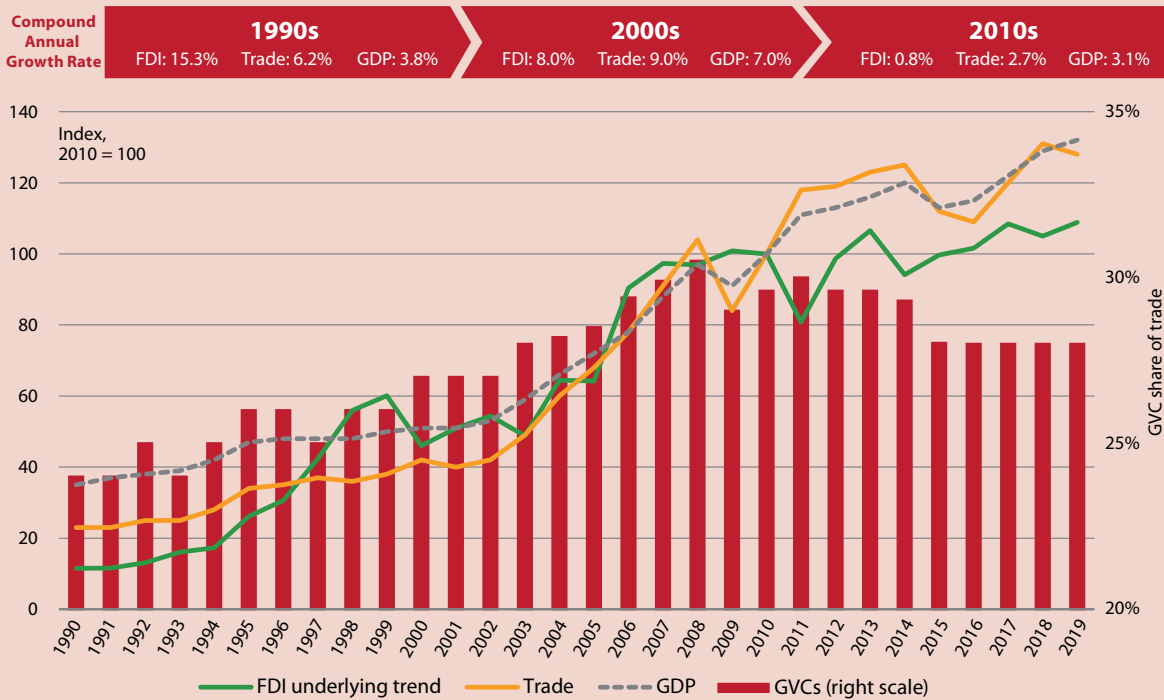


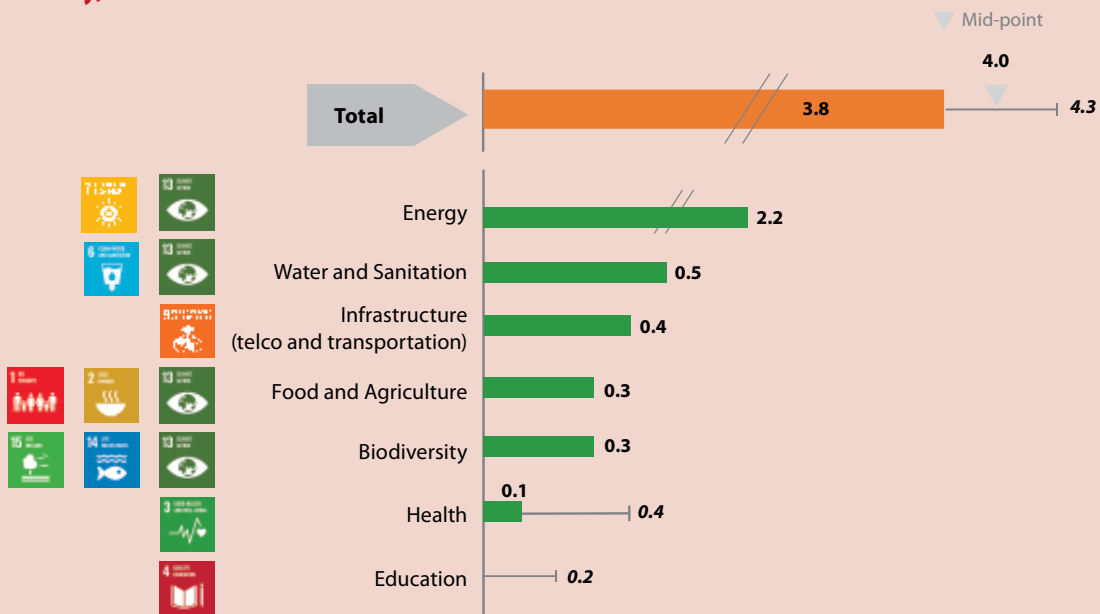


Domestic and international private business and finance in numbers

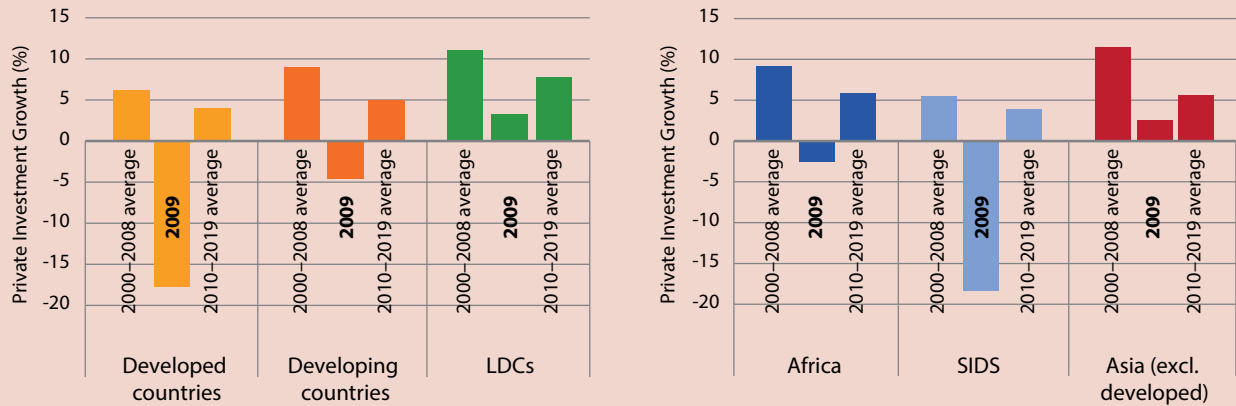
FDI growth slowed significantly after the 2008 world financial and economic crisis, in line with the broader deceleration of global economic growth and trade.



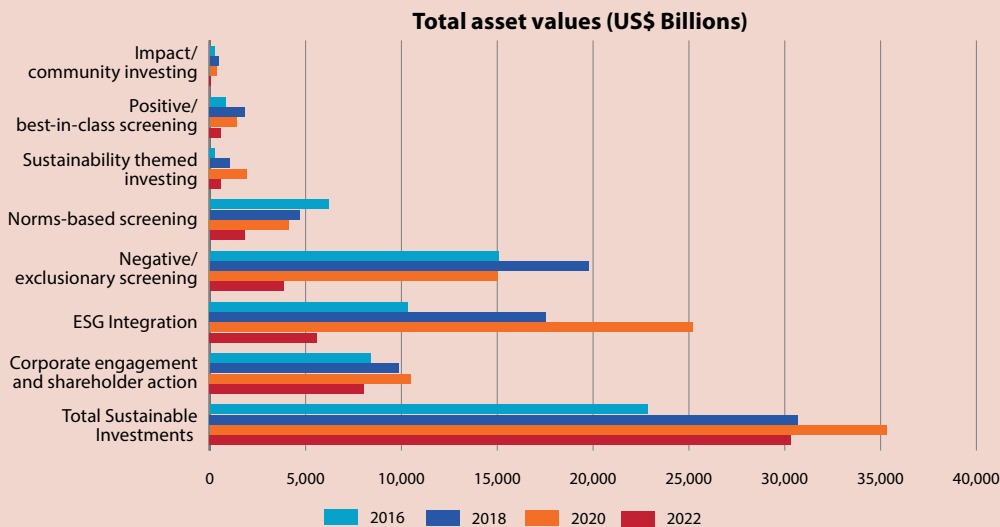
Annual investment gaps across all SDG sectors increased from \$2.5 trillion in 2015 to more than \$4 trillion today, due to underinvestment and additional needs.



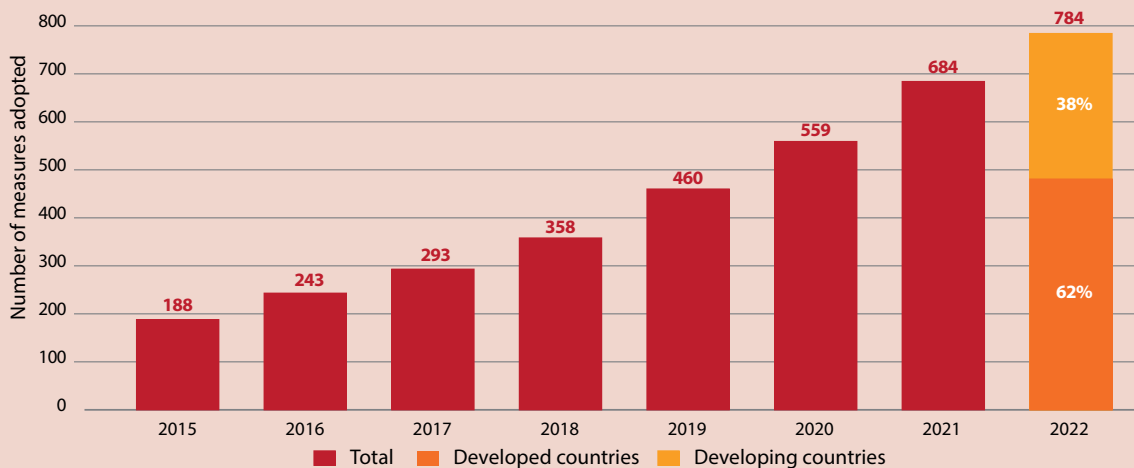
The private sector is at the heart of sustainable growth and development, but its dynamism slowed after the 2008/09 crisis.



Investments in sustainable assets have surged over the past three decades but remain limited in scale and primarily tied to risk mitigation, with impact investing seeing relatively lower adoption rates despite growing interest.



Sustainable finance legislation is increasingly being adopted at the regional and national levels, with a greater number of measures in developed countries.





Chapter III.B



Domestic and international private business and finance

1. Key messages and recommendations

Private business and finance is an important driver of sustainable growth and development. As noted in the Addis Ababa Action Agenda, “private business activity, investment and innovation are major drivers of productivity, inclusive economic growth and job creation”. To deliver on these promises, business activity and investment (both foreign and domestic), need to be dynamic, inclusive, risk-informed and sustainable. However, private sector dynamism slowed after the 2008 world financial and economic crisis, in parallel with the broader macroeconomic growth slow-down, which also led to a widening Sustainable Development Goal (SDG) investment gap. Revitalizing private sector development that is fully aligned with sustainable development will be a core task of the upcoming Fourth International Conference on Financing for Development.

Along with a broader slow-down in global growth, foreign direct investment (FDI) flows have decelerated, revealing disparities in both geographical and sectoral distribution. Investment trends have been highly uneven since Member States convened in Monterrey, Mexico, in 2002. Following rapid acceleration in the 1990s and 2000s, the past 15 years have seen a slowdown in foreign investment, driven largely by shifts from capital intensive activities towards digital business models, “asset-light” forms of production and a servicification of economies. These trends in turn are making “traditional” models of development based on exports of manufactured goods increasingly difficult to pursue. At the same time, the investment gap is continuing to grow across all SDG sectors, reflecting both underinvestment and additional needs, particularly in energy and infrastructure. While investment in these sectors has grown rapidly since 2015, growth has been highly uneven, with much of it concentrated in developed countries and China as well as some large developing countries. Least developed countries (LDCs)

have seen only marginal investment growth over the past two decades and will require dedicated assistance. The Fourth International Conference on Financing for Development will provide an opportunity to agree on ambitious measures to support LDCs and other developing countries to mobilize long-term financing and investment for the SDGs. This could include efforts to tackle the high costs of capital and risk premia, which are thwarting efforts in many developing countries to finance projects across SDG sectors, as well as an Investment Support Centre for LDCs as mandated in the Doha Programme of Action.

Significant structural changes in the global economy are reshaping private investment and developing countries’ ability to integrate productively in the global economy, necessitating a search for new growth and development strategies. Changes have included the geographical concentration of manufacturing in several large developing countries, technological change – most notably digitalization – and unequal gains from global value chains (GVCs). These have contributed to very uneven growth in manufacturing activities, which have traditionally been a “development escalator”, with some regions experiencing “premature deindustrialization”. Nonetheless, some economies have leapfrogged certain stages, developing in non-linear ways, influenced by factors like digitization, global economic shifts, and domestic policy and institutional frameworks.

Today, smaller firms and modern service providers can play a more central role in connecting companies with international supply chains and boosting countries’ industrial transformation. However, relying on services as a basis for economic growth can prove challenging for those developing countries (including LDCs) where energy supply, information and communication technology (ICT) infrastructure and human capital

remain limited. Services also tend to create fewer jobs. As new growth and development strategies – suitable for an age of climate change, rapid technological change and a changing global economy – emerge, there has been renewed interest in sustainable industrial policies to support sustainable and inclusive transformations. The Fourth International Conference on Financing for Development can help to enable the alignment of financing frameworks and actions (across all action areas of the Addis Ababa Action Agenda, at both national and international levels) to facilitate such transformations, taking into account the great diversity and complexity of economic contexts across different developing countries.

Transformation strategies can build on and must complement growing interest and efforts by the private sector to integrate sustainability considerations. While significant progress has been noted in corporate sustainability over the past 30 years, risks of misalignment with sustainability goals persist. On the one hand, companies have actively engaged in voluntary sustainability initiatives to address risks and capitalize on opportunities tied to emerging macro trends and stakeholder expectations. On the other hand, however, short-term-oriented decision-making, particularly evident in moments of crisis, reveals the ongoing need to redefine the broader “rules of the game” via policy frameworks. This includes shifting focus from minimizing the negative consequences of shocks when risks are realized, to preventing the creation of risks and reducing existing risks before these manifest as shocks.

A more dynamic and sustainable business sector will only arise with more inclusive and sustainable financial markets. Lack of access to affordable finance and financial incentives misaligned with sustainability are often among the most binding constraints for sustainable private sector development. While important progress was made towards financial inclusion, with more than half a billion people gaining access to financial services between 2017 and 2021 alone, the availability of long-term financing continues to be a challenge for small- and medium-sized enterprises (SMEs) and individuals, particularly in developing countries. Short-term incentives and decision making also often stand in the way of more sustainability – with longer-term investors more inclined to incorporate sustainability risks into their decision making, and to seek companies that prioritize long-term business fundamentals over short-term targets. Efforts to extend investors’ time horizons, such as those being proposed by Global Investors for Sustainable Development in preparation for the Fourth International Conference on Financing for Development, are imperative to align private actions with long-term sustainable development trends; stability, sustainability and greater access to financing are mutually reinforcing.

Following the rapid emergence of sustainable finance over the past 25 years, the current moment offers a chance to accelerate progress. Investor interest in sustainable finance has grown steadily since the 1990s, with a net expansion from 2015. Sustainable fund flows have remained relatively resilient, consistently surpassing 2016 levels since then despite year-on-year fluctuations following the COVID-19 pandemic. But sustainable fund assets still make up a small percentage of total global assets under management today, estimated at less than 5 per cent of the global fund market in 2023. Furthermore, impact investing, designed to contribute to real-world solutions in line with the SDGs, represents only a small portion of sustainable assets. Weaknesses related to the field’s information infrastructure that have given rise to greenwashing concerns, are

compounded by an enabling environment that still incentivizes traditional investment strategies. Growing political polarization of the field has also led to a backlash in some countries. Against this challenging backdrop, the field has commenced a journey towards maturation, marked by the refinement and consolidation of voluntary standards and the enactment of legislation at the national and regional levels. The upcoming Fourth International Conference offers an opportunity to continue collaborating towards (i) the interoperability of sustainable finance legislation across regions to prevent uneven progress and heavy compliance burdens, while accounting for regional and local specificities; (ii) the adoption of mandatory national disclosure standards with a double materiality vision; (iii) frameworks and carefully crafted incentives for impact investing at scale to align capital markets with real-world impact; and (iv) a broader set of macroeconomic policies that create enabling conditions for sustainable transformations.

