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Financing for development: Issues in domestic public resource mobilization and international development cooperation

Note by the UNCTAD secretariat

Executive summary

This note summarizes core issues in the areas of domestic public resource mobilization and international development cooperation, as discussed in the Addis Ababa Action Agenda of the third International Conference on Financing for Development.

In action area II.A of the Agenda, on domestic public resources, core concerns relate to domestic taxation regimes and fiscal policy space, to the role of national and subregional development banks, to the mitigation of illicit financial flows from developing countries and to international tax cooperation. This note provides overviews of the main challenges that developing countries face in these areas.

In action area II.C of the Agenda, on international development cooperation, core issues are the role of official development assistance and the strategic use of international public finance to catalyse other sources of development, including private capital flows. This note summarizes recent discussions on the modernization of official development assistance and the role of blended finance for resource mobilization to achieve the Sustainable Development Goals. In addition, the note considers the role of new multilateral development banks, as well as the concern over stagnation tendencies and developmental reversals in many middle-income economies, whose special requirements may require further attention in the international community.

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I. Introduction

1. At the fourteenth session of the United Nations Conference on Trade and Development, member States agreed that, in line with the structure of the intergovernmental machinery as laid out in the Accra Accord, the Trade and Development Board would operationalize the creation of two intergovernmental groups of experts and that the topics to be considered would include, inter alia, electronic commerce and the digital economy and financing for development, as reflected in the Addis Ababa Action Agenda and within the work of UNCTAD.[1]

2. At its thirty-first special session on 5 April 2017, the Trade and Development Board adopted the terms of reference for the Intergovernmental Group of Experts on Financing for Development, according to which the discussion topics and guiding questions for the first session are as follows:[2]

(a) Domestic public resources: What can be done to enhance the mobilization of domestic public resources for development in developing countries?

(b) International development cooperation: How can international development cooperation maximize its contribution to achieving the Sustainable Development Goals?

3. This note summarizes core challenges faced by developing countries and the international community in these areas, in line with their discussion and specific emphases in the Addis Ababa Action Agenda.[3] The discussion topic and guiding question in (a) correspond to action area II.A, and those in (b) correspond to action area II.C.

II. Domestic public resources

4. Action area II.A discusses a range of challenges and potential measures for improvement with regard to revenue and expenditure in domestic taxation regimes (paragraphs 22, 26, 30, 32 and 34). In addition, the role of national and subregional development banks in mobilizing domestic public resources is noted, and illicit financial flows and international tax cooperation are addressed (paragraphs 33, 24 and 25 and 28 and 29, respectively).

5. Strengthening domestic public resource mobilization is crucial for Governments in financing national sustainable development strategies and implementing Agenda 2030 for Sustainable Development and the Addis Ababa Action Agenda. The particular role of fiscal revenues in public resource mobilization lies in their greater stability and predictability compared to other sources of long-term finance. As noted in the Addis Ababa Action Agenda, economic growth is the main determinant of fiscal revenue (paragraph 20). An enabling macroeconomic policy stance, including appropriate countercyclical fiscal policies, plays an important growth-enhancing role at the national level.

6. In many developing countries, however, growth is strongly affected by the rate of expansion of the global economy. Rapidly expanding global demand generally provides opportunities for developing country firms to earn revenue from exports that, depending on national tax regimes, translates into tax payments and other public revenue. However, a number of additional elements determine the fiscal space – the ability of Governments to use fiscal instruments to pursue various economic, development and social policy objectives – that such revenue provides. The quantitative or budgetary dimension of fiscal space can be approximated by the share of public revenue in gross domestic product, yet this should not be seen as reflecting fiscal balance, as Governments may sustainably debt-finance some expenditure, if the rate of interest on debt incurred does not exceed the rate of growth. In addition, a stable or falling ratio of debt to gross domestic product must be considered with regard to the market risks attached to the types and compositions of

[1] TD/519/Add.2.
[2] TD/B(S-XXXI)/2.
[3] A/RES/69/313.

government or sovereign debt. The qualitative dimension of fiscal space relates to the composition of public revenue and expenditure, given their distributive implications and role in generating incentives for particular components of demand and supply. Finally, fiscal space is dynamic; not only do higher levels of public spending tend to boost growth and thereby government revenue, but more developed countries have greater revenue collection capacities and therefore tend to have greater fiscal space.

A. Domestic taxation and fiscal policies

7. The efficient management of domestic public finances requires the implementation of measures that affect both public revenue and expenditure. This process involves the identification of available domestic resources and their mobilization, budgeting and efficient use. The development of a framework to address these different aspects requires recognizing that many of the obstacles faced by public administrations in developing countries result from structural conditions and related developmental challenges. For example, high wealth concentration and levels of income inequality are often associated with political capture and weak law enforcement, limiting the capacity of a State to implement progressive tax reforms aimed at mobilizing domestic resources. Similarly, dependence on the extraction of natural resources can translate into an unpredictable and volatile public revenue structure, constraining the ability of a State to plan and sustain levels of investment consistent with long-term development goals. Large informal sectors add an additional layer of complexity by simultaneously reducing tax compliance and undermining the capacity to develop an effective social safety net.

