the benefits from such technology transfer do not accrue automatically, but require appropriate policy frameworks and local investments for adaptation to country-specific conditions and acquisition of tacit knowledge.

In follow-up to Rio+20, the General Assembly is considering possible arrangements for a facilitation mechanism to promote the development, transfer and dissemination of clean and environmentally sound technologies. Many facilitation mechanisms and processes exist, but there is a lack of overall coherence, and gaps remain. The STI capacity gap remains particularly pronounced for the LDCs. To address their needs, the international community committed itself in the Istanbul Programme of Action to establish a Technology Bank and Science, Technology and Innovation Supporting Mechanism dedicated to LDCs, with a view to 'help improve least developed countries' scientific research and innovation base, promote networking among researchers and research institutions, help LDCs access and utilize critical technologies, and draw together bilateral initiatives and support by multilateral institutions and the private sector'.[13] It could consist of a patents bank to facilitate access to appropriate technologies; a STI supporting mechanism to improve countries' research and innovation base, and a science and research depository facility to promote global networking of researchers and institutions.[14]

Guiding questions

1. *What has been the progress and what are the remaining gaps in innovation and technological capabilities in developing countries, and what policy actions are needed to address them?*
2. *Specifically, what is required to mobilize long-term and patient capital required to finance innovation?*

[12] Ibid
[13] Istanbul Programme of Action, A/Conf.219/3/Rev.1
[14] Report of the Secretary-General on *'Technology bank and science, technology and innovation supporting mechanism dedicated to the least developed countries'*, A/68/217