This chapter will give a brief overview of investment trends in the past two decades, including investment trends in sustainable transformations. It will then discuss developments in aligning business activity with sustainable development, including efforts to strengthen the business environment and private sector development in a changing global economy. Lastly, the chapter discusses trends and progress in achieving a financial sector that is both inclusive and sustainable.

2. Investment trends in an evolving global economy: The long view

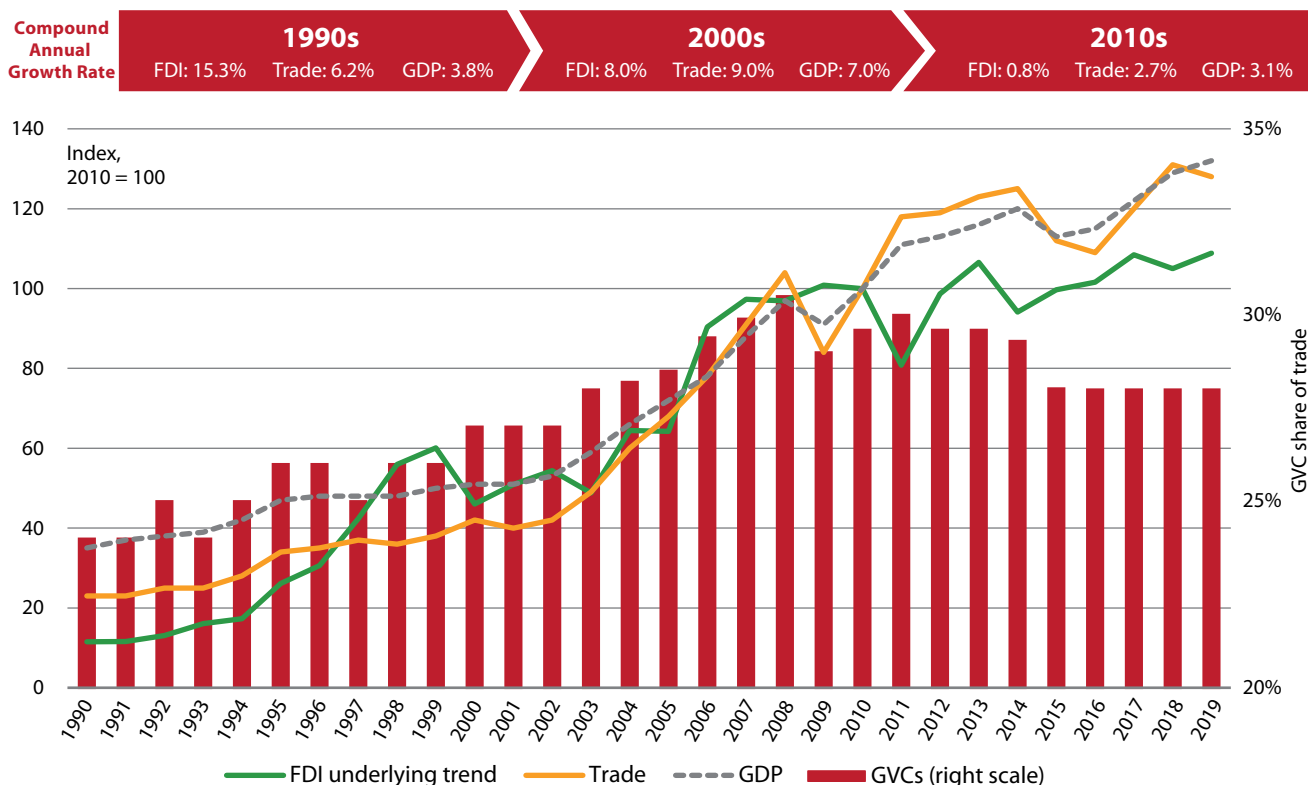
2.1 Foreign direct investment trends since Monterrey

Since Member States convened in Monterrey in 2002, global foreign investment patterns have changed dramatically, with the 2008 world financial and economic crisis proving to be an inflection point. In the context of massive changes in the global division of labour and rapid technological change, including the shift towards digital business models and asset-light forms of production, increased geopolitical fragmentation and accelerating climate change, FDI trends have shifted over the past decades, evolving in terms of volume, direction and sectoral breakdown. A number of crises, including the 2008 world financial and economic crisis and the COVID-19 pandemic, have proved to be inflection points, accelerating trends driven by structural rather than transitory factors. Amid changing investment patterns, growing efforts to align foreign investment trends with sustainable development have thus far fallen short of what is needed to achieve the 2030 Agenda for Sustainable Development. Changing FDI patterns have also cast doubts on the viability of “traditional” models of economic development based on attracting FDI and exports of manufactured goods.

The first International Conference on Financing for Development in Monterrey took place against the backdrop of a decade of FDI expansion – a trend that has since slowed and, more recently, stalled. Enabled by an acceleration of technological progress and fuelled by the quest for low labour costs and increased productivity, the 1990s and early 2000s saw a rapid growth in global FDI stocks, along with a rapid expansion of global trade (figure III.B.1). This trend slowed markedly following the 2008 world financial and economic crisis. FDI growth slowed

Figure III.B.1

Foreign direct investment and trade trends, 1990–2019



Source: UNCTAD.

Note: Trade is global exports of goods and services. GVC share of trade is proxied by foreign value added in exports, based on the UNCTAD-Eora GVC database (see Casella et al., “Improving the analysis of global value chains: the UNCTAD-Eora database”). The underlying FDI trend is an UNCTAD indicator capturing the long-term dynamics of FDI by netting out fluctuations driven by one-off transactions and volatile financial flows. CAGR: Compound annual growth rate.

dramatically compared to average growth rates in the 2000s, increasing only 0.8 per cent on average in the 2010s along with decelerating trade growth and a stagnation in GVCs. The shift towards digital business models and asset-light forms of production, a rise in protectionism and policy uncertainty as well as the COVID-19 pandemic have contributed to this slowdown. In 2023, global FDI marginally increased to US\$1.37 trillion, following a decline in 2022.¹

The growth and integration of developing countries into the global economy has been a major driver of FDI trends. Against the backdrop of a changing global economic landscape outlined in chapter I, developing countries have accounted for increasing shares in both inward and outward FDI. As shown in figure III.B.2a, in 2018, developing countries eclipsed developed countries for the first time as a destination for FDI flows, gradually doubling their share from around one third to two thirds of global FDI. While developing countries as a group have increased their share, including due to the rise of China as major recipient of inward FDI, LDCs continue to trail behind. Over recent years, LDCs have seen only a 0.5 percentage point higher inflow of FDI than over a comparable time frame between 2002 and 2004. Developing countries have also increased their share of outward FDI, which rose significantly from 7 per cent in 2002 to around one third of all FDI (31 per cent) in 2022. As shown in figure III.B.2b,

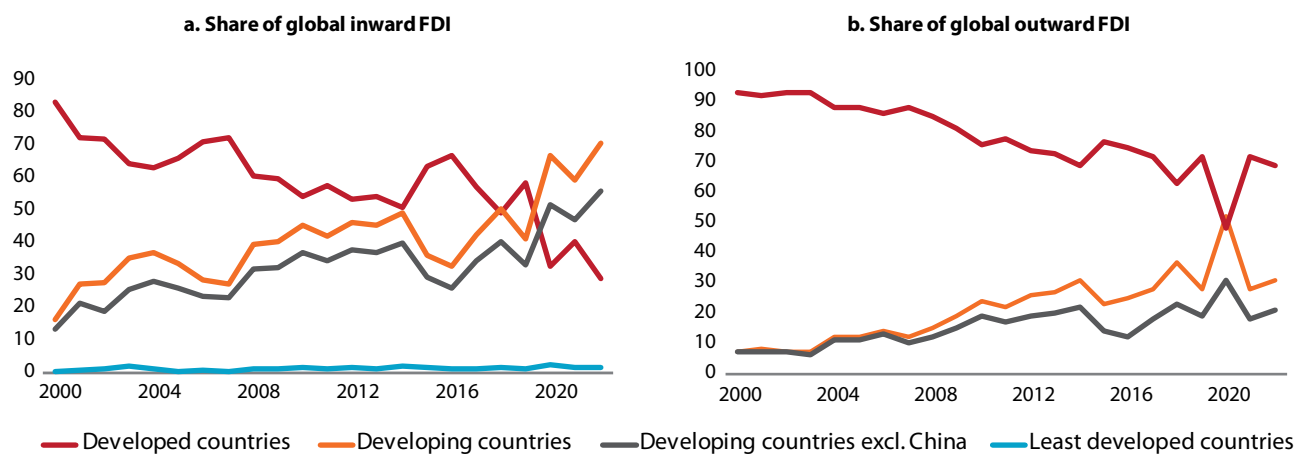
China has played an increasingly important role as a source country of FDI since the mid-2000s.

In addition to changes in volume and direction, FDI flows have also seen a transformation in composition. FDI flows into services sectors have expanded significantly, fuelled by an increased internationalization of services and a servicification of manufacturing. These trends, together with accelerating digitalization, have contributed to a slowdown of cross-border investment in physical assets, as international investment has been increasingly directed towards more intangible and asset-light modes of production. Accordingly, greenfield investment in manufacturing has dropped by up to a quarter, making it harder for countries to pursue export-based development models contingent upon inward greenfield FDI for capital formation. In addition, as figure III.B.3 suggests, the share of developing countries in global greenfield investment by value has declined below its long-run average of around 56 per cent and below the respective share of developed countries.

2.2 Investment trends in sustainable transformations

Have investment trends facilitated sustainable transformations for the 2030 Agenda for Sustainable Development? Despite some

Figure III.B.2
Share of global inward and outward FDI, 2000–2022
 (Percentage)

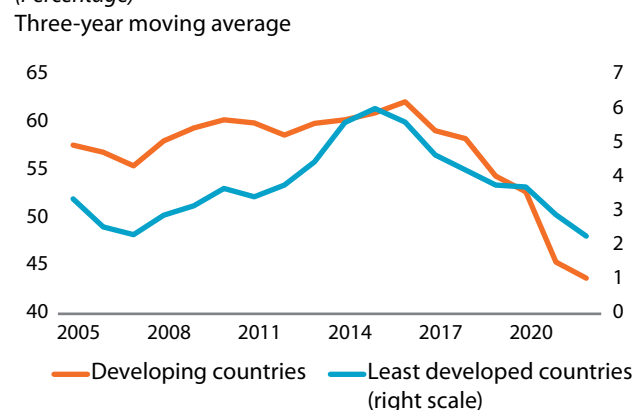


Source: UN DESA calculations based on UNCTAD data.

progress, the answer thus far is no, or rather not yet. A review of investment needs suggests that the investment gap across all SDG sectors has increased from \$2.5 trillion in 2015 to more than \$4 trillion per year today, due to both underinvestment and additional needs² (see also chapter I). Investment needs continue to be particularly large in the area of energy and infrastructure (figure III.B.4). While international investment in the renewable energy sector has nearly tripled since the adoption of the SDGs and the Paris Agreement, this growth has been unbalanced, with much of it concentrated in developed countries and China. Installed capacity and new investments still fall far short of what is needed to meet the Paris goals, with an additional 578 GW of installed capacity in emerging renewable technologies required by 2030. The largest gaps are in Africa and the Middle East, where capacity needs to grow more than tenfold by 2030, requiring cumulative investment of \$1.36 trillion (figure III.B.5).

Achieving energy transitions for sustainable development requires significantly scaled-up investment in a number of sectors, but the high cost of capital in developing countries remains a significant obstacle. A number of factors have hampered the channelling of sufficient investment in necessary infrastructure, the entire renewable energy value chain, alternative technologies and energy efficiency. FDI flows have largely been directed towards renewable energy generation, but much less so to related critical industries or to those developing countries where investment needs are greatest. Project financing continues to be hampered by the high cost of capital in developing countries, which is driven more by macroeconomic risk perceptions than by project risk. Indeed, the cost of capital for comparable projects is significantly higher in developing countries than in developed countries; perceived macroeconomic risks play a much larger role in explaining risk premia than project-specific/micro risks (table III.B.1). Such a high cost of capital is a significant impediment to investment in both renewable infrastructures and other necessary long-term investments in the SDGs. Overall, the high cost of capital, particularly in countries in debt distress or with high-risk ratings, is a strong disincentive for investors to shift towards renewable energy assets.³

Figure III.B.3
Share of global greenfield investment by developing countries and LDCs, 2005–2022
 (Percentage)



Source: UN DESA calculations based on UNCTAD data.

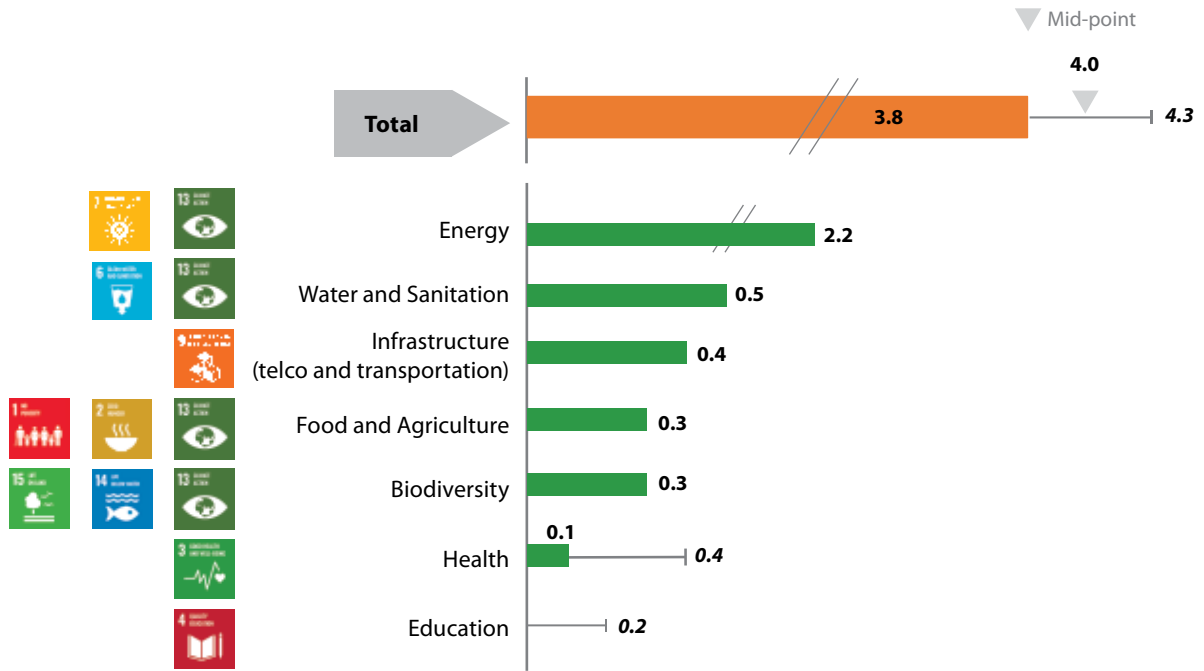
Table III.B.1
Comparative project risks and weighted cost of capital for developed and selected developing countries

Country category	Weighted cost of capital	Government cost of borrowing	Project risk
Developed countries	4.0%	-0.3%	4.3%
Industrializing developing countries	10.6%	7.7%	2.9%

Source: Persaud, “Unlocking the green transformation in developing countries with a partial foreign exchange guarantee”, based on IEA and Bloomberg data.

Note: The sample of industrializing developing countries comprises Brazil, India, Indonesia, Mexico and South Africa. Cost of government borrowing reflects ten-year government bond rates for 2021.

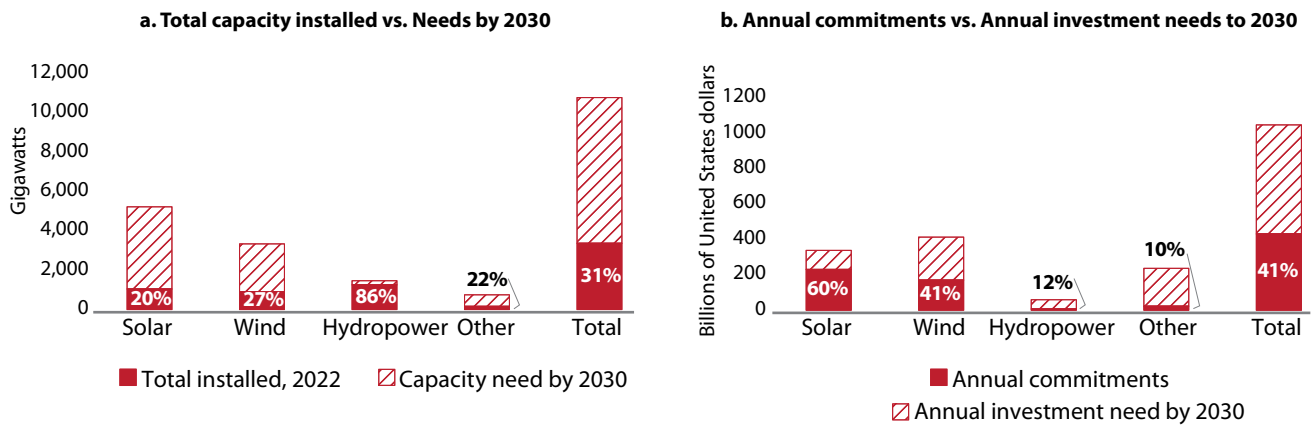
Figure III.B.4
Estimated annual investment gap (public and private) in key SDG sectors
 (Trillions of United States dollars)



Source: UNCTAD, SDG Investment Trends Monitor (Issue 4).