8. Measures to strengthen the management of public finances and, consequently, domestic public resource mobilization, need to acknowledge these different and often structural challenges. Crucial to the success and effectiveness of fiscal reforms in most developing countries is recognition that the development of administrative and institutional capacities at the national level is a complex and lengthy process, the benefits of which take time to materialize. Building such capacities requires a persistent high level of investment and the transfer and adaptation of expertise. In many instances, developing countries may lack the resources and political stability required to build such capacities, requiring a coordinated effort in the international community to help provide the necessary human and financial resources, with a view to supporting measures that can improve the overall regulatory framework for the management of public finances and domestic public resource mobilization. This includes the expansion and strengthening of tax collection and budgeting agencies, in addition to the provision of training and the sharing of international expertise.

9. Measures that support the development of medium-term fiscal frameworks are of similar importance, and consist of analytical tools that provide policymakers with valuable information on the different short and medium-term trade-offs for developing countries with regard to their economic, social and political capacities to mobilize domestic public resources for development. They constitute a key building block for the establishment of revenue and expenditure strategies consistent with national development goals.

10. Furthermore, fiscal reform plans and their implementation must ensure that the mobilization and use of domestic resources is inclusive and transparent, and that the relevant agencies are accountable to the public. Placing such features at the forefront of the design of public fiscal policies helps develop a dynamic relationship of trust and cooperation between citizens and the State. This is a basic prerequisite for the establishment of a culture of tax compliance and collection that underpins successful efforts to mobilize domestic public resources in the longer term.

11. Beyond such broader considerations, more specific measures can help to improve fiscal policy frameworks and their ability to effectively mobilize domestic public resources in terms of both revenue and expenditure.

12. With regard to revenue, while economic growth is the main source of domestic resources, robust yet flexible mechanisms to boost public revenue are vital, such as the development of a broad and progressive tax structure that provides a basic level of revenue throughout an economic cycle. There is no one-size-fits-all model but there is increasing evidence that countries with a tax revenue of below 15 per cent of gross domestic product

have difficulty in funding basic public services and functions, yet tax revenues in around half of the least developed countries remain below this threshold.[4] Stronger public institutions are instrumental in ensuring tax enforcement and deterring fraud and evasion. In addition, the revision of domestic tax codes can help to boost tax compliance and collection. Reforms should aim to balance the capacity to raise revenue in the short term, through measures such as the modification of indirect tax rates, with the setting of medium-term revenue goals, through the establishment of a progressive structure of direct taxes. Supported by national dialogue, such a gradual approach to tax reform can help ensure fairness and the proper reflection of domestic priorities. Further measures are required to address informality, including significant improvements in the efficiency of tax registration and collection. Informality may be the result of structural conditions, such as low rates of profitability and capital constraints, yet lowering the costs of registration and compliance can play an important role in facilitating the transition of small and medium-sized enterprises to the formal sector. Finally, specific attention should be paid to the domestic public control of natural resource rents in developing countries. Many resource-rich developing countries are starting to revise the regulatory and legislative taxation frameworks that apply to multinational enterprises specializing in primary commodity extraction, and evidence suggests that tax benefits granted in the past have exceeded reasonable limits.[5] Authorities in developing countries should therefore explore available mechanisms to improve State participation in the revenue arising from the extraction of primary commodities.

13. With regard to expenditure, authorities should develop a clear overview of competing priorities. Public expenditure structures in developing countries are often characterized by a high degree of inflexibility, reflecting the fact that a substantial share of public expenditure is directed to current expenditure, as well as the often large fluctuations arising from high volatility in an economic cycle. In this context, developing country capacity to introduce drastic changes in the management of public finances aimed at supporting a process of structural transformation is limited. As with tax revenue, it is important to aim at a gradual process of transformation that considers domestic preferences. A transparent process for the appropriation, procurement and provision of public goods and services is central to the relationship of trust and cooperation between citizens and the State and the establishment of a culture of tax compliance and collection. In addition, developing country authorities should identify suitable levels of expenditure and investment in critical areas, including social protection floors. Developing countries highly dependent on revenue from primary commodity exports are particularly susceptible to procyclical fiscal policies, which may lead them to reduce social expenditure in times of negative external shocks to commodity prices. Developing effective social protection floors requires the establishment of mechanisms that allow countries to preserve levels of expenditure in key social areas throughout an economic cycle while creating additional tools to act as a countercyclical safety net. This process should be accompanied by spending reviews, which can help expand the fiscal space available for social protection and for achieving the Sustainable Development Goals.

B. National and subregional development banks

14. National development banks can play a leading role in the mobilization of domestic public resources for sustainable development, generally by filling financing gaps left by private sector institutions, whose financing is often directed towards commercial activities. The main gap is usually insufficient financing for economic transformation, which involves large-scale projects with long maturation periods that require long-term finance and involves risks that private banks are often unwilling to take. However, many large-scale

[4] V Gaspar, L Jaramillo and P Wingender, 2016, Political institutions, State building and tax capacity: Crossing the tipping point, International Monetary Fund Working Paper 16/233; Inter-Agency Task Force on Financing for Development, 2017, *Financing for Development: Progress and Prospects* (United Nations publication, Sales No. E.17.I.5, New York).

[5] E/C.18/2010/CRP.13.

projects generate positive externalities with social returns that exceed private returns. Such externalities are pivotal to dynamic growth and structural transformation.