Note: Figures are rounded at the first decimal (\$100 billion). Investment refers to capital expenditure (capex). The range reflects the uncertainty about the size of the capex component investment gap for two sectors (Health and Education) for which the operational expenditure component is substantial.

Figure III.B.5
Renewable energy: Global total installed capacity and investment needs



Source: UNCTAD.

As investment in manufacturing capacity is stagnating and investment trends are aligning with asset-light and digital business models, new investment strategies and development pathways need to be found. These could include investment promotion and facilitating strategies aimed at attracting investment in areas such as digital infrastructures and innovation, as well as infrastructures that can act as enabling environments for thriving service sectors. This is likely to prove particularly challenging for LDCs, which will require significant support. It also highlights the role of international development cooperation (see chapter III.C) and of multilateral development banks in facilitating and investing in this shift towards new development pathways (see box III.B.1 regarding the World Bank's Private Sector Investment Lab and box III.B.2 on the Global Emerging Markets Risk Database Consortium). Blended concessional finance for private sector projects is one of the most valuable tools that development finance institutions (DFIs) can use, in cooperation with donors and other development partners, to help address the SDGs, increase finance and mobilize private capital (see chapter III.C). Initiatives like the ECOSOC SDG Investment Fair hosted by UN DESA provide a platform for connecting governments, investors, DFIs, and the UN SDG investment ecosystem. This initiative helps to devise solutions that enable the mobilization of private investment for projects that significantly contribute to the achievement of the SDGs. Since its launch in 2018, 23 countries have participated and over 130 projects have been presented, amounting to over \$50 billion in SDG-aligned investment opportunities.

Box III.B.1. World Bank-led Private Sector Investment Lab

The Private Sector Investment Lab, launched in 2023, is composed of a group of 15 chief executive officers (CEOs) of leading global institutions who have agreed to provide their insights, expertise and experience to help the World Bank Group scale up the mobilization of private capital for financing climate and other development priorities in emerging economies. The Lab has identified five areas as critical to private capital mobilization on which its work is currently focused. These are: guarantees; foreign exchange (FX) risk solutions; scaling capital markets and securitization solutions to distribute assets; country level approaches to

3. Aligning business with sustainable development

3.1 Private sector development in a changing global economy

Private sector development is at the heart of sustainable growth and development; yet private sector dynamism slowed following the 2008 world financial and economic crisis, in parallel with the broader macroeconomic growth and FDI slow-downs discussed above. As noted in the Addis Ababa Action Agenda, "private business activity, investment and innovation are major drivers of productivity, inclusive economic growth and job creation". The private sector contributes 84 per cent to GDP and 90 per cent to job creation in developing countries.⁴ It is private sector development that creates technological and organizational capabilities at scale, the resource base for revenue mobilization, and the vast majority of decent jobs in most countries. Yet, private sector dynamism stuttered after the 2008 world financial and economic crisis, following a period of very high rates of private investment growth, during the first decade of this century, particularly in developing regions such as Africa and Asia. Many economies witnessed a strong contraction in private investment in 2009 and only a partial subsequent recovery, with

improve enabling environments and support bankable project pipelines; and mobilizing early-stage capital for high impact projects. The aim is to turn the Lab's ideas into action through the development of new instruments of intervention and delivery mechanisms, some of which will be tested through pilot projects. The Lab will continue to work towards developing and scaling new and existing innovative solutions for private capital mobilization in partnership with all relevant stakeholders. Specific projects that can serve as pilots for testing and, if successful, scaling up, are already being discussed, with new solutions to be developed pursuant to Lab recommendations.

Source: World Bank.

Box III.B.2. Global Emerging Markets Risk Database Consortium

The Global Emerging Markets Risk Database (GEMs) Consortium is one of the world's largest credit risk databases for the emerging markets operations of multilateral development banks and development finance institutions that are members of the initiative. GEMs pools data on credit defaults on the loans extended by members, the migrations of their clients' credit rating and the recoveries on defaulted projects. GEMs was established in 2009 as a joint initiative between the European Investment Bank (EIB) and the International Finance Corporation (IFC) and has now grown to 25 members. Consortium members contribute anonymized data on their projects' credit events notably in emerging markets and developing economies. The GEMs Consortium has been publicly disseminating statistics through its website since 2020 to address the

need for greater volumes of private investment tackling sustainable development goals in the most challenging markets. This was initially done through annual reports focusing on default rates for private/sub-sovereign lending. Starting in 2022, the reports have also covered sovereign and sovereign-guaranteed lending. The latest default statistics were published in November 2023 on the GEMs website. For both lending universes, statistics are disaggregated across regions, income groups, sectors, and counterpart types. The publication on private/sub-sovereign lending also showcases specific statistics for infrastructure. In the first quarter of 2024, the GEMs Consortium will publish for the first time recovery statistics for private and sub-sovereign lending from 1994 to 2022, building on more than ten years of successful cooperation among GEMs members.

Source: World Bank.

growth rates substantially below pre-2008 levels (figure III.B.6). The recent COVID-19 pandemic has further slowed – if not reversed – gains from private sector development in many developing countries and LDCs.

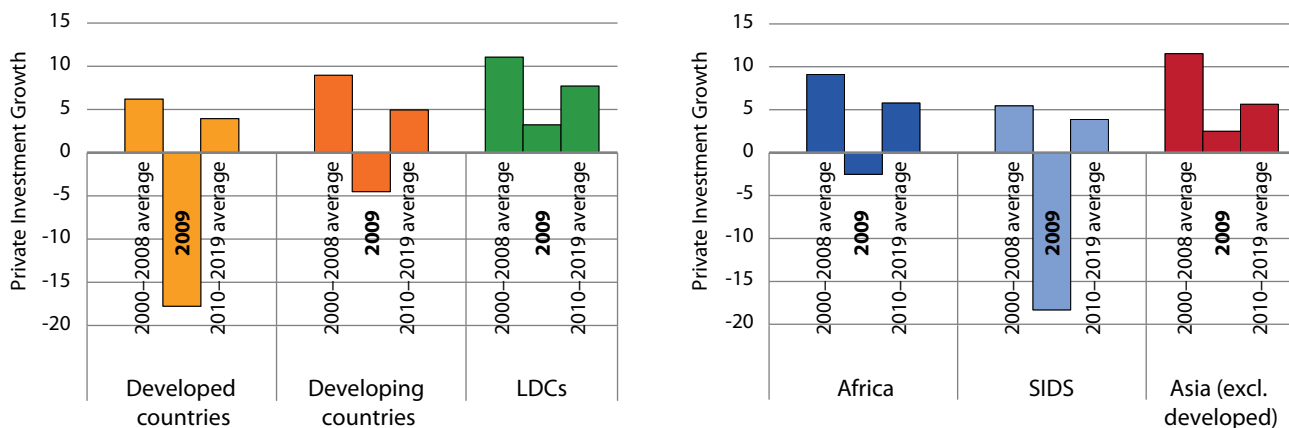
Private sector development has traditionally been associated with industrialization and diversification, which in turn facilitated sustained economic development and improvements in living standards. Such structural transformations involve the reallocation of capital and human resources from low- to high-productivity activities and sectors through economic diversification and strengthening productive linkages in the economy (see the *Financing for Sustainable Development Report 2023*). Historically, a thriving manufacturing sector has often been at the heart of such transformations, because of several unique properties: technological advances often originate in the manufacturing sector, and developing countries were able to import these and achieve rapid productivity growth even when broader institutional capabilities and skills were still comparatively scarce. Many low-skilled workers found employment in manufacturing; and its products are tradeable, hence growth was not limited by the small size of domestic markets in many developing countries.⁵ Overall, more diversified economies tend to have higher per capita incomes and better long-term growth prospects, are less volatile and do better on poverty reduction.⁶ Since 2000, less diversified economies – usually commodity exporting developing countries – have tended to experience higher volatility and have been less likely to experience stable growth rates (see chapter III.D).

Manufacturing has become less effective as a development escalator. At the current pace of progress, the world will not achieve SDG 9 and its industry-related targets. Developing countries face significant challenges, notably African LDCs, which have seen manufacturing value-added mostly stagnate as a share of GDP over the past 20 years (figure III.B.7). This phenomenon has been described as “premature deindustrialization”: as economies grow and per capita income rises, the share of labour employed in manufacturing tends to first rise and then fall. Since the 1980s,

this turning point has arrived at increasingly lower levels of per capita income, with workers moving from agriculture to services such as trade and hospitality rather than manufacturing or modern services. Productivity growth has declined, with working conditions often characterized by widespread informality in countries where this premature deindustrialization is taking place, particularly in Africa and Latin America. Where jobs are being created, it is usually by small, less productive, and often informal manufacturing companies. Moreover, where natural resource exports or capital inflows provide external fuel to growth, growth dynamics tend to be fragile and exposed to global market shocks.⁷ Several factors are responsible:

- The **geographic concentration** of manufacturing activities in a few large economies and regions. This trend results from the streamlining of supply chains and the search for price competitiveness by producers. For example, China has emerged as the preeminent global manufacturing hub, producing 28.7 per cent of global manufacturing output in 2019, up from only 8 per cent of the global total in 2004;
- Productivity-enhancing **technological change**, primarily in advanced economies. While the emergence and diffusion of advanced digital production technologies is creating new opportunities for developing countries, they have also “raised the bar” for these same countries to develop a modern manufacturing sector and may limit employment creation opportunities, particularly considering the lack of affordability of some advanced technologies. New technologies facilitate small-scale manufacturing, and additive manufacturing allows firms to cut down on production by reducing the cost of customization while enabling creative firms to compete thanks to their knowledge of local needs. New business models based on the collaborative economy allow small firms to take advantage of under-utilized resources to reach scale, become more competitive, and improve the efficiency of environmental resource use. New communication technologies can also help firms to participate in global trade. Companies can reach

Figure III.B.6
Private investment growth slowed in most regions during the 2010s
(Percentage)



Source: UN DESA calculations based on IMF data.

Note: Private investment is defined as private gross fixed capital formation in constant 2017 dollars. LDCs: Least developed countries; SIDS: Small island developing States.

markets beyond their geographical location with an online presence. Yet, there is a need to better understand and manage the risks associated with rapid technological change. Technological changes and digitalization can decrease the demand for low-cost labour in manufacturing and increase the need for skills. As a result, it may reduce the incentive for multinational companies to offshore production to countries with low-cost labour.⁸

- The **rise in GVCs**, which has created opportunities for firms in developing countries but with a very unequal distribution of gains. Between 2002 and 2022, global trade in intermediate goods (a proxy for GVC trade) more than tripled, with Asia and Europe accounting for 40 per cent and 34 per cent of GVC trade, respectively, even with the more recent slowdown of their expansion (see chapter III.D). Elsewhere, firms have found it more challenging to integrate into GVCs. Lead firms have seen increasing mark-ups and profits, suggesting that a growing share of cost reductions from GVC participation is not being passed on. Large firms in developing countries have adopted more capital-intensive technologies, similar to their peers in advanced markets. At the same time, mark-ups for producers in developing countries are declining and gains from GVC participation can be lost if a country’s private sector is unable to continue upgrading its activities.⁹ Countries can industrialize through GVCs thanks to the possibility of specializing in certain tasks. However, investing in the wrong combination of skills and production patterns could limit the opportunity to upgrade, innovate and break into more sophisticated value chains – effectively trapping firms in stagnating segments and low value added activities and “hollowing out” the domestic manufacturing sector.¹⁰ More broadly, GVCs can exacerbate the unequal distribution of gains, skills and wages within the labour market and across country groups. It is also crucial to identify and address vulnerabilities in GVCs, especially more sophisticated ones, as this increases the potential for risk exposure. Making production decisions based on risk assessment can also facilitate moving away from cost-based competition, safeguard against disruptions and promote more sustainable and resilient industries.

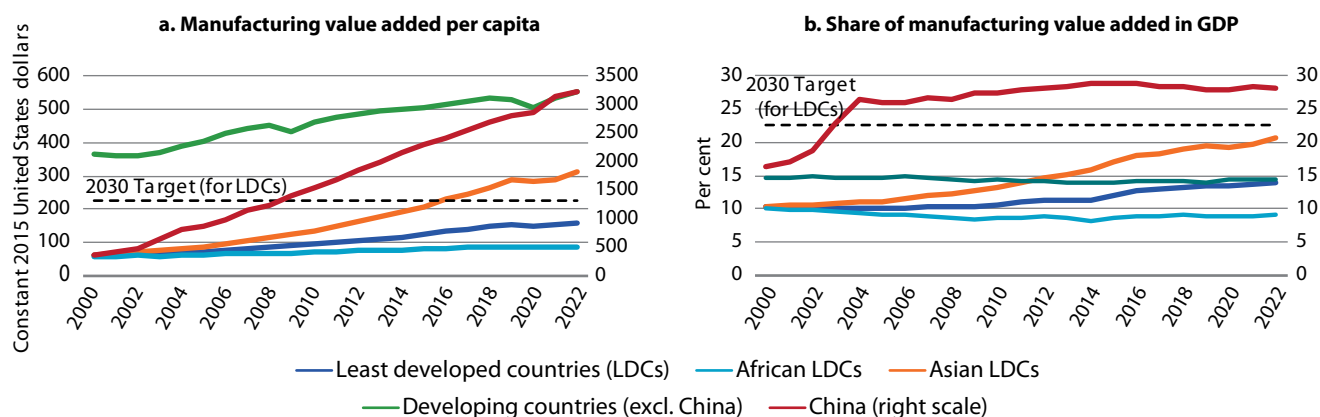
Today, modern services can play a more central role in connecting firms with international supply chains and boosting the industrial transformation of countries. Together with digital technologies, international supply chains rely on four services sectors – financial services, ICT, transport and logistics, and business and professional services – for their functioning. These service sectors have also become major sources of employment creation, exports, FDI, and innovation. Through linkages to other sectors, their presence also enhances the competitiveness of firms in other fields. For example, in regions with high-quality connected services, 44 per cent of all companies are engaged in export, compared with 19 per cent of firms where such services are weaker.¹¹ The services sector can allow firms to tap into value chains for manufacturing products that would otherwise be beyond their capability. Modern communications technology and the fall in transport costs have created opportunities for developing countries to export ancillary services such as back-office processing (e.g., customer care or data handling).¹² However, relying on services can prove challenging for those developing countries (including LDCs) where energy supply, ICT infrastructure, and human capital remain limited. In this case, policy makers can play a major role in helping their countries and firms become competitive in high-productivity manufacturing-related services (see section 3.3 and chapter III.B of the *Financing for Sustainable Development Report 2023*).

Private sector development, decent jobs and gender equality

Private firms account for the vast majority of employment creation in most countries; in a challenging global context the creation of sufficient and decent jobs remains a major challenge in many developing countries. Global employment growth has slowed down significantly since the 2008 world financial and economic crisis along with the broader deceleration of growth, trade and investment. While employment growth averaged 0.9 per cent per year between 2000 and 2008, it has fallen to only 0.1 per cent annually since then. Countries that have successfully transformed their economies, such as Bangladesh, China and Thailand, have also created good jobs on a large scale. For example,

Figure III.B.7

Prospects of least developed and developing countries achieving SDG target 9.2



Source: UN DESA calculations based on UNIDO data.

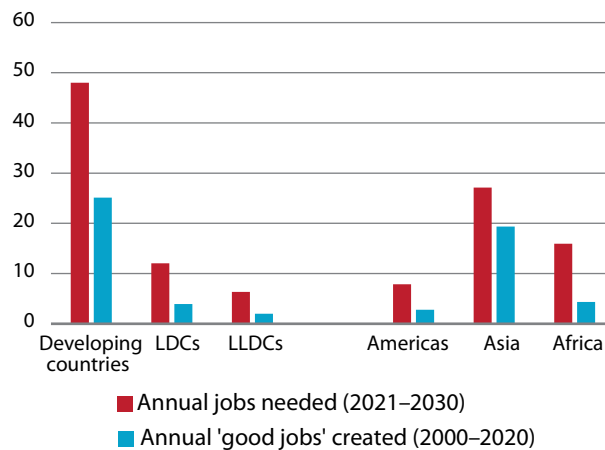
Note: 2022 per capita manufacturing value added levels for Developing countries (excl. China) are based on 2021 population figures.

between 2003 and 2016, Bangladesh experienced an almost 10 percentage point shift in the share of employment towards manufacturing and services. Waged jobs grew by almost 6 per cent annually, almost three times faster than the increase in the workforce. Moreover, 70 per cent of all new jobs created went to women.¹³ As manufacturing-based and labour-intensive transformations become more challenging, closing the “decent jobs”¹⁴ gap is emerging as a major challenge (figure III.B.8).

The quality of employment also remains a critical challenge. High levels of informality still prevalent in many developing countries result in gaps in social protection coverage and limit revenue mobilization, holding back socio-economic development.

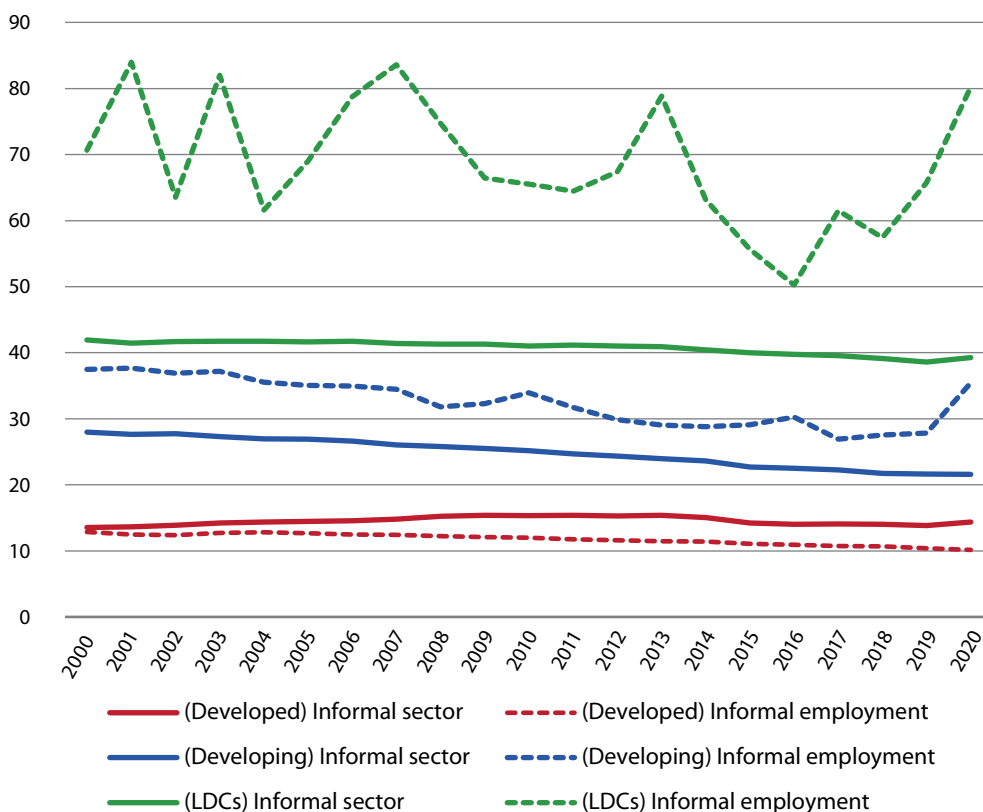
This includes the negative effects of informality on labour productivity and human capital accumulation. Fifty-eight per cent of jobs globally, or around 2 billion people, remain in the informal sector, mostly but not exclusively in developing countries. Around 90 per cent of total employment in LDCs and low-income countries can be considered informal, compared to 67 per cent in middle-income countries and 18 per cent in advanced economies.¹⁵ A great majority of workers in the informal economy and their families do not have access to adequate healthcare and income security, and as a result are particularly vulnerable to economic shocks.¹⁶ Most workers in the informal economy are not affiliated with contributory

Figure III.B.8
Annual jobs needed and quality jobs created
(Millions)



Source: UN DESA calculations based on World Bank data.
Note: LDCs: Least developed countries; LLDCs Landlocked developing countries.

Figure III.B.9
Informal activity (share of GDP) and self-employment rates (share of employment), 2000-2020
(Percentage rates)



Source: UN DESA calculations based on Elgin et al. and World Bank data.
Note: LDCs: Least developed countries.

schemes, nor are they reached by narrowly targeted “safety nets”, as they are not considered “poor enough” to qualify for these. Many countries have introduced forms of mandatory coverage, while others have opened social insurance to informal economy workers and micro-entrepreneurs with mixed results.¹⁷

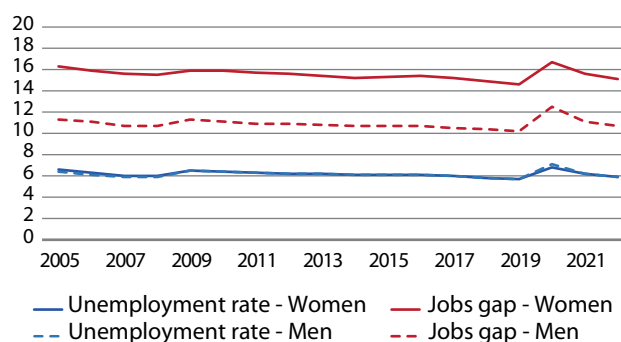
High levels of informality and a dearth of decent jobs are related to younger and smaller firms accounting for a large proportion of economic activity and job creation in many developing countries.

Many jobs created by young, small or informal firms are in low-productivity sectors, with unequal employment opportunities, lower wages and limited access to social protection. In 2019, more than 630 million workers worldwide (19 per cent of all those employed) did not earn enough to lift themselves and their families out of poverty.¹⁸ Moreover, and in the event of shocks and crises, economies relying on smaller firms tend to take a bigger hit, as micro-, small- and medium-sized enterprises (MSMEs) tend to have fewer assets and limited cash reserves to cushion against slowing demand and liquidity shortages. An example of this are SMEs in the agrifood sector, which are often scattered, small to very small, informal and family-based and lack economies of scale – with jobs in these tending to be highly insecure.¹⁹ In the case of the COVID-19 crisis, MSMEs, particularly in developing countries, were severely impacted and faced a higher risk of permanent closure. In August 2020, 22 per cent of MSMEs surveyed reported that they risked shutting down permanently within three months, compared to 9 per cent for large firms and 34 per cent for companies operating in LDCs.²⁰ While SMEs can occupy niches of digital success, it is large firms that are typically associated with frontier innovation. These companies can usually afford higher levels of research and development expenditure, have more experience and can more easily form partnerships or prompt government intervention.²¹

Gender inequality remains pervasive and persistent in the labour market. Gender inequality in employment access has remained a major challenge with no improvement registered since 2005. Worldwide, the labour force participation rate of women stands at 47 per cent, compared to 73 per cent for men. The gender gap remains a major concern across all regions, ranging from 11 percentage points in Europe to 30 percentage points in Asia.²² Improved educational attainment among women has done little to shift deeply entrenched occupational segregation in both developed and developing countries. As a result, the global gender pay gap persists, with women earning 51 cents to every dollar earned by men.²³ Part of this is attributable to the time women dedicate to unpaid care and domestic work, which was 3.3 times more than men in 2014 and has decreased to 2.6 times more in 2023.²⁴ The smallest jobs gaps are found in high-income countries, with men registering an unemployment rate of 7.4 per cent and women 9.6 per cent. However, as national income decreases, the jobs gap between women and men increases, reaching 24.9 per cent and 17.4 per cent in low-income and lower-middle-income groups, respectively.²⁵ This points to persistent and structural problems worldwide. Women additionally face challenges in more competitive and open sectors: firms integrated into GVCs may offer jobs to more women, but such firms seem to have even lower glass ceilings. Women are generally found in the lower value added segments, and it is hard to find women owners and managers. The share of women in informal employment exceeds that of men in 56 per cent of countries, especially in low- and lower-middle-income countries.²⁶

Figure III.B.10

Unemployment and jobs gap rate by gender, 2005–2022
(Percentage)



Source: Gomis et al., “New Data Shine Light on Gender Gaps in the Labour Market”.
Note: The jobs gap rate measures the share of persons who would like to work but do not have a job.

3.2 Sustainability in business

In the past 30 years, businesses have increasingly factored in sustainability considerations driven by the recognition of their long-term benefits, but risks of misalignment or backtracking underscore the need to redefine the “rules of the game”. In efforts to try to fill remaining gaps (e.g. see aforementioned gender disparities), companies today are routinely integrating sustainability issues in their decision-making. Yet, despite much greater awareness of environmental, social and governance (ESG) factors, many business activities and investments remain misaligned with sustainable development due to short-term incentives and the absence of enabling environments for long-term decision-making. To fully align business models with sustainable development will require redefining the rules of the game, including through legislation or regulations, coupled with incentivizing financial markets to be a catalyst for change (see section 4.2).

A longstanding relationship between business and society

Modern interpretations of corporate responsibilities to society evolved with globalization and the internationalization of sustainable development. The first notions of the contribution of business to society have been traced back to as early as ancient Mesopotamia and ancient Rome.²⁷ Modern interpretations of what has been termed “corporate social responsibility” (CSR) arose in the 1950s²⁸ and broadened with the rise of an international approach to sustainable development. In 1999, the concept of “triple bottom line” provided a sustainability framework that aims to balance a company’s social, environmental and economic impact. In the same year, in Davos, Switzerland, United Nations Secretary-General Kofi Annan proposed what subsequently became the UN Global Compact. Twenty years later, the Business Roundtable codified the new purpose of corporations as stakeholder capitalism, extending beyond solely serving shareholders.

Driven by globalization and other systemically significant trends, alongside stakeholder pressures, companies have increasingly acknowledged the importance of addressing sustainability risks and opportunities. Globalization expanded the reach of multinational

corporations into diverse business environments, often with weak regulatory frameworks, introducing new reputational, legal and operational risks. In response, companies adopted voluntary internal sustainability policies to ensure uniform management across territories (e.g. transparent supply chains to avoid human rights risks). Moreover, the emergence of new systemic risks (e.g. climate change) and environmental, social, or economic crises (e.g. the 1989 Exxon Valdez oil spill, the 2008 world financial and economic crisis, COVID-19) contributed to reshaping perceptions of the role of business in society and companies' own risk assessments. Evolving stakeholder expectations further influenced companies' cost/benefit analyses on the integration of sustainability issues. Among these expectations are investors' pursuit of more sustainable investment options and the update of their policy frameworks which encourages more attention to sustainability risks and opportunities (see section 4.2), the growing preference of consumers for ethical products, a modern workforce leaning towards purpose-driven employers, as well as the heightened regulatory focus of policymakers on corporate duties. Regulation, at the international level at first, and more recently also at the national level, has focused on both corporate operations and supply chains. Prominent examples of the latter including the United States' 2010 Dodd-Frank Act (which regulates conflict minerals), the United Kingdom's 2015 Modern Slavery Act (which includes a clause on transparency in supply chains), France's 2017 Duty of Vigilance law, Germany's 2021 new Supply Chain Due Diligence Act, and, more recently the European Union's Corporate Sustainability Due Diligence Directive.

Sustainability integration in modern corporate practices

Many companies have implemented voluntary actions on sustainability, independent of legislative requirements. CEOs are broadening their roles, with 91 per cent acknowledging a duty to protect local communities and 70 per cent recognizing the need to address public concerns.²⁹ Companies' sustainability impacts can stem both from (i) their products, services and activities, and (ii) their operational practices. Initially, business' approach to sustainability was primarily centered around the latter, via the risk-oriented consideration of externalities. This vision gradually expanded with the realization of the importance of aligning core business activities with real value creation (see, for example, the recent discourse around the B Corporation or the "regenerative company" that not only avoid externalities, but also actively contribute to solutions). Businesses have embraced voluntary commitments, such as pledges and standards to standardize their approaches in line with peers, and to adopt a common language for communicating alignment to shareholders and stakeholders. Bottom-up initiatives have also emerged to help companies align with international agreements (see, for example, the Science Based Targets Initiative helping companies to align with the goals of the Paris Agreement), as well as to respond to increasing ESG demands from investors (see section 4.2).

Remaining barriers

Despite increasing commitments, SDG-aligned companies remain in the minority. In 2020, 62 per cent of MSCI SDG Alignment dataset companies (over 8,500 companies) displayed neutral alignment or misalignment across the SDGs for their products, services and activities.³⁰ Beyond business models, business practices also remain deficient from a sustainability perspective. Echoing the aforementioned challenges in the global labour market, gender equality has not yet been achieved in

corporate leadership. Despite the growing number of exchanges that promote gender equality, the number of women in high-level positions within companies remains low in many markets. Women were holding only 23 per cent of the board seats at the top-listed companies on 22 major G20 stock exchanges in 2022.³¹ Disclosure is another telling example of the misalignment of corporate practices with sustainable development. While 98 per cent of S&P 500 companies engaged in corporate sustainability disclosure in 2022 – up from only 20 per cent in 2011³² – the quality of data remains weak and greenwashing risks abound (see section 4.2).

Reversals and short-term-oriented decisions in moments of crisis reveal the limitations of voluntary and bottom-up approaches. A recent survey identified ESG as the primary investment focus for chief financial officers, but also indicated that this area is most likely to face near-term budget cuts.³³ While sustainability investments or programmes enable companies to mitigate long-term risks, crises tend to shorten time horizons and reveal an enduring misalignment between long-term non-financial considerations and prevailing incentives in markets, exacerbated by the mispricing of externalities. This is particularly evident in the current context characterized by high inflation, high interest rates and geopolitical divides. For example, the surge in oil prices following the COVID-19 pandemic led to renewed interest in brown investments along the fossil fuel value chain, underlining the need to change incentives and permanently alter the rules of the game through policies.

3.3 Strengthening the business environment

Changing business practices must be a core element of sustainable transformations, yet the private sector will not be able to systemically change behaviour unless profitability and sustainability are aligned. The rules of the game (i.e., the environment in which companies evolve) must change to enable sustainable practices. Policymakers have various tools at their disposal to align sustainability and profitability, including the pricing externalities (e.g. through carbon pricing mechanisms), the phasing out harmful subsidies, the prohibition of activities with negative impacts (such as single use plastics), or mandating certain corporate practices such as sustainability reporting (see section 4.2). Further options include the promotion of business models and opportunities with a positive impact on sustainable development, for example through subsidies, as well as public investments and other efforts through fiscal tools, regulations and laws to overcome coordination challenges that abound in economy-wide transformations (e.g. in the decarbonization of the transport sector).

Efforts to create an enabling environment for the private sector and the provision of relevant public goods should thus be aligned with sustainable development objectives. The rule of law, the absence of corruption and the quality of institutions are important determinants of private sector growth prospects. Investments in public infrastructure, education and health, stable and growth-oriented macro policies and exchange rates, and regulatory frameworks (including competition policies) all contribute to reducing uncertainty and risks for firms and thus to creating a better business environment and a lower cost of borrowing. But to achieve sustainable transformations, even these "horizontal" policies should be informed by broader sustainable development objectives. This includes: sequencing and prioritization of public investments, where governments are "doomed to choose", particularly in

an environment of tight fiscal constraints; setting the “right” incentives through fiscal and tax policies; ensuring that regulatory frameworks reflect appropriate labour, environmental and health standards; and aligning investment and trade facilitation policies with sustainability. For example, policymakers can use land-use procedures and building codes to ensure that infrastructure is not constructed in disaster-prone areas and meets appropriate design and construction standards.

Ensuring that gender equality is enshrined in law and implemented effectively is another key aspect. Currently, laws in 93 economies do not mandate equal pay between men and women for work of equal value. Women’s property rights are still restricted in 76 countries, and women cannot run a business the same way as men in 101 countries. As a result, women are less likely to become entrepreneurs, with 68 women entrepreneurs for every 100 men entrepreneurs active globally.³⁴

Easing financial constraints for firms, particularly for long-term investments, requires addressing multiple financial sector bottlenecks. The latest data for SDG indicator 9.3.2 (“Proportion of small-scale industries with a loan or line of credit”) show that nearly one third of small manufacturing firms have a loan or line of credit. Yet, access to credit remains uneven across countries and regions. For example, only 15.7 per cent of firms in sub-Saharan African countries and 17 per cent in LDCs have access to financial services, well below the global average and far from the rates in Latin America and the Caribbean, and Oceania (44.2 per cent and 45 per cent, respectively). For SMEs in manufacturing and services activities, policy-makers will have to develop and implement programmes to make formal lines of credit more accessible, increase financial literacy among entrepreneurs and introduce targeted lending in underserved areas. Constraints are most prevalent for long-term financing. Accessing financing on such terms can be a particular challenge, with lenders reluctant to provide long-term credit to borrowers about whom they have very limited information (e.g. SMEs) or for activities regarding which they are uncertain about future returns (e.g. investments in innovation; see section 4 of this chapter and box II.8 of the *Financing for Sustainable Development Report 2023*). Well-managed public development banks can play a role in filling such gaps (see chapter III.A).