15. In contrast to private financial institutions that rely on short-term sources of funding, national development banks have a liability structure that is designed and often mandated to provide financing for long-term investment, including in infrastructure projects, capital-intensive industries and strategic sectors. In addition, such banks provide both lending and equity participation, thereby having an interest in the close monitoring of projects, which facilitates relationship banking with borrowing firms. Such banks also have in-house technical expertise that allows them to contribute to technical and operational decision-making to improve the quality of projects, and they can help raise capital elsewhere by underwriting the issuance of equity securities and/or attracting other lenders through co-financing arrangements or the provision of guarantees.

16. For these reasons, national development banks have become valuable multifunctional policy tools in addressing market failures and growth bottlenecks, as part of overall national development strategies. As such strategies evolve, national development banks have the ability to adapt to the changing priorities associated with rapid structural transformation.[6] Crucially, such banks can play a countercyclical policy role, to help sustain overall investment levels and protect the productive structure of a country during economic downturns. Protecting existing industries is important in facilitating a more rapid and sustained recovery, while ensuring that the productive capacities of an economy are not denuded by sudden distant external shocks.

17. National development banks tend to be fully owned by the State, but can also have minority and majority private sector shareholders.[7] There are over 250 such banks currently in operation, mainly in Asia, followed by Latin America and the Caribbean, Africa, the Middle East and Europe and North America and, according to some estimates, in 2015, five banks in Brazil, China, Germany, India and South Africa accounted for three fifths of total national development bank assets in the global economy.[8] The funding structures of such banks can be diverse and take different forms; the exact mix is critical in determining sources of funding and the extent to which a bank can deviate from commercial considerations in pursuit of policy objectives.

18. The global financial crisis in 2008 brought national development banks back onto the policy agenda, as countries sought sources of long-term financing to stimulate economic recoveries, and there is greater international acceptance of such banks. However, poorer and smaller developing countries may face greater obstacles in setting up such banks, due to funding and technical constraints, and would therefore benefit from concerted regional efforts to set up subregional development banks and/or enhance existing subregional development banks as a way to pool resources and share financing needs.

19. For example, in Latin America and the Caribbean, such banks have successfully supported the strengthening of the national productive sectors of members, in particular the development of value-added products and services, as well as job creation and the promotion of access to social services. In contrast, in Africa, such banks have a limited capacity to provide financing for large development-oriented projects on a scale that meets the needs of respective subregions.[9] This may be explained by their small capital base and the fact that most shareholders are the borrowing countries themselves and have limited financial resources. The creation of subregional development banks can potentially help support economic development, yet ensuring that the factors constraining the lending

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[6] J Hermann, 2010, Development banks in the financial liberalization era: The case of BNDES [National Bank for Economic and Social Development] in Brazil, *CEPAL [Economic Commission for Latin America and the Caribbean] Review*, 100:189–204.

[7] J de Luna-Martinez and CL Vicente, 2012, Global survey of development banks, World Bank Policy Research Working Paper No. 5969.

[8] R Studart and KP Gallagher, 2016, Infrastructure for sustainable development: The role of national development banks, Global Economic Governance Initiative Policy Brief No. 7.

[9] UNCTAD, 2016a, *Trade and Development Report, 2016: Structural Transformation for Inclusive and Sustained Growth* (United Nations publication, Sales No.E.16.II.D.5, New York and Geneva).

capacity of such banks are addressed is therefore an important challenge, including governance structures, to help mitigate risks related to greater lending capacity, in particular in financing large-scale projects vital for further structural change in the developing world.

C. Illicit financial flows from developing countries

20. Illicit financial flows involve resources that have been obtained, transferred or used illegally or illicitly. A common concern with regard to illicit financial flows from developing countries is the identification of flows considered potentially damaging to economic development. In developing economies, vital development resources are being lost "because of the ease with which capital flight can flourish in the context of a burgeoning yet opaque international financial system [and] closely related to this is the idea that illicit capital flows from developing economies are indicative of deeper structural problems of political governance in these countries".[10] Concerns over illicit financial flows therefore reflect a range of relevant policy concerns, yet underlying analytical frameworks and empirical methodologies continue to be the subject of debate. Illicit financial flows need not be illegal if relevant legal frameworks do not adequately reflect wider public social and economic interests or do not cover such flows. The High-level Panel on Illicit Financial Flows from Africa states that "the various means by which illicit financial flows take place in Africa include abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using unequal contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange".[11] Tax evasion is illegal and tax avoidance is not, but is considered under illicit financial flows.

21. While there is no agreed definition of illicit financial flows, they are generally grouped into three categories, which are not mutually exclusive or comprehensive, namely flows originating from transnational criminal activity, corruption-related flows and tax-related flows. Empirical estimates suggest that, among these three categories, about one third of total illicit financial flows represent criminal money related to drugs, racketeering and terrorism, and resources emanating from corruption account for only about three per cent of the total, while cross-border tax-related transactions account for the remaining two thirds of total flows, about half of which correspond to transfer pricing through multinational corporations.[12] However, outstanding definitional issues also preclude agreement on the precise measurement of illicit financial flows, in particular with regard to tax-related flows. Tax-related practices such as base erosion, profit shifting and transfer pricing constitute grey areas, given the lack of a common set of norms for international taxation and different interpretations and legal standards at the national level.[13]

22. Despite such definitional and measurement difficulties, empirical estimates provide approximate orders of magnitude and suggest that the amounts involved, and their impacts on available resources for development, are substantial. In Africa, it is estimated that countries lost about $854 billion in illicit financial flows in 1970–2008, which corresponds on average to $22 billion per year and is nearly equivalent to all official development assistance received by Africa in that period.[14] In Latin America, it is estimated that illicit financial flows reached a total of $765 billion in 2004–2013, equivalent to 1.8 per cent of regional gross domestic product on average throughout this period.[15]

[10] P Reuter, ed., 2012, *Draining Development? Controlling Flows of Illicit Funds from Developing Countries* (World Bank, Washington, D.C.).