A new generation of sustainable industrial policies

In response to the need for sustainable transformations, industrial policies have once again become more prevalent. Unlike policies aimed at improving the broader enabling environment for private business and investment, industrial policies and strategies are targeted in nature. They typically connect policy making with long-term visions and development priorities, help to overcome information and coordination problems, and can reduce the uncertainty that necessarily accompanies investments in new sectors, activities and technologies. Industrial policies³⁵ have been resurgent since the 2008 world financial and economic crisis, with the revival driven by several factors: the decline of decent jobs tied to the decline in manufacturing sectors in some countries; vulnerabilities in supply chains revealed by the COVID-19 pandemic and inflation driven by other supply shocks; rising geopolitical tensions that have created an additional geostrategic impetus to “avoiding external dependencies”, particularly in sectors that are deemed strategically important such as semiconductors, other high-tech sectors and energy; and finally the need to accelerate the development and deployment of low-carbon technologies and the

energy transition, which has led many countries to adopt “green industrial policies”.³⁶ Industrial policy measures more than doubled between 2009 and 2019, with the revival particularly pronounced in developed countries: four out of the five countries with the largest number of industrial policies are developed countries.³⁷

This new generation of industrial policies has to respond to a changing and challenging global environment. Developing countries must harness new opportunities in the context of stagnating trade and investment growth and a slow-down in GVCs, the geographic concentration of manufacturing activities in a few large countries and rapid technological change and digitalization – and doing so under global rules that have made industrial transformation more challenging in recent decades. The objective of such sustainable and inclusive industrial policies is also broader, and more ambitious. It is not just to spur sustained economic growth and build capabilities in the domestic private sector to innovate and enhance productivity, but also to “shape” growth, ensuring that it creates decent jobs and provides opportunities for all, is environmentally sustainable, and is aligned with the SDGs more broadly. Chapter II of the *Financing for Sustainable Development Report 2023* laid out a set of recommendations for such a strategic approach.

4. Aligning finance with sustainable development

A more dynamic, inclusive and sustainable business sector depends also on the emergence of a financial sector that is both inclusive and sustainable. Lack of access to finance, the excessive costs of finance and other financial constraints are often among the most binding constraints for private sector development. Access to financial services also remains a concern for households and individuals, particularly in LDCs, despite the significant progress achieved in this area. There has also been an enormous increase in interest in “sustainable finance” – the alignment of the financial sector with sustainability.

4.1 Inclusive finance

Over the past two decades, significant progress has been made in financial inclusion for businesses and individuals alike, driven in particular by innovations in digital finance and financial technology (fin-tech). Yet, despite the progress, significant challenges remain, particularly with regards to access to long-term finance, highlighting the sustained need for financial sector development. Moreover, gender, age and geographical location continue to be critical factors in determining access to financial resources. At the same time, the financing gap between MSMEs and large companies is widening, as MSMEs face greater difficulties in navigating the post-COVID-19 economic landscape and adapting to the shift from a low to a high interest rate environment. MSMEs from developing countries and those in the informal economy lack the capacity to navigate and hedge against various forms of risks, including exchange rate risks. These challenges need to be urgently addressed to ensure that both MSMEs and individuals have access to affordable, quality financial services. Financing costs have increased globally following a tightening of monetary policy. Inflationary pressures have also risen, increasing living expenses and impacting firms with lower elasticity in product pricing.

Access to finance for firms

Developing domestic financial sectors that are aligned with the SDGs and provide long-term financing for sustainable development in developing countries continues to be a key challenge.

Well-developed local financial markets can facilitate risk-sharing and improve the availability of long-term finance beyond a small number of large firms that can tap global financial markets. Despite efforts to promote long-term finance in domestic markets and an increase in bank lending to the private sector over the past 20 years, financial and capital markets remain underdeveloped in terms of size, liquidity and maturity in many developing countries, and long-term credit continues to be scarce, both for sovereigns and for corporates (figure III.B.11). To avoid maturity mismatches, banks require longer-term funding options in order to provide long-term lending. Studies have shown that despite improvements in financial depth, characterized by higher lending from banks to the private sector, developing countries have generally seen smaller increases in long-term finance.³⁸ The recent tightening of global financial conditions has also made long-term finance scarcer in both developed and developing countries.

Domestic efforts to extend maturity structures towards longer-term finance have been hampered by a number of factors, including market inefficiencies, an absence of local currency financing and institutional gaps, as well as macroeconomic volatility. Despite progress in promoting domestic capital markets, these markets have stagnated in many developing countries, not (yet) reaching sufficient scale to provide sufficient amounts of long-term and local currency-denominated finance.³⁹ Policies that can support the development of capital markets include strengthening institutional and legal frameworks as well as fostering financial infrastructure. At the same time, building local capital markets is an inherently gradual process that depends on the local needs and context, including the country's size.⁴⁰

Long-term credit in developing countries also continues to be highly skewed towards a small number of very large firms. Faced

with significant hurdles to access long-term finance, smaller firms are reliant on short-term loans and exposed to rollover risks that may preclude them from investing in long-term projects. Unlocking greater long-term investment in the SDGs will require financial sector development through policies that promote macroeconomic stability, strengthen regulation and supervision of banking systems as well as facilitate the long-term development of capital markets and institutional investors. In this regard, national development banks can play an important role given their ability to extend longer-term financing due to their policy mandates and funding structures (see chapter III.A).

Access to finance continues to be a critical challenge for SMEs in particular. In response to tightening financial conditions and the unwinding of COVID-19 support measures, the outstanding value of commercial bank loans extended to SMEs relative to GDP has declined. Seventy-five per cent of economies saw a drop in lending to SMEs in 2022.⁴¹ Data suggests that COVID-19 relief was directed to entities within the digital ecosystem, which left those not registered as businesses unable to access relief funds. In addition, there continues to be a gender gap in access to SME financing with women-owned businesses facing a disproportionate gap in funding. Informality continues to be a key factor determining access to finance and vice versa. Given this interplay between informality and access to finance, policy action is needed that recognizes that formalization and financial access need to be advanced in tandem.

Access to finance for individuals and remittances

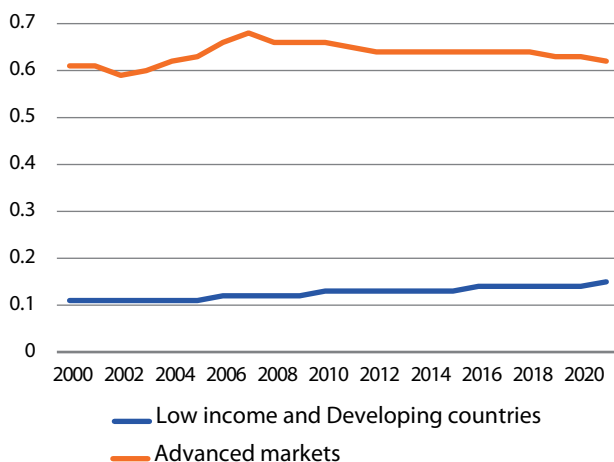
Enhancing access to finance for all individuals, including women, has been a Financing for Development priority from the outset. It featured prominently in the Monterrey Consensus and subsequent Financing for Development outcomes, recognizing the contributions that greater financial inclusion can make to business development, social protection, enhancing household and business resilience and lowering the costs of remittances, among other issues. These commitments have translated into progress on the ground. In the past 10 years, account ownership has increased worldwide from 51 per cent in 2011 to 76 per cent in 2021. In developing countries, account ownership grew by 30 percentage points over this period, reaching 71 per cent in 2021; 567 million adults gained access between 2017 and 2021 alone.⁴²

Despite the progress, significant gaps remain in access to and the affordability of financial services, not least for women. The global gender gap in account ownership has narrowed over the past decade, from 8 to 4 percentage points, but it remains significant: in 2021, 78 per cent of men and 74 per cent of women had access to financial services.⁴³ In developing countries, the gap is slightly broader still (figure III.B.12). Women continue to face multiple barriers, such as cost and affordability of financial services and financial literacy. Studies⁴⁴ have also highlighted the issue of women's indebtedness, suggesting that a larger proportion of women than men may use credit to pay for health and education expenses, underlining the need to consider how policy actions, including reductions in spending on public services, affect women's spending needs. There also needs to be greater efforts to advance asset ownership incentives for women to enable them to pledge collateral to access financing.

Overall, 1.4 billion adults remain unbanked globally. With account ownership nearly universal in developed countries, virtually all unbanked adults live in the developing world, with the largest gaps in LDCs, where

Figure III.B.11

Financial Development Index, 2000–2021



Source: UN DESA calculations based on IMF data.

Note: This chart uses IMF country classifications.

more than half of all adults remain unbanked. Vulnerable adults, such as the poorest, women, the unemployed and the elderly continue to be those most likely to be unbanked.

Migrant remittances and diaspora investment are important sources of income for households and SMEs. Remittances directly augment incomes of poorer households and tend to be counter-cyclical. They are expected to continue to increase due to rising migration pressures. Remittances to low- and middle-income countries are expected to have reached \$669 billion in 2023.⁴⁵ However, remittances continue to be more expensive than the commitments made in the Addis Ababa and 2030 Agendas, which set a 3 per cent target for 2030. The global average cost of sending \$200 fell slightly, from 7.7 per cent in the second quarter of 2015 to 6.2 per cent in the second quarter of 2023, but it continues to be more than twice as high as the SDG target.⁴⁶

Technological innovations have been a major driver for advancing financial inclusion.⁴⁷ Mobile money has facilitated a vast expansion of low-cost and small-scale transactions.⁴⁸ Between 2021 and 2022 alone, the number of mobile money transactions per 1,000 adults increased by 28 per cent and 24 per cent in Africa and the Asia-Pacific regions, respectively. Similarly, the value of mobile money transactions increased from 26 per cent to 35 per cent of GDP in Africa.⁴⁹ Of the 76 per cent of people worldwide who have an account at a financial institution, 36 per cent used a mobile phone or the Internet to access their account.⁵⁰ This has been driven by the adoption of digital technologies for carrying out financial transactions, such as mobile money, fast payment systems, digital identity, data-sharing arrangements and, more generally, digital public infrastructures (DPIs). Digital financial inclusion, and secure and responsible digitally enabled financial services and products could also be a key means to reach the remaining unbanked, financially excluded and underserved populations with a range of formal financial services suited to their needs. This will require greater use of national digital IDs to make it easy to open accounts. Identification is almost always a requirement for opening an account and owning a mobile phone. Digitally enabled financial services

could reduce transaction costs and foster innovative models for small business. Responsible finance lending principles should also be promoted along with greater financial consumer protection as digital lending takes off in many markets.

4.2 Redirecting investments towards the SDGs

Sustainable finance has risen to prominence over the past three decades on the back of growing investor interest. The modern approach to sustainable finance can be traced back to the 1990s, with a steady increase in investor interest since then. Over this period the field was codified at a blistering pace within a short time frame, by industry players who were grappling with new investment practices. However, the resulting high number of bottom-up standards and frameworks also led to confusion, hampering investor confidence over time. Growing political polarization has recently led to a backlash in some countries, with early signs already indicating a slowdown of investors' use of the term ESG in 2023. On the other hand, the increasing spotlight and mainstream attention on the field also underscore its rise to prominence.

While many challenges remain, the field has recently entered a maturation phase, with sustainable finance at a crossroads.

Following a rapid development phase and rise to prominence, the current moment presents an opportunity for refinement, recognizing that systemic transitions are lengthy and non-linear (see, for example, the gradual century-long development of other fields like financial accounting). There needs to be an honest reassessment of the field's real-world impact to help identify where complementary policy is necessary to achieve broader systemic change. Early maturation signals have included the clarification and consolidation of voluntary standards and regulatory and legislative action to further enhance impact (see section 4.2.4).

4.2.1 Rising interest and deepening focus

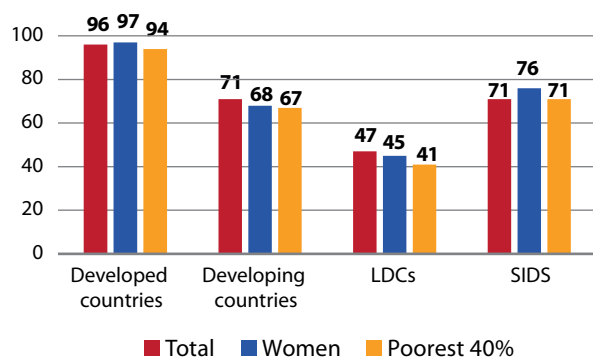
Sustainable investing was a niche practice until a transformative shift in the late 1990s and a notable acceleration after 2015.

Ethical funds emerged in the 1920s as an early form of socially responsible investing, restricting investments in industries that investors considered unethical, such as tobacco and firearms. Despite their early origin, these funds had limited influence. With global conferences such as the Earth Summit in 1992, sustainable development became a more prominent concern for all stakeholders, including private actors. The 2015 global agreements – the Addis Ababa Action Agenda, the 2030 Agenda for Sustainable Development, and the Paris Agreement on Climate Change – accelerated the expansion of sustainable finance (figure III.B.13). These agreements shed light on increasing systemic risks for investors and brought to the fore the interlinkages between social, environmental, economic and financial factors.

ESG factors are routinely considered by investors today. Over time, asset owners have increasingly recognized the material risks that their portfolio companies might pose, and the growing investment opportunities in sustainable sectors. This has driven a shift in portfolio reallocation and an acceleration of sustainable investment, as well as the growing integration of non-financial issues in investment decisions.⁵¹ Investors no longer consider these factors as purely philanthropic issues but view them as an integral part of risk management, and a growing number of actors also realize their value creation and impact potential. Additionally,

Figure III.B.12

Adults (age 15+) with a bank account by country grouping, 2021
(Percentage rates)



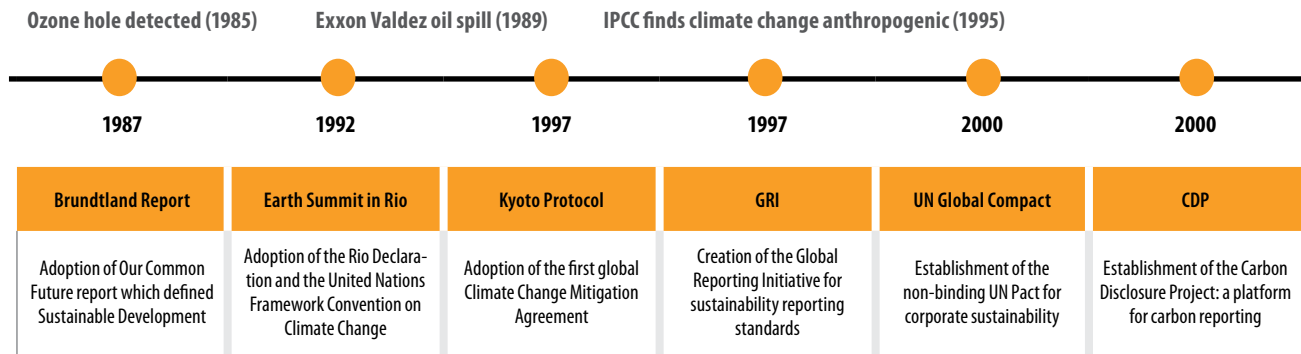
Source: UN DESA calculations based on the Global Findex Database 2021.

Note: LDCs comprises 38 countries from the UN DESA list of 45 Least Developed Countries. SIDS only includes data for Dominican Republic, Jamaica, Mauritius and Singapore, which are a subset of the list of SIDS produced by UN DESA.

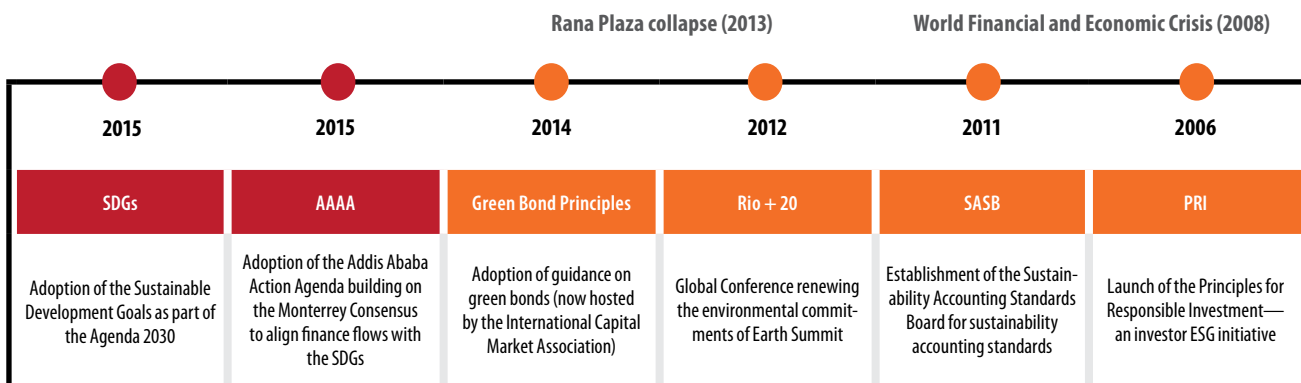
Figure III.B.13

The evolution of sustainable finance: An historical timeline of select milestones

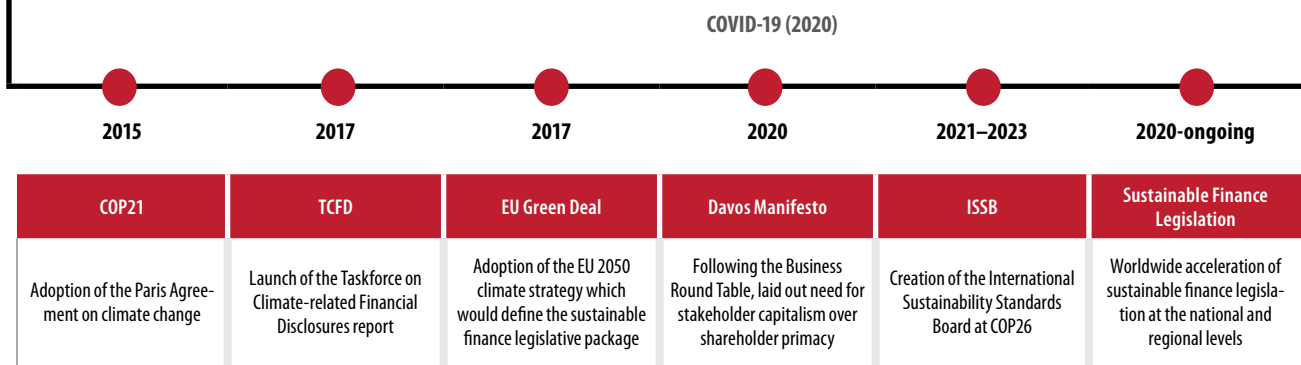
Igniting change: International societal sensitization (1990s–2000)



Empowering transformation: Industry-driven progress (2001–2014)



Accelerating impact: Towards regulatory frameworks (2015–Present)



Source: UN DESA.

Note: This is a non-exhaustive list of key events.

asset owners have become more active owners or “stewards” of their investments and increasingly seek engagement with investee companies on sustainability issues.⁵² Today, around 85 per cent of chief investment officers consider ESG an important factor in their investment decisions.⁵³

The interpretation of fiduciary duty has evolved over time but remains contested. Fiduciary duties ensure that asset owners (including institutional investors, insurers and banks), also known as fiduciaries, who exercise discretionary power in managing the assets of their beneficiaries, act responsibly in the interest of these shareholders. Over time, the interpretation of these duties has widened to include the consideration of ESG issues. Under current practice, asset managers largely consider ESG risks within an overall process of commercial risk management, as studies have shown that responsible investment allows them to maximize long-term returns for their clients. A series of landmark reports, including the 2005 Freshfields Report⁵⁴ and its sequel, *Fiduciary Duty in the 21st Century*,⁵⁵ indeed concluded that investment approaches which consider ESG factors are permissible and arguably required for long-term investments. The rationale is that sustainability considerations will impact financial performance in the long-term, and neglecting ESG analysis may cause the mispricing of risks (whether legal, reputational, operational or systemic), leading to poor asset allocation and stranded assets.⁵⁶ More ambitious interpretations of fiduciary duty also encourage fiduciaries to pursue sustainability goals that may reflect beneficiaries’ preferences, regardless of whether these preferences are financially material. Financial return remains the primary goal of institutional investors today, but further analysis shows that in some jurisdictions investors are already facing a legal obligation to consider setting and pursuing real-world sustainability impact goals where doing so can be effective in achieving their financial goals.⁵⁷ However, amid the current ESG backlash, critics have recently reopened the debate on fiduciary duty, opposing the evolution of the concept and advocating for a return to its traditional interpretation (see section 4.2.3).

4.2.2 Sustainable investing trends

Sustainable investing assets have grown significantly since 2016, albeit with some year-on-year declines following the COVID-19 pandemic. Global sustainable investing assets – defined here to include all strategies of ESG integration, screening and impact investing – reached \$30.3 trillion in 2022, representing a significant increase from 2016, but below the record highs of 2020 and 2021.⁵⁸ This recent decline was fuelled by high oil prices and the turbulent economic environment during the COVID-19 pandemic. Looking at the subset of sustainable products (sustainable funds, bonds and voluntary carbon markets) rather than the entire universe of strategy-based approaches, sustainable products reached \$5.8 trillion in 2022.⁵⁹

Sustainable investment funds experienced a surge in inflows until 2021; and continued to outpace the broader market in 2022 and 2023. Sustainable funds⁶⁰ reached \$2.56 trillion in assets under management at the end of 2023,⁶¹ representing roughly 10 per cent of all sustainable assets. Their inflows of net new deposits peaked at \$558 billion in 2021 during the pandemic period, and subsequently experienced a decline to \$158 billion in 2022 and \$72 billion in 2023.⁶² Inflows still remained positive and outpaced flows into traditional funds, which suffered net outflows. But in absolute numbers, sustainable fund assets have

remained a small share of total fund assets under management, representing less than 5 per cent of total global fund assets (i.e., \$2.56 trillion of \$55.16 trillion at the end of November 2023).⁶³

Sustainable funds are mostly domiciled in developed countries, which also dominate capital allocation. Europe hosts the majority of sustainable funds, capturing 81 per cent of the market; the United States is the second-largest contributor at 13 per cent while all other countries combined account for only 6 per cent of total market share.⁶⁴ In terms of allocation, taking impact capital as an example, in 2023 the highest portion went to the United States and Canada (29 per cent of impact assets under management), followed by Western, Northern and Southern Europe (23 per cent) and sub-Saharan Africa (10 per cent).⁶⁵

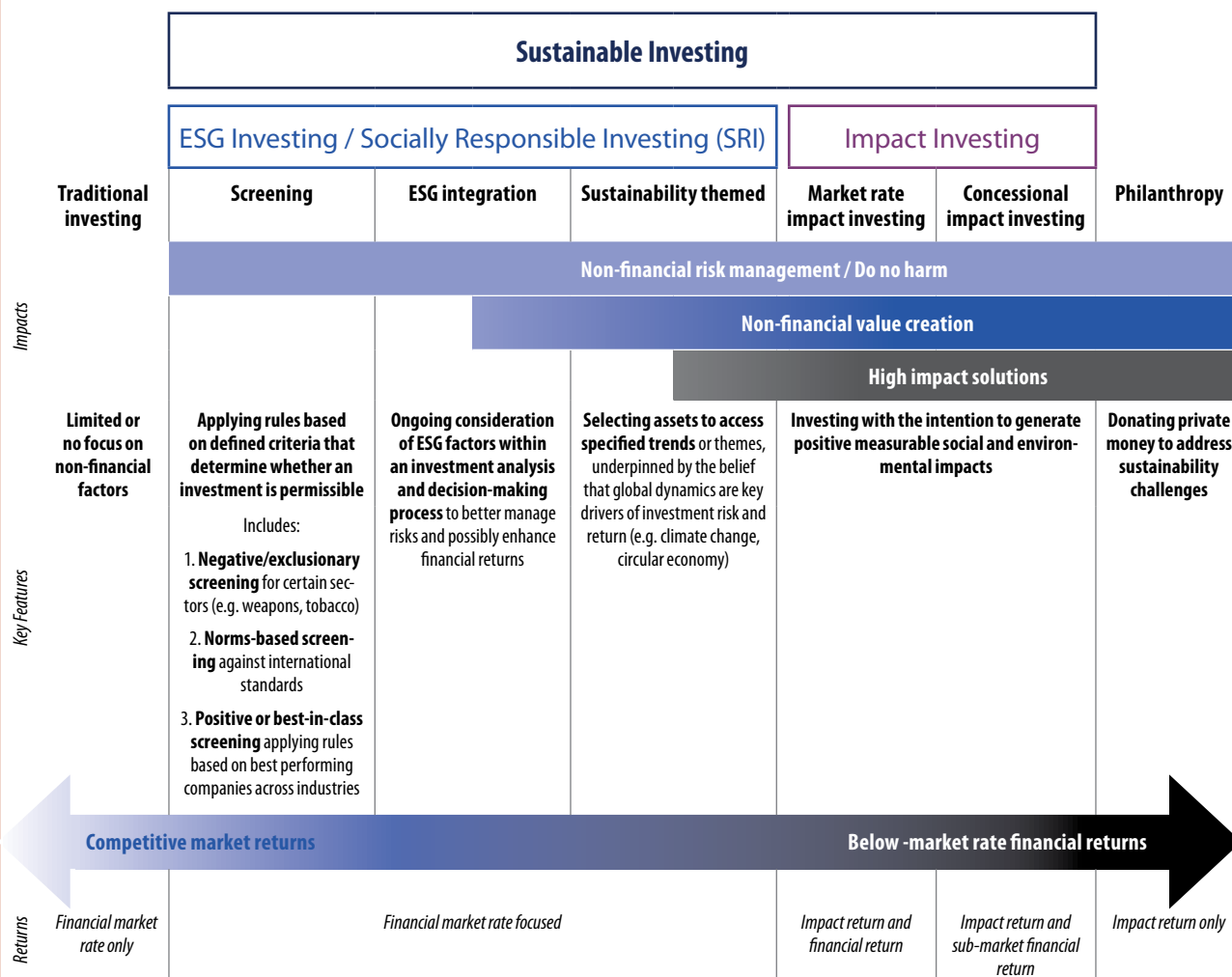
ESG integration and negative screening strategies dominate the field today, with impact investing representing only a modest fraction of total sustainable assets. Across a wide sustainable investing spectrum (box III.B.3), the majority of sustainable asset managers today prioritize “ESG integration”. This consists in integrating ESG factors into investment decisions to better manage risks and possibly enhance financial returns. The surging interest in ESG strategies is evident in the quadrupling of the number of asset managers and asset owners signing the Principles for Responsible Investment from 2015 to 2023 (although their minimum requirements do not reflect the actual level of ESG integration from signatories). Negative screening is the second most popular approach, while impact investing or thematic investing remains much smaller in scale (figure III.B.16). This may in part reflect these strategies’ short-term effects on financial performance. Impact or thematic investing, characterized by more structural biases and a focus on single industries (e.g. funds concentrated on the clean energy value chain), generally underperform other more flexible traditional or ESG strategies in the short-term. For instance, Article 9 products in the European Union (that is, for which sustainable investment is the primary objective as per the European Union Sustainable Finance Disclosure Regulation) have come under pressure in the current inflationary landscape, underperforming by -1.7 per cent in the first quarter of 2023.⁶⁶

Impact investing, although not yet dominant, holds significant growth potential and is gaining important momentum. Impact assets under management surpassed \$1.164 trillion in 2022,⁶⁷ and continued to grow across nearly every region in 2023.⁶⁸ Impact investing strategies are also evolving in terms of both depth and sophistication. This is exemplified, for example, in the rise of impact lenses, which complement impact strategies focused on sectors (e.g. renewable energy investments) by applying cross-cutting social themes to investments (e.g. applying a social lens to a renewable energy fund). These lenses have the potential to enhance investors’ positive impacts by integrating overlooked injustices that indirectly affect the outcome of all investments. Impact lenses include a gender lens,⁶⁹ a racial equity lens,⁷⁰ and a recently developed child lens.⁷¹

The impact investing market’s growth is fuelled, in part, by the rapid rise of green, social, sustainability, and sustainability-linked (GSSS) bonds. Investment figures on the labeled bonds that meet the Global Impact Investing Network’s (GIIN) definition of impact investing (e.g. certain types of green bonds and other use-of-proceed bonds) have been integrated in total impact market figures for 2022 (i.e. \$1.164 trillion).⁷² Taken separately, total labeled

Box III.B.3.
Decoding sustainable finance

Figure III.B.14
Navigating a broad investment spectrum



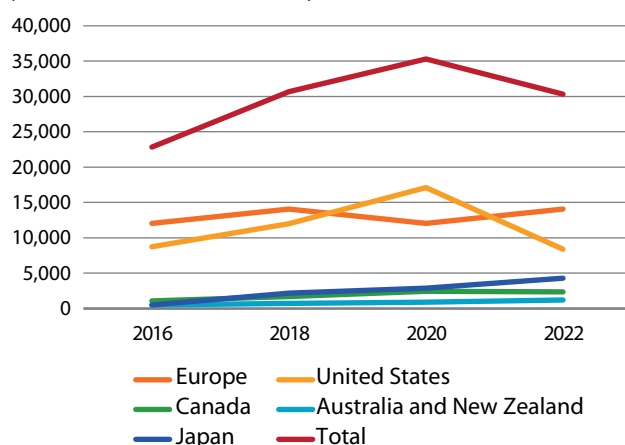
Source: UN DESA and Global Investors for Sustainable Development Alliance based on RIAA (Responsible Investment Association of Australasia), CFA Institute, Global Sustainable Investment Alliance, and Principles for Responsible Investment.

- A range of investment approaches are grouped under the term “sustainable investing”, with varying contributions to sustainable development (with ambition increasing from left to right in figure III.B.14). Definitions and denominations for sustainable investing strategies are not always used consistently; terms like “responsible investing”, “socially responsible investing”, and “sustainable investing” are frequently employed interchangeably, leading to confusion in the space. Moreover, despite being a subset of this space, the phrase ESG Investing is also commonly used as a proxy for sustainable investing as a whole. In a collaborative effort, the CFA Institute, the Global Sustainable Investment Alliance, and Principles for Responsible Investment released a detailed report to consolidate language and interpretations of the investment spectrum in November 2023^a (where applicable, these have been reflected in figure III.B.14).
- Beyond allocating capital to sustainable strategies, sustainable investors can engage in stewardship, using their rights and influence to guide businesses towards more sustainable business models and practices. Stewardship spans all asset classes, although the methods vary. Examples for equity investments include serving on or nominating directors to a company’s board and filing shareholder resolutions or statements, while for debt investments investors can attach ESG legal conditions to loans (as conditions precedent and/or subsequent). Such practices have started with multilateral investors (e.g., the International Finance Corporation) and eventually spread to the whole investment ecosystem. Asset owners and managers today regularly engage on a wide range of environmental, governance and social issues.

^a CFA Institute, Global Sustainable Investment Alliance, and Principles for Responsible Investment, “Definitions for Responsible Investment Approaches”.

Figure III.B.15

Global sustainable investing assets, 2016–2022 (Billions of United States dollars)



Source: Global Sustainable Investment Alliance (GSIA).

Note: A change in United States Sustainable Investment Forum methodology contributed to the material decrease of United States and total assets under management in 2022.

bond issuance reached \$946 billion in 2023, showing a small rebound (of 2.2 per cent) after a decline in 2022. As a whole, sustainable bond issuance grew five-fold over the past five years (see figure III.B.17). Labelled bonds span use-of-proceeds bonds (e.g. green, social, sustainability bonds), which are used to finance earmarked green or sustainable activities, and sustainability-linked bonds, which are general purpose bonds wherein issuers commit to improving overall firm performance against environmental or social key performance indicators. Representing only 6 per cent of all issuances, sustainability-linked bonds face challenges in scaling. While these instruments offer flexibility for business models unsuited to use-of-proceeds bonds, questions remain regarding the targets' rigour and ambition and their capacity to influence issuers' incentives. Despite also contending with some structural weaknesses (e.g. greenwashing concerns, lack of standardization and verification), the green bond model has given rise to a range of use-of-proceeds bonds, including but not limited to blue bonds, resilience bonds, transition bonds and orange bonds. As of today, green bonds remain the favoured instrument (60 per cent of total issuance), with a primary focus on climate mitigation. Sustainable Fitch predicts a continued rise in biodiversity and social use-of-proceeds instruments going forward.⁷³ Guidance is also gradually emerging to incentivize market uptake of these newer instruments, such as, for example, the Guidance on Sovereign SDG Bonds for Countries and Investors developed by the Global Investors for Sustainable Development (GISD) Alliance under the leadership of UN DESA and the United Nations Development Programme (UNDP), as well as the recent Climate Resilience Classification Framework for resilience bonds by the Climate Bonds Initiative.