[11] United Nations Economic Commission for Africa, 2015, Illicit financial flows: Report of the High-level Panel on Illicit Financial Flows from Africa.

[12] UNCTAD, 2014, *Trade and Development Report, 2014: Global Governance and Policy Space for Development* (United Nations publication, Sales No. E.14.II.D.4, New York and Geneva).

[13] Inter-Agency Task Force on Financing for Development, 2017.

[14] UNCTAD, 2016b, *Economic Development in Africa Report 2016: Debt Dynamics and Development Finance in Africa* (United Nations publication, Sales No. E.16.II.D.3, New York and Geneva).

[15] Economic Commission for Latin America and the Caribbean, 2017, *Flujos Financieros Ilícitos en América Latina y el Caribe* (United Nations publication, Santiago), p. 25.

23. Illicit financial flows originating in criminal activity are of concern. A large share of criminal proceeds are illicitly channelled abroad, often to safe havens, for laundering and reuse. Effectively countering illicit financial flows, within the broader context of preventing money laundering, is therefore central to fighting organized crime in most of its forms, including human trafficking, migrant smuggling, drug trafficking and several other forms. Illicit financial flows are also often instrumental to funding terrorist activities, with illegal trafficking and related proceeds in many cases directly fuelling such activities or legitimately earned proceeds being transferred illegally for this purpose. Strengthening intervention to combat illicit financial flows can therefore be considered one of the most cost-effective strategies to be pursued by the international community in the area of crime prevention and related capacity-building.

24. Tax-related illicit financial flows are also of considerable importance for developing countries, as State capacities to collect taxes have progressively eroded in recent years, despite government initiatives to strengthen taxation capacities as part of efforts to enhance domestic resource mobilization. Tax erosion undermines efforts to finance social and economic progress and support the achievement of the Sustainable Development Goals. As emphasized by the High-level Panel on Illicit Financial Flows from Africa, a major cause of such erosion has been the growing ability of multinational enterprises to avoid and/or evade taxes. At the centre of the problem has been the emergence of a highly sophisticated offshore service industry, including international banks, law firms and large accounting firms, providing professional services to assist multinational enterprises and large corporations in the design of tax planning schemes with the ultimate goal of minimizing tax payments on a consolidated basis. This can involve the transfer of funds from high to low tax jurisdictions to avoid or evade taxes in areas in which the funds originate.[16] With regard to multinational enterprises, such transfers usually take the form of intrafirm transactions between affiliates, for example through transfer pricing or the transfer of goods and services between affiliates at prices that do not reflect the true value of the underlying assets but are designed to facilitate the shifting of profits from high to low tax jurisdictions.

25. The Organization for Economic Cooperation and Development highlights that poorer countries have the most to lose from such practices, as corporate income taxes constitute a large proportion of their total revenues; in 2012, in low-income and lower middle-income countries, corporate income taxes made up nearly 16 per cent on average of total revenue, compared with less than 9 per cent on average in high-income countries.[17] Tackling base erosion and profit-shifting practices is therefore of vital importance to support improved taxation capacities in developing countries as part of the broader challenge of domestic public resource mobilization. According to the Organization for Economic Cooperation and Development, core issues faced in these countries with regard to base erosion and profit-shifting practices include excessive payments to foreign affiliated companies in the form of interest, service charges, management fees and royalties; pressure to provide tax incentives; profit shifting by firms through corporate restructuring; and the use by affiliates of sophisticated means to obtain treaty benefits. Developing countries face multiple challenges in addressing such problems, such as a lack of appropriate legislative frameworks and measures and insufficient information and capacity to implement complex rules and challenge the base erosion and profit-shifting practices of multinational enterprises.[18]

26. As is true for illicit financial flows in general, there are no precise or comprehensive global estimates of the extent of base erosion and profit-shifting practices. However, rough estimates have been made of revenue losses due to such practices. One study suggested

[16] UNCTAD, 2016a.

[17] Organization for Economic Cooperation and Development, 2014, *Report to Group of Twenty Development Working Group on the Impact of Base Erosion and Profit-Shifting in Low-Income Countries*, part 1 (Paris).

[18] Ibid.

that, globally, such losses amounted to 4–10 per cent of corporate income tax revenues,[19] corresponding to an accumulated revenue loss of $0.9 trillion−$2.1 trillion in 2005–2014. Two thirds of these losses are estimated to have been due to profit shifting and the remaining one third to mismatches between tax systems and preferential tax treatment.[20] Another study suggested that in 2013, global revenue losses due to profit shifting by multinational enterprises may have amounted to around $600 billion, taking account of the fact that the impact of profit-shifting on public revenue may be felt only after some delay.[21] Yet another study found that the proportion of profits obtained by United States of America companies, domestically or abroad, and held in tax havens rose tenfold between the early 1980s and 2013.[22] UNCTAD has estimated that developing countries lose $100 billion annually in tax revenue owed by multinational enterprises, solely due to the use of offshore hubs as an investment conduit.[23] Given the greater reliance on corporate tax revenue in developing countries, as well as weaker enforcement capabilities, it is likely that the loss of public revenue from such practices is proportionately larger in developing countries than in developed countries.