Despite their potential, the global labelled bond market remains largely concentrated in high-income countries, much like other sustainable assets. Looking at the use-of-proceeds green, social and sustainability (GSS) bonds subset, for example, only 13 per cent of the overall GSS bond market was issued by entities in developing countries

in 2022 (further reducing to around 5 per cent when not including China). Bottlenecks to increasing GSS and sustainability-linked bond issuances in developing countries include illiquid domestic capital markets, lack of bankable and relevant projects, limited familiarity with international investors, complex public budgeting processes, and the high level and often voluntary nature of applicable global standards.^{74,75}

4.2.3 Persisting challenges

The sustainable finance field still grapples with challenges that limit both its scale and impact. These include:

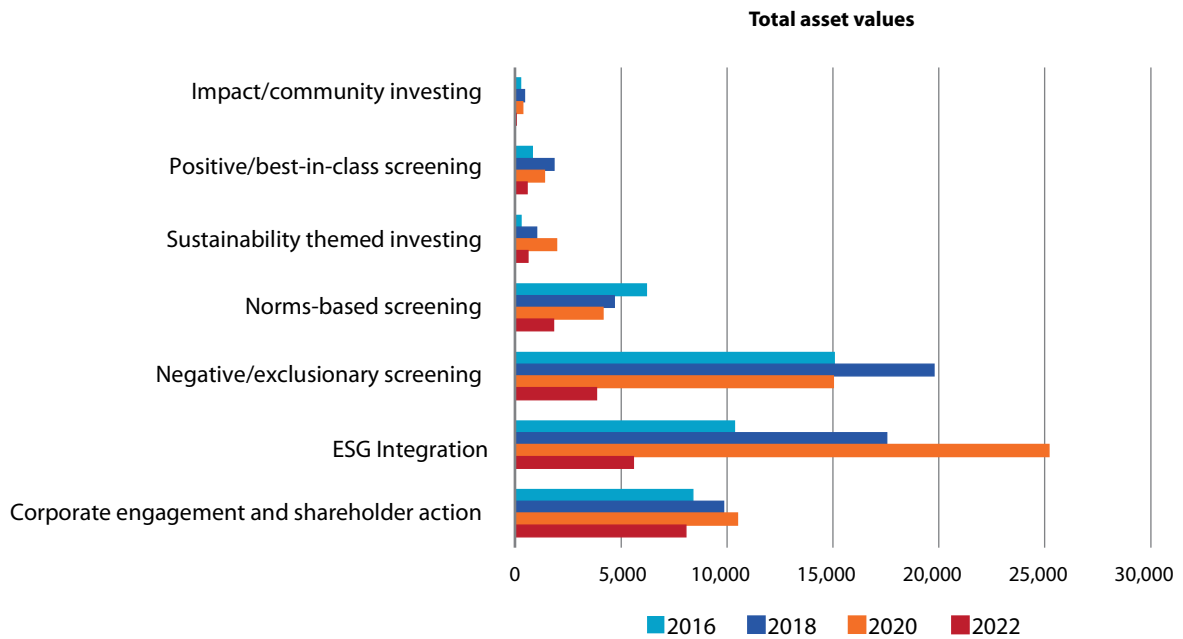
- A weak information infrastructure leading to data gaps and greenwashing risks. High-quality, exhaustive and comparable data are prerequisites for informed investment decisions. Despite recent progress, a weak information infrastructure reduces market transparency and increases risks of greenwashing;
- A lack of global standardization in terminology, standards, and frameworks. A lack of consensus on terminology as well as the coexistence of various standards and investment approaches, lead to complexity and confusion in the field, although harmonization efforts are ongoing;
- Flawed ESG ratings. ESG ratings are failing to restore investor confidence, compounding existing challenges;
- Political polarization. An "ESG backlash" has introduced new reputational and regulatory risks for investors;
- Systemic barriers within the wider financial system. The persistence of traditional forms of investment alongside the increasing adoption of sustainable investing, and the limited share of more ambitious impact investing strategies, highlight broader systemic obstacles.

Weak information infrastructure

Data gaps and inconsistencies limit the ability of investors to make informed decisions. Data is one of the prerequisites to assess and price risks and opportunities. The number of companies and General Partners (GPs) reporting on sustainability data has increased over time, namely due to Limited Partners' (LPs) increasing demands. However, while 98 per cent of S&P 500 companies engaged in sustainability disclosure in 2022,⁷⁶ available data is still inconsistent and difficult to compare, pointing to remaining quality and relevance issues. Non-listed entities, as well as companies in developing markets, present even greater data availability and quality challenges due to fewer reporting requirements from investors and regulators. Standard-setters, international organizations and industry players have started making progress towards improving the global sustainability data landscape (see section 4.2.4).

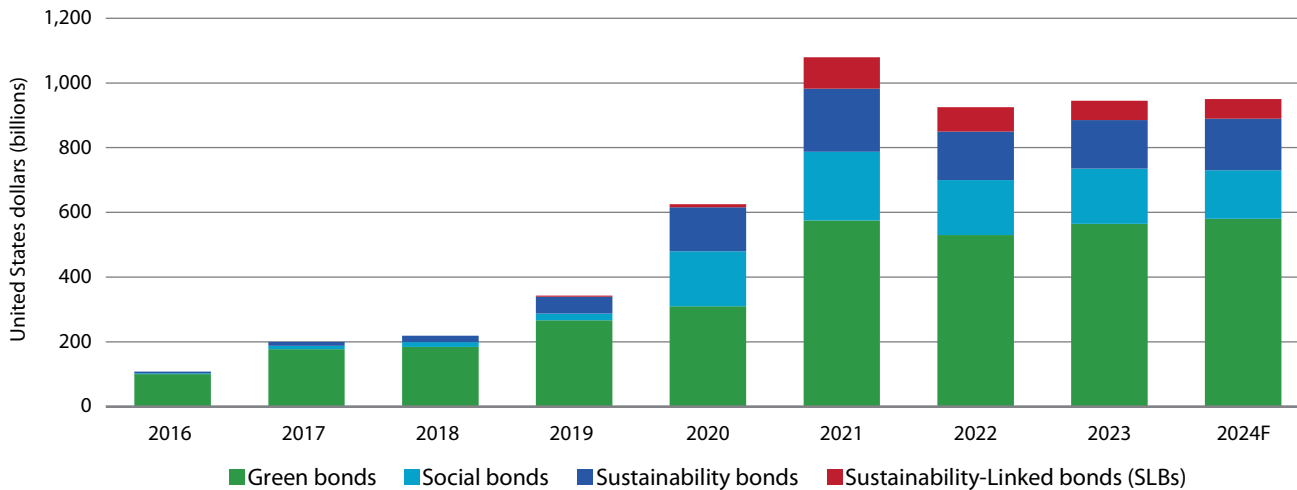
A fragmented data landscape increases greenwashing risks, further jeopardizing the accurate identification of sustainable investments. Greenwashing refers to misrepresenting the sustainability profile of an entity or product through omissions, unsubstantiated claims, inconsistency, or exaggeration.^{77,78} It can be carried out by both investors and investee companies, and has become an important concern for all market participants, undermining their confidence in the sustainable investment industry.⁷⁹ Authorities are starting to adjust regulatory and supervisory mandates in response to data and greenwashing challenges (see section 4.2.4).

Figure III.B.16
Sustainable investing assets by strategy, 2016–2022
(Billions of United States dollars)



Source: Global Sustainable Investment Alliance (GSIA).
Note: The sum of assets across each strategy does not equal the total assets. A change in methodology during 2022 makes comparison across report periods challenging. European data for the use of each strategy was not available in 2022.

Figure III.B.17
Annual global sustainable bond issuance (GSSS) by label, 2016–2024
(Billions of United States dollars)



Source: Moody's Investors Service, Environmental Finance Data and Dealogic.
Note: 2024F represents the full-year sustainable bond issuance forecast.

Lack of standardization

The rapid evolution of sustainable finance has given rise to a multifaceted system of norms and standards. The field predominantly evolved from the bottom-up, with market practitioners shaping industry rules based on international organizations’ foundational principles. An array of principles, standards, frameworks and ratings emerged (see figure III.B.18). While instrumental to the field’s development phase, this multifaceted normative landscape has eventually also caused confusion within the field and contributed to a fragmented information infrastructure. Harmonization efforts are ongoing (see section 4.2.4).

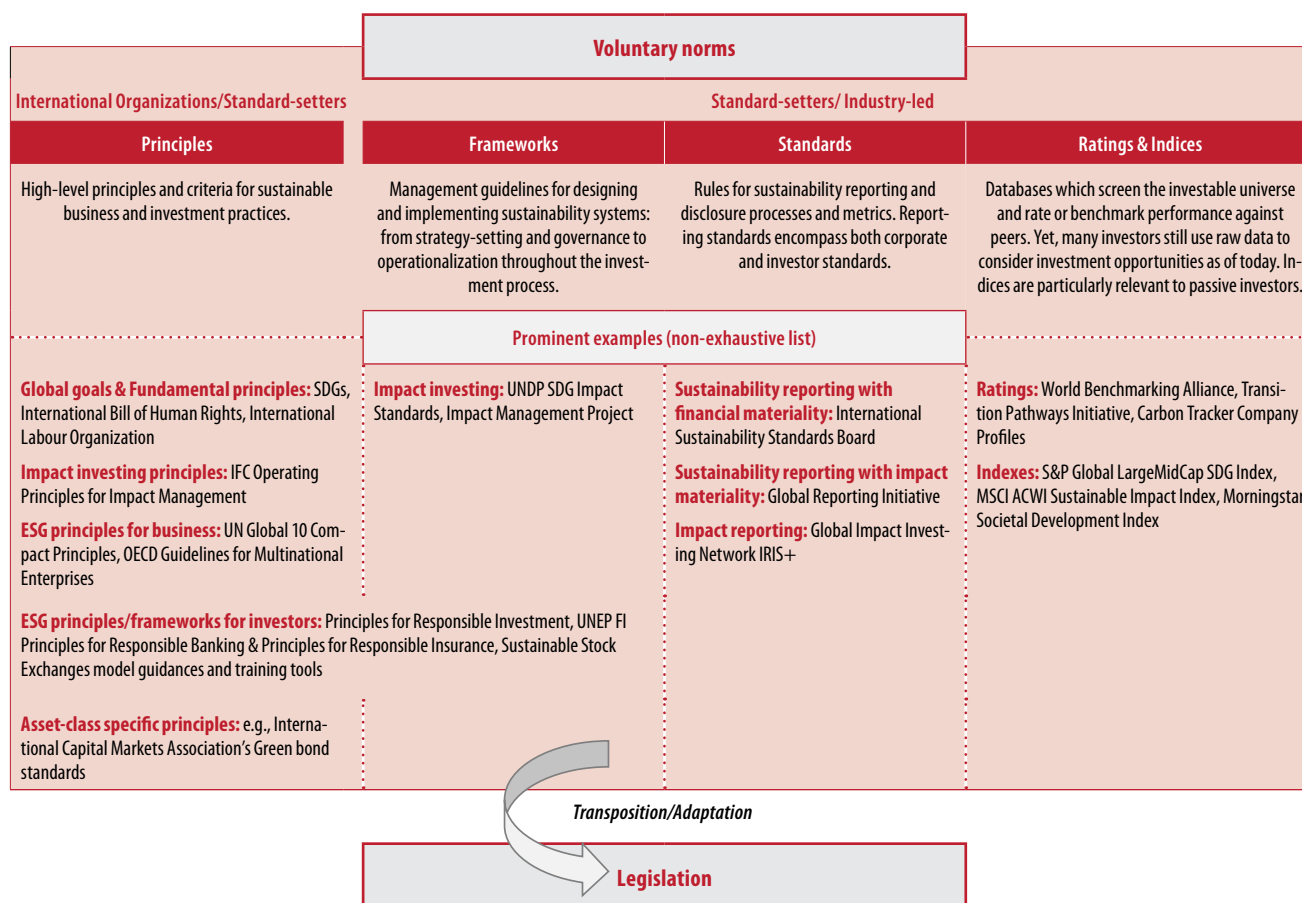
A connected challenge lies in the lack of clearly defined terminologies, including with the debated “ESG” concept. Various investing approaches fall under the umbrella term of “sustainable investing” (see box III.B.3), leading to the use, and often misuse, of different terms. Moreover, confusion arises within the sub-set of ESG investing itself. First, ESG is often equated with environmental topics only. Moreover, critics argue that the scope of issues under the ESG umbrella remains too broad, with a high and varying number of topics under each pillar (i.e., the environmental, social and governance pillars), resulting in a loss of clarity and strategic focus. The process of consolidating and refining definitions has started, including through investment taxonomies (see section 4.2.4).

Flawed ESG ratings

Thus far ESG ratings have not been able to bridge information gaps, nor to contribute to lengthening the time horizons of investment benchmarks. ESG and SDG indices, along with sustainability-inclusive credit ratings, have a role to play in supporting access to reliable sustainability conclusions, key to guiding investment decisions, particularly in the absence of audited sustainability reports. Additionally, sustainability-aligned benchmarks can contribute to lengthening investors’ time horizons and performance incentives, by providing benchmarks with similar longer-term oriented strategies. However, these ratings face legitimacy issues, with ESG/SDG scores showing low correlation among providers at less than 60 per cent, compared to 99 per cent for financial ratings.⁸⁰ Moreover, there are methodological challenges and transparency gaps in the underlying information (e.g., relating to estimates) and aggregation criteria. This is particularly evident in SDG ratings, which may oversimplify companies’ positive contributions by linking entire sectors to certain positive or negative impacts, neglecting the specifics of a company’s activities within that sector. Concerns about potential conflicts of interest have also been brought forward, as a few major players dominate both the credit rating and sustainability ratings markets.⁸¹ There have been recent voluntary and regulatory efforts to

Figure III.B.18

A multifaceted system of sustainable finance norms



Source: UN DESA.

tackle these outstanding issues, including a Code of Conduct launched in December 2023⁸² and regulatory action in several countries, following the International Organization of Securities Commissions' (IOSCO) recommendations (see table III.B.2 in section 4.2.4).

Political polarization

The field has become increasingly politicized amid an ESG backlash. This is manifesting in scepticism, in some jurisdictions, regarding ESG integration, objections to evolving perceptions of fiduciary duty, and other more opportunistic factors and ideologies.⁸³ The increasing noise surrounding the field also underscores its rise to prominence into the mainstream discourse. According to a recent survey,⁸⁴ the financial services and insurance industries have been most targeted by the backlash, with some financial institutions facing legal action for upholding ESG criteria. This has caused a visible shift in discourse, although it is still too early to assess long-lasting effects on sustainability programmes. In 2023, 30 per cent of asset managers removed references to "ESG" or "net zero" from their marketing materials and websites in the United States.⁸⁵ Only 61 S&P 500 companies mentioned ESG in earning calls, a 60 per cent decline from 2021.⁸⁶

Systemic barriers

Systemic factors continue to favour traditional investment strategies and limit the scale of sustainable investing. Costs of capital continue to favour traditional investments, as they do not yet systematically reflect long-term sustainability risks. This is especially the case for investments with shorter holding periods. Since 2010, the borrowing costs for bonds for oil and gas firms in the United States and Europe have closely mirrored those for other debt issuers, with no premium.⁸⁷ Conversely, an analysis of euro-area credit registers indicates that banks applied higher interest rates to firms with higher carbon emissions during the period from 2018 to 2022.⁸⁸ This could be attributed at least in part to the longer loan terms for bank credits. Indeed, an analysis of the world's largest public institutional investors revealed that more than half these asset owners consider the material impacts of sustainability issues, such as climate change, a determining factor in their investment strategies and portfolio selection.⁸⁹ Extending investors' time horizons is thus imperative to align their objectives with long-term sustainable development trends. This is one of the focus areas of work of the Global Investors for Sustainable Development (GISD) Alliance, whose efforts will contribute to the preparations for the Fourth International Conference on Finance for Development.

4.2.4 Maturation

Sustainable finance is showing signs of maturation. Despite the varying pace of change across regions and industries, several consistent trends are emerging:

- a. **The streamlining and refinement of voluntary standards.** Standard-setters have started the consolidation and refinement of voluntary disclosure standards and management frameworks;
- b. **The adoption of national and regional legislation.** A burgeoning body of sustainable finance legislation is addressing issues related to the sustainable finance information infrastructure and broader investor duties.

However, persistent challenges remain in aligning finance with global sustainability goals, requiring collaborative efforts among countries and continued public-private cooperation. The upcoming Fourth International Conference on Financing for Development offers a timely platform for Member States to continue collaborating towards (i) widespread adoption and coordination of sustainable finance legislation to allow for interoperability and prevent fragmentation, while taking into account regional and local specificities; (ii) mandatory disclosure standards with a double materiality vision at national level; (iii) facilitation of impact investing at scale; and (iv) adoption of a more systemic whole-of-government approach that makes sustainable finance policy part of a broader set of economic and financial policies that align all financial flows to national and international sustainability goals.

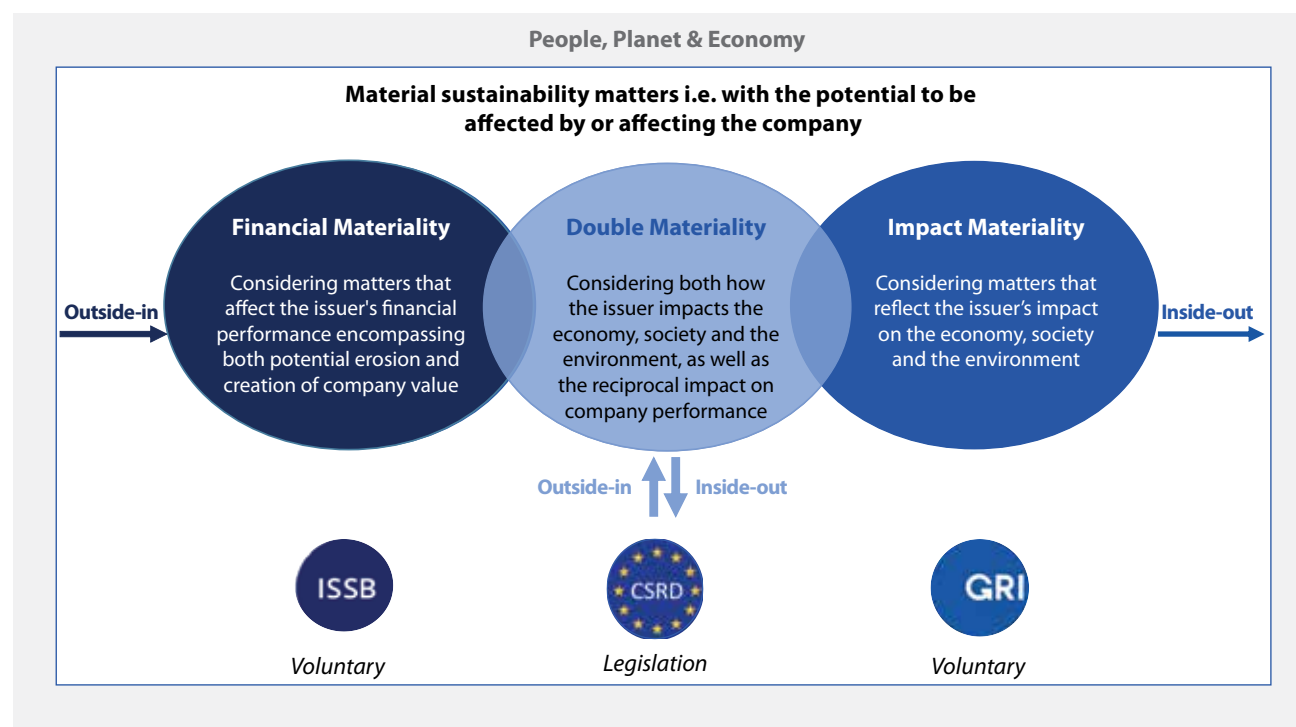
Consolidating and clarifying voluntary standards

An early signal of market maturation has been progress around the consolidation of disclosure standards for a stronger ESG data infrastructure. Leading these efforts are two primary standard-setters: the Global Reporting Initiative (GRI), established to foster more corporate accountability in 1997 (a few years after the public outcry post-Exxon Valdez oil spill), and the International Sustainability Standards Board (ISSB), founded in 2021 in response to investor-focused reporting needs identified at the United Nations Framework Convention on Climate Change Conference of the Parties (COP) 26. The ISSB has so far consolidated five major reporting standards, including: the Task Force on Climate-Related Financial Disclosures, the Climate Disclosure Standards Board, which included the Carbon Disclosure Project, as well as the Value Reporting Foundation which housed the Sustainability Accounting Standards Board and the International Integrated Reporting Framework. The ISSB's inaugural standards on sustainability-related financial disclosures (S1) and climate-related financial disclosures (S2) were published in June 2023 and endorsed by IOSCO thereafter.

Differing materiality visions should eventually converge into a double materiality approach, ensuring short-term interoperability. Operating under the umbrella of the International Financial Reporting Standards (IFRS) Foundation, which also houses the International Accounting Standards Board (IASB), ISSB supports financial (or single) materiality for investor decision-making. This approach adopts an "inward" vision, prioritizing sustainability issues that affect entities' cash flow and value. On the other hand, GRI focuses on impact materiality from an "outward" perspective, prioritizing matters that have an impact on the economy, society and the environment, thereby catering to a wider range of stakeholders (figure III.B.19). A third perspective, double materiality, integrates both perspectives, in a two-pillar structure with equal footing. This perspective was endorsed by EFRAG for its European Sustainability Reporting Standards in 2023, as well as by China's three major stock markets in early 2024.⁹⁰ Given the coexistence of single, impact, and double materiality approaches, interoperability is crucial in the short term, to facilitate international investors' reporting. ISSB and GRI have made significant progress through a Memorandum of Understanding, referencing GRI in ISSB standards and developing targeted interoperability guidance, including for greenhouse gas emissions reporting.⁹¹

Assurance standards are a key component of reporting standards, as mechanisms for auditing disclosures are essential to ensure

Figure III.B.19
Materiality visions



Source: UN DESA.

data reliability and comparability. IOSCO has begun work to coordinate and promote global consistency for sustainability assurance standards. In 2022, IOSCO started the process of assessing whether the existing sustainability assurance ecosystem is fit for purpose or whether further enhancements, including through standard setting, will be required. IOSCO has engaged key stakeholder groups, including the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants. The IAASB is currently developing a standard for assurance on sustainability reporting, with plans to publish it before the end of 2024.⁹² The assurance standard will allow to verify sustainability information prepared under different reporting standards, including those of the ISSB. As jurisdictions transpose voluntary standards to national legislation, they can also opt to tailor assurance requirements to their specific legislative provisions, such as was done by the European Union for its Corporate Sustainability Reporting Directive.

Diverse initiatives have also emerged to strengthen and deepen the field's data information architecture. Guidance from international organizations has emerged to help investors navigate the landscape of voluntary standards, including studies⁹³ and a wide range of databases (see, for example, the United Nations Global Sustainable Finance Observatory⁹⁴ and the Global Economic Monitor⁹⁵).

Beyond data, clarification is also underway for management frameworks, but persistent fragmentation highlights the need for consolidation. While reporting standards have been a focal point in sustainable finance discussions, they constitute just one element of investors' sustainability management toolkit. Management frameworks

provide wider comprehensive guidance for designing and implementing sustainability systems, encompassing aspects from strategy-setting and governance to operationalization throughout the investment process. They are necessary to ensure that disclosure is coupled with actual management of sustainability impact, as studies have shown that disclosure alone is not sufficient to influence lending.⁹⁶ In the impact space for example, management frameworks have been used to translate and operationalize the SDGs for private actors. As of today, the SDGs are used by 75 per cent of impact investors as a baseline framework.⁹⁷ However, this translation process has led to a proliferation of impact management frameworks and lack of harmonization. As a result, industry-led groups like the Impact Management Platform and the GISD Alliance have worked to enhance clarity with a System Map⁹⁸ and an SDG Navigator,⁹⁹ respectively, which summarize and categorize available resources. Despite strides in transparency, fragmentation endures, highlighting the need for consolidation akin to the approach taken with reporting standards. Early indications of consolidation have included, for example, the announcement by the GIIN that it would host the IFC Operating Principles for Impact Management from 2022.¹⁰⁰

Accelerating the adoption and harmonization of sustainable finance legislation

Sustainable finance is increasingly embedded in regulatory and legislative frameworks. Countries are strengthening the financial sector's role in advancing sustainable development. Several databases have emerged to record progress made.^{101,102} As of July 2023, the

Green Finance Measures Database registered over 780 sustainable finance policy measures in 109 countries, a 70 per cent increase since 2015.¹⁰³ Taxonomies and disclosure legislation have been at the heart of legislative efforts, with at least 30 taxonomies and 200 frameworks, standards and guidelines on sustainability and climate disclosures in place across 40 countries. By setting out clear and transparent criteria for sustainable economic activities, sustainable finance regulatory frameworks can enable the development of a reliable and credible market for allocating capital to the sustainability transition. Table III.B.2 provides examples of sustainable finance legislation along four main categories: alignment definitions (e.g. taxonomies), data availability and reliability (e.g. disclosure legislation, investment product labels, greenwashing), data comparability (e.g. regulating ESG ratings), as well as investor duties (e.g. stewardship-related legislation). Such sustainable finance policy tools are to be complemented by wider national strategies or frameworks mainstreaming sustainability considerations, as well as other sector-specific and product-specific measures.

The growing regionalization of sustainable finance legislation already reveals disparities and fragmentation across jurisdictions, highlighting the need for global interoperability. Sustainable finance legislation is being tailored to regional priorities, as seen by the different taxonomies adopted by the European Union, Latin America and

the Asia-Pacific region, each emphasizing different social or environmental aspects reflecting the regions’ unique local contexts. While this regionalization is legitimate and important, without effective coordination it risks causing fragmentation and high compliance burdens for investors, which would reverse progress made on the consolidation of standards. In fact, this could potentially go as far as leading investors to underestimate the sustainability credentials of funds (IOSCO is already warning of emerging “green muting” and “green bleaching” practices).¹⁰⁴ This emphasizes the necessity for, at minimum, global collaboration towards interoperability, while simultaneously exploring a global foundational framework which would leave room for regional adaptation. For example, a global taxonomy could link all industry activities to a global framework such as the SDGs, helping regions to coordinate their own visions across regional taxonomies. There is already a growing focus on the harmonization and interoperability of regulations across jurisdictions to accelerate sustainable finance flows.

With uneven progress across regions, promoting universal coverage requires addressing several challenges. As of now, the majority of sustainable finance legislation is being adopted in developed economies (62 per cent of 109 countries).¹⁰⁵ Successful implementation of sustainable finance legislation requires bolstering institutional means, legal frameworks and capital markets through enhanced capacity building support and technical guidance. The United Nations Global Sustainable

Table III.B.2
Sustainable finance legislation—Key policy categories & prominent examples

Legislation	Description	Prominent examples
Category 1: Alignment		
Taxonomies	Classification systems for sustainable economic activities, defining alignment criteria based on shared sustainability goals	<p><i>Green taxonomies</i></p> <ul style="list-style-type: none"> European Union Green Taxonomy Colombia Green Taxonomy <p><i>Social taxonomies</i></p> <ul style="list-style-type: none"> Georgia Sustainable Finance Taxonomy <p><i>Transition taxonomies (with traffic light system)</i></p> <ul style="list-style-type: none"> Singapore Green & Transition Taxonomy <p><i>SDG taxonomies</i></p> <ul style="list-style-type: none"> China Technical Report on SDG Finance Taxonomy
Category 2: Data availability		
Disclosure legislation	Corporate and investor sustainability disclosure requirements, including mandatory assurance provisions	<ul style="list-style-type: none"> Countries accounting for nearly half of the world’s GDP have either passed or proposed sustainability-related disclosure legislation, with many jurisdictions contemplating ISSB adoption A prominent example is the European Union Corporate Sustainability Reporting Directive (CSRD) and its European Sustainability Reporting Standards (ESRS)
Category 3: Data & Product Reliability and Comparability		
Greenwashing and conduct-related	Financial and consumer product classifications (e.g. regulating fund classification systems, regulating eco-labels)	<ul style="list-style-type: none"> United Kingdom Financial Conduct Authority (FCA) Sustainability Disclosure Requirements (SDR) Switzerland’s Federal Department of Finance (FDF) sustainable investment labelling rules European Union Sustainable Finance Disclosure Regulation (SFDR) and European Union Proposed Directive on Green claims (consumer products)
ESG rating legislation	Regulating ESG service providers’ methods and transparency	<ul style="list-style-type: none"> Regulatory action emerging in different countries including Japan, Hong Kong as well as the European Union
Category 4: Investor duties		
Stewardship-related legislation	Outlining good practice for investor engagement with companies and related issues, such as proxy voting	<ul style="list-style-type: none"> United Kingdom Stewardship Code European Union Shareholder Rights Directive II (2017/828/EU)

Source: UN DESA.

Finance Observatory informs capacity-building efforts on sustainability disclosure, taxonomies, carbon pricing, as well as sector and product specific measures. Stock exchanges can also play an important role in helping markets navigate new ESG requirements. The number of exchanges that have ESG disclosure guidance, mandatory ESG reporting, ESG training, and related bond and equity offerings has increased in the past few years. Moreover, support from development cooperation providers is needed to build capacity in developing countries to access sustainable finance, including the use of innovative instruments, such as insurance and investment based on results, which mitigate risk and attract external resources aligned with the SDGs without increasing debt distress. Strengthening the climate information architecture and aligning the practices and products of financial and information intermediaries can contribute to scaling up blended finance for climate mitigation and adaptation in developing countries (e.g., see the Network for Greening the Financial System's Technical Document on Scaling up Blended Finance for Climate Mitigation and Adaptation in Emerging Markets and Developing Economies¹⁰⁶).

Legislative efforts should incentivize impact across asset classes in line with Agenda 2030 and global climate goals, while being carefully crafted to avoid distortions. Only 14 per cent of impact investors have perceived progress in government support over the last decade.¹⁰⁷ A global taxonomy linking global industry activities to the SDGs could be the first step towards improving the identification of SDG-aligned investments, supported by policies financially incentivizing them. These include: (i) developing the supply of capital, such as through risk-sharing mechanisms, adjusted market costs and improved transaction efficiency or guarantees; and (ii) developing pipelines and the capacity of capital recipients. To address current funding gaps, a specific focus could be placed on channelling impact funds towards underfunded sectors, particularly those requiring private investment to complement public funds (e.g., climate adaptation and disaster risk reduction activities). Nevertheless, such incentives should be carefully crafted to avoid distortions and stability risks for the global financial system.

New disclosure legislation should aim to facilitate the measurement of the private sector's progress towards impact and climate goals by adopting an impact or double materiality perspective.

Countries accounting for nearly half of the global GDP are adopting disclosure legislation, with many having already pledged the transposition of ISSB standards. Jurisdictions already contemplating ISSB adoption can leverage current progress while integrating additional provisions for a double materiality vision. This should not be misconstrued as imposing additional burdens on investors, but rather as aligning with the objective of preventing fragmentation across jurisdictions and reducing investor confusion, which in turn decreases transaction costs and high compliance burdens (i.e. preventing global investors from having to prepare different sustainability reports to comply with varying financial and double materiality requirements across jurisdictions). Additionally, the double materiality approach mitigates medium to long-term transition risks for policymakers and investors. It will seamlessly align with transition-aligned legislation, which will progressively demand increased accountability from companies regarding their externalities and contributions to global climate goals.

Beyond policies focused on improving or widening the field, sustainable finance must become integrated into broader efforts to achieve sustainable transformations. Regulatory frameworks need to consider the roles of actors across the financial system, including pension funds, insurers, and banks, to align financial flows with national, regional or global sustainability objectives. Sustainable finance policy must be seen as part of a whole-of-government approach and a wider set of economic and financial policies that together create enabling conditions for sustainable transformations. Sustainable finance policy reform has already moved from a siloed approach led by environmental ministries to a key consideration for financial policymakers. This includes the consideration of the interplay between sustainability and financial stability (see also chapter III.F), for instance through climate transition plans (see, for example, the recommendations of the Network for Greening the Financial System on transition plans for banks¹⁰⁸ or the Glasgow Financial Alliance for Net Zero Financial Institution Net-Zero Transition Plans' report¹⁰⁹). It also includes broader fiscal and regulatory policies to create the "right" (sustainability-aligned) incentives for real economy actors, and financial sector and macroeconomic policies supportive of sustainable transformations which create investment opportunities for sustainable finance at scale.

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