27. Notwithstanding serious limitations, national-level action in developing countries has generated concrete results. Examples include an increase in tax revenue in Kenya by $33 million in 2012–2013 following a training programme on advance transfer pricing, and transfer pricing adjustments of $110 million in Viet Nam in 2013 following an increase in audits conducted by tax authorities as part of actions to enforce national transfer pricing rules.[24] Such efforts may be insufficient, however. For example, Kenya benefited from capacity-building from the Organization for Economic Cooperation and Development, which established a transfer pricing unit of some 20 staff; the same number of people were "employed to advise on transfer pricing in one single private sector firm in Nairobi".[25]

28. Measures taken by developing countries can have an impact on addressing base erosion and profit-shifting. However, tax rules that can be administered easily and in line with developing country resources and implementation capacities are needed the most. Rather than adapting complex international rules through specialized tools and toolkits, efforts should be dedicated to developing simpler and clearer rules that may be more suitable to increasing taxation capacities in developing and developed countries. In addition, the increased participation of developing countries in the design of international standards and rules to reduce tax erosion from base erosion and profit-shifting and other practices is important to support their efforts to counter tax erosion.

D. International tax cooperation

29. The combating of illicit financial flows has been a core driver of international tax cooperation in recent years. In general, international tax cooperation assumes particular importance in a world of hyperglobalization, in which tax systems in some countries can affect public revenue collection in other countries. Such cross-national effects can result from tax evasion, for example if high net worth individuals place financial assets in tax havens, as well as from illicit financial flows arising from the creative accounting or transfer pricing practices of multinational enterprises.

[19] Organization for Economic Cooperation and Development, 2015, *Measuring and Monitoring Base Erosion and Profit-Shifting: Action 11 – 2015 Final Report* (Paris).

[20] Ibid.

[21] E Crivelli, R De Mooij and M Keen, 2015, Base erosion, profit shifting and developing countries, International Monetary Fund Working Paper 15/118.

[22] G Zucman, 2014, Taxing across borders: Tracking personal wealth and corporate profits, *Journal of Economic Perspectives*, 28(4):121–148.

[23] UNCTAD, 2015, *World Investment Report, 2015: Reforming International Investment Governance* (United Nations publication, Sales No. E.15.II.D.5, New York and Geneva).

[24] Organization for Economic Cooperation and Development, 2014, part 2.

[25] S Picciotto, ed., 2017, *Taxing Multinational Enterprises as Unitary Firms* (Institute of Development Studies, Brighton, United Kingdom of Great Britain and Northern Ireland).

30. An important aspect of current debate on this issue is the review and update of the United Nations Model Double Taxation Convention between Developed and Developing Countries. The model aims to guide countries that engage in bilateral tax treaties in avoiding the double taxation of multinational enterprises while promoting revenue collection and economic growth, especially in developing countries. The guidelines help to contain base erosion and profit shifting resulting from the tax avoidance strategies of multinational enterprises that exploit gaps and mismatches in tax rules to shift profits to no-tax or low-tax administrations. They aim to set international parameters for cooperation, including more effective measures against treaty abuse and a code of conduct for automatic exchanges of financial information, whereby developing countries may be granted a transition period during which they receive data without reciprocity while adapting their tax systems to ensure confidentiality for their taxpayers.

31. A second important contribution to current debate is the updated and enhanced *United Nations Practical Manual on Transfer Pricing for Developing Countries*, published in April 2017, which addresses the lack of information on the worldwide activities and operations of multinational enterprises that facilitates the mispricing of their activities to minimize taxation. A core focus is intragroup services and intangible assets, in particular a clear and transparent definitions for associated service fees. Similarly, a United Nations handbook on the taxation of extractive industries in developing countries, to be issued in October 2017, aims to promote coordination and clarity with regard to taxation regimes for extractive industries. This addresses the challenge of balancing the protection of a national tax base, by maintaining source taxing rights, with the attraction and retention of foreign direct investment inflows through tax incentives.

32. The Platform for Collaboration on Tax, established in 2016 as a joint initiative of the International Monetary Fund, Organization for Economic Cooperation and Development, United Nations and World Bank, aims to intensify cooperation on tax issues, with a view to strengthening their capacity-building support for developing countries. A major challenge remains in the need for a single and inclusive global forum for international tax cooperation at the intergovernmental level. The Addis Ababa Action Agenda highlights that only such a universal forum can effectively discuss related matters in an inclusive manner and appropriately reflect developing country concerns (paragraph 28).

33. Another challenge relates to combining tax recovery and aid in a single system of fiscal cooperation. Developing countries that are tax havens would not gain from such an exercise. In addition, tax recovery would mainly benefit richer and larger developing countries that are more integrated into the world economy, whereas official development assistance is focused on poorer countries and regions, in particular in Africa.

III. International development cooperation

34. Action area II.C of the Addis Ababa Action Agenda raises a number of issues with regard to the role of international public finance for development, in particular official development assistance. It emphasizes the need to fulfil existing commitments, the growing relevance of South–South cooperation, including the role of multilateral development banks, and the need to use international public finance, including official development assistance, to catalyse additional resource mobilization from other sources, both public and private (paragraphs 53, 54, 56, 57 and 70). In this context, the Agenda acknowledges the importance of taking into account the three dimensions of sustainable development, namely economic, climate change-related and humanitarian (paragraph 62). Finally, the Agenda highlights specific challenges faced by middle-income countries (paragraphs 71 and 72).

A. Official development assistance and blended finance

35. UNCTAD estimates that implementation of Agenda 2030 will cost around $2.5 trillion per year in developing countries.[26] To meet the first of the Sustainable Development Goals, on ending poverty, by 2030 and assuming that savings, foreign direct investment and official development assistance remain at current levels, gross domestic product in Africa must grow at double digit rates of over 15 per cent per year.[27] Investment in infrastructure development alone, which is a key bottleneck for economic transformation and sustainable growth, faces financing needs at the global level of $5 trillion–$7 trillion per year.[28] With regard to developing countries, the infrastructure financing shortfall is estimated at $1.0 trillion–$1.4 trillion per year.[29] In this context, international public finance and effective international development cooperation are important in helping to achieve the Goals, yet domestic public resource mobilization and domestic and international private capital flows are critical to closing current financing gaps.

36. In 2016, net official development assistance from members of the Development Assistance Committee reached its highest level to date, at $146.2 billion, up from $131.5 billion in 2015, representing an 8.9 per cent rise in real terms.[30] As a percentage of gross national income in members of the Development Assistance Committee, official development assistance reached 0.32; the highest ratio since 2005. This continues a long-term upward trend in official development assistance, amounting to an increase of 83 per cent in real terms in 2000–2015. However, the increase in 2016 was in part driven by large increases of in-donor refugee costs, which rose from $12.1 billion in 2015 to $15.4 billion in 2016 and from 9.2 per cent to 10.8 per cent of net official development assistance, an increase by 27.5 per cent in real terms. Other factors driving the increase included a substantial rise in net debt relief, from $431 million in 2015 to $2.5 billion in 2016, due to exceptional debt relief for Cuba and, in addition, official development assistance allocated to humanitarian aid increased by 8 per cent in 2016 over 2015, to $14.4 billion.[31]

37. The overall increase in official development assistance masks a continued downward trend in the delivery of aid to the poorest countries. For example, net official development assistance to Africa decreased by 0.5 per cent in real terms in 2016 over 2015, to $27 billion, of which $24 billion was allocated to sub-Saharan Africa and represented a decrease in 2016 over 2015 of 0.7 per cent. In addition, in the same period, bilateral net official development assistance to the least developed countries decreased by 3.9 per cent in real terms, to $24 billion. This trend is of particular concern as the least developed countries rely on official development assistance to make up more than two thirds of their external financing. Moreover, while the overall upward trend in the delivery of official development assistance is positive, it continues to fall short of the commitment made by members of the Development Assistance Committee to deliver 0.7 per cent of gross national income.[32] If all members had delivered 0.7 per cent, total official development assistance in 2016 would have amounted to $316.4 billion.[33] In 2016, net and gross levels of official development

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[26] UNCTAD, 2014, *World Investment Report 2014: Investing in the Sustainable Development Goals – An Action Plan* (United Nations publication, Sales No. E.14.II.D.1, New York and Geneva).

[27] UNCTAD, 2016b.

[28] A/69/315.

[29] A Bhattacharya and M Romani, 2013, Meeting the infrastructure challenge: The case for a new development bank, available at https://g24.org/wp-content/uploads/2016/01/Session-4_2-1.pdf (accessed 24 August 2017).

[30] Organization for Economic Cooperation and Development, 2017, Development aid rises again in 2016, available at http://www.oecd.org/dac/financing-sustainable-development/development-finance-data/ODA-2016-detailed-summary.pdf (accessed 24 August 2017).

[31] Ibid.

[32] In 2015, six countries either met or exceeded this target, namely Denmark, Luxembourg, the Netherlands, Norway, Sweden and the United Kingdom.

[33] UNCTAD secretariat calculations based on Organization for Economic Cooperation and Development official development assistance and gross national income estimates for 2016.

assistance fell short of this amount, by $173.8 billion and $161.5 billion, respectively. The official development assistance amount delivered by members of the Development Assistance Committee therefore remains modest compared with the financing gap for the Goals of around $2.5 trillion per year in developing countries. Full delivery of the commitment would constitute a significant source of additional external financing for developing countries.

38. At least partly in response to increased financing requirements to meet the Goals, the use of blended finance and related new financing instruments has been promoted, including through the Financial Innovation Platform for the Goals launched in October 2016 by the Secretary-General of the United Nations. The objective is to use conventional bilateral and multilateral development finance with a strategic view, to facilitate the mobilization of private capital for investment projects with a high developmental impact.[34] Blended finance instruments are wide-ranging and not always new, including public–private partnerships, challenge funds and innovation ventures, public credit guarantees, political risk insurance, advanced market commitments, social or development impact bonds, syndicated loans and shares in collective investment vehicles.[35]

39. To track such additional financing, the Organization for Economic Cooperation and Development has led the development of the new statistical measurement framework Total Official Support for Sustainable Development, which aims to measure all external financial flows from traditional and emerging donors, whether public, private, blended, concessional or non-concessional, delivered to support global public goods and sustainable development in developing countries. The framework seeks to support target 17.3, to mobilize additional financial resources for developing countries from multiple sources, of Goal 17 on revitalizing the Global Partnership for Sustainable Development. The framework is intended to complement existing statistics provided by members of the Development Assistance Committee, rather than to replace official development assistance, and seeks to measure the gross contributions of donors in relation to the financing needs of recipient countries. Much work remains to be done with regard to setting statistical classifications and boundaries, to ensure the compatibility of the framework with existing relevant statistical databases, and identifying eligible countries, sectors and organizations, to ensure that data is relevant, comparable and sound.[36] A survey of blended finance instruments by the Organization for Economic Cooperation and Development found that such instruments had mobilized an estimated $36.4 billion of private capital over three years in 2010–2014, falling short of the financing gap for the Goals of around $2.5 trillion per year in developing countries.

40. A number of concerns have been raised in the context of ongoing consultations on the Total Official Support for Sustainable Development framework.[37] Most concerns focus on the transparency of the framework and clear and separate accounting for the longer term costs and benefits of different types of financial flows and financing instruments, and their developmental impacts. One concern relates to the continued additionality of conventional official development assistance and the potential risk that donor countries will downsize aid allocations by replacing official development assistance with other forms of financing under the framework, thereby further undermining efforts to meet the 0.7 per cent threshold. Another concern is that the broad scope of financial flows under the framework may dilute the core economic functions of development finance and the focus on achieving the Goals, by diverting development finance into related but broader areas, such as conflict resolution.

[34] World Economic Forum and Organization for Economic Cooperation and Development, 2015, *Blended Finance Vol. 1: A Primer for Development Finance and Philanthropic Funders* (Geneva).

[35] For a detailed discussion of blended finance instruments, see A/69/315.

[36] Organization for Economic Cooperation and Development, 2016, Total official support for sustainable development: A new statistical measure for the Sustainable Development Goals era, available at http://www.oecd.org/dac/financing-sustainable-development/tossd.htm (accessed 24 August 2017).

[37] See http://www.oecd.org/dac/financing-sustainable-development/tossd-public-consultation.htm.

41. An example of the issues raised by the lack of clarity on official development assistance accounting, related to non-traditional international public finance schemes, is new and additional climate finance. A number of internationally agreed documents, such as the Copenhagen Accord adopted by the fifteenth Conference of the Parties to the United Nations Framework Convention on Climate Change in 2009, state that new and additional climate finance will be needed,[38] yet it is unclear how climate finance additionality should be defined and recorded in statistics on official development assistance. As a result, some concerning trends have emerged. It has become common practice to merge climate-related finance with official development assistance budgets, due to their overlaps and the broad definition of official development assistance that allows for such mergers. Most of the funding raised by member States under the commitment by developed countries in the Copenhagen Accord to provide $30 billion for climate change adaptation and mitigation has come from official development assistance budgets.[39] Ongoing efforts to create reporting mechanisms to separate climate finance reporting and avoid double accounting should be supported.[40]

B. Multilateral development banks

42. Financing needs to support the achievement of the Sustainable Development Goals are considerable. Lack of financing is not due to a shortfall in global savings; at the global level, institutional investors currently have assets under their management totalling $115 trillion.[41] Most are in the form of developed country securities and other assets that offer low returns. Multilateral development banks and other international banks, existing and new, are therefore needed to bridge finance from end-savers to development projects. Development banks can thus be key players in development by providing long-term financing directly from their funding sources, by tapping into new sources and by leveraging additional resources, including private, through the co-financing of projects with other partners.

43. Multilateral development banks and other international banks can play a critical role not only in providing financing directly, for example for much needed infrastructure investment, but also as market makers, by creating and providing financing instruments that improve longer term risk sharing between creditors and borrowers. They can also help mitigate informational deficiencies faced by the private sector by providing screening, evaluating and monitoring functions to improve the quality of projects and, when needed, can engage with private investors through co-financing arrangements in various forms.

44. In addition, multilateral development banks can help address the need in low-income countries to access loans for financing socioeconomic projects at subsidized rates. Multilateral development banks and other international banks are few, however and, except for the European Investment Bank, have exhibited limited and slow disbursements of loans. A critical challenge, therefore, is linked to governance reforms of multilateral development banks that can lead to increases in their capital bases and to lending as a greater proportion of their existing capital.

45. In response to the lack of sufficient financing for development and, in particular, to the slow pace of governance reforms in existing multilateral development banks, developing country-led multilateral development banks are emerging. Their institutional design and set up are aimed at addressing the shortage of long-term capital for investment in crucial infrastructure areas. Such initiatives include the recently created New Development Bank and the Asian Infrastructure Investment Bank.

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[38] This commitment was also made in the Kyoto Protocol, 1992, article 11, and the Bali Action Plan (decision 1/CP.13), paragraph 1 (e) (i) of the thirteenth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (FCCC/CP/2007/6/Add.1).

[39] I Knoke and M Duwe, 2012, Climate change financing: The concept of additionality in the light of the Commission proposal for a development cooperation instrument for 2014–2020, European Union.

[40] See UNCTAD, 2015, “New and additional” climate finance: A continuing lack of clarity, Policy Brief No. 41.

[41] Inter-Agency Task Force on Financing for Development, 2017.

46. The establishment of these two banks is a positive initiative, not only for the reasons indicated above but also for their potential role in strengthening a network of development banks at national, (sub)regional and international levels. It is also timely, since the new development banks can be an important vehicle for channelling at least part of global savings and liquidity into much needed productive and long-term investment, including to achieve the Goals. The new South-led multilateral development banks can work closely with long-established multilateral and national development banks, to both complement and improve upon existing lending practices. Multilateral development banks may have greater expertise in the engineering and financing aspects of loans, yet national development banks have greater local knowledge, thereby helping to reduce asymmetries of information at the national level. By strategically partnering with both multilateral and national development banks, the new multilateral development banks have the potential to shape development finance in the twenty-first century. The main strength of such a network would be its diversity in terms of expertise, focus, operational practices and geographic reach.

C. The middle-income trap

47. The Addis Ababa Action Agenda recognizes that middle-income countries "still face significant challenges to achieve sustainable development" (paragraph 71). Debates are ongoing on the causes for stagnation at middle-income levels and the fact that developing countries have not moved out of low-income status towards the level of developed countries. Explanations have ranged from structural factors that create developmental turning points – such as upward pressures on real wages as cheap surplus labour from traditional sectors of the economy is absorbed into modern manufacturing sectors, and skills bottlenecks that make it more difficult after a certain point to climb up the technology ladder – to more general considerations about growing obstacles to continued economic diversification in the current volatile and slow-growth global economy, in combination with greater demands on the institutional and political infrastructure and capacities of middle-income countries.[42]

48. Deliberations on international development cooperation and public international finance for development should consider the different challenges facing developing countries at different stages of per capita income and structural transformation dynamics. In particular, from a historical perspective, the later that countries have embarked on industrialization and catch-up processes, the greater have been the investment pushes required that are critical to enable expansion and synergies, to increase productivity and to improve international competitiveness.[43] If investment requirements for embarking on a path to industrialization and economic development can be met, sustaining this effort and remaining on a sustainable development path remains an ongoing challenge. In the past decades, many middle-income economies that had begun to close their relative productivity gaps with developed economies have seen their paths reverse and this gap widen again rather than further narrow. Staying on a sustainable development path is not automatic; and the challenges faced by developing countries that are on such paths and need to maintain momentum should be considered by the international community with as much weight as those faced by poorer and less diversified developing countries that face the challenge of orchestrating initial investment pushes to initiate catch up and sustainable development.

IV. Conclusion and policy concerns

49. This note summarizes core issues with regard to action areas II.A, on domestic public resources, and II.C, on international development cooperation, of the Addis Ababa Action Agenda. The most central topics and policy concerns are highlighted for further discussion and deliberations at the first session of the Intergovernmental Group of Experts on Financing for Development.

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[42] UNCTAD, 2016a, pp. 40–41. See also R Doner and B Schneider, 2016, The middle-income trap: More politics than economics, available at web.mit.edu/polisci/people/faculty/documents/SchneiderandDoner2016.pdf.

[43] UNCTAD, 2016a, p. 45.

50. Many of the topics and policy issues raised in the Agenda are closely interrelated, as are the two action areas and corresponding guiding questions to be considered at the first session. Domestic public resource mobilization does not take place in isolation from the global economy, as demonstrated by growing concern over the damage caused to public revenue and institutions by cross-border illicit financial flows. It may be difficult to achieve substantial improvements in many developing country taxation regimes and frameworks without taking into account spillover effects between national taxation systems and the global reach of the activities of some economic actors, such as multinational enterprises. Similarly, national development banks can usefully interact with subregional and multilateral development banks to improve lending practices, as well as overall regulatory and financial engineering capacities. Particular challenges are posed by the large financing gap for achieving the Sustainable Development Goals, giving an important role to international public finance and international development cooperation, to support domestic public efforts for resource mobilization and to leverage private finance for sustainable development. Some of the new instruments to promote blended finance are relatively untested with regard to efficacy in reliably providing long-term productive investment and their consequent development impacts. There is therefore ample space for further analysis in this area in particular.

51. These considerations highlight core policy concerns in the above areas that may be considered by the first session of the Intergovernmental Group of Experts on Financing for Development, as follows:

(a) How best can domestic policy tools for resource mobilization, including domestic taxation frameworks, fiscal policy design and development banking, be fine-tuned to allow developing country Governments to leverage domestic policy space in the interest of long-term developmental financing, in the context of an uncertain and volatile global economic environment?

(b) How can the systematic coordination of macroeconomic policies to promote development financing be better coordinated between countries and through multilateral initiatives, including with regard to the reduction of illicit financial flows from developing countries, international tax cooperation and multilateral development banking?

(c) What is the role of public international finance and development cooperation in meeting shortfalls in development finance, in particular with regard to the financing gap for Agenda 2030? How should official development assistance be defined, or redefined, in relation to new financing instruments oriented to public–private cooperation and blended finance?

(d) To what extent, if any, do low-income and middle-income countries face substantially different challenges with regard to domestic and international financing mechanisms and policies?