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EUROPEAN REPORT ON DEVELOPMENT 2015

COMBINING FINANCE AND POLICIES TO IMPLEMENT A TRANSFORMATIVE POST-2015 DEVELOPMENT AGENDA

Executive Summary

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EUROPEAN REPORT ON DEVELOPMENT 2015

We need a completely new approach towards finance for development - this is what follows from the lessons learned from the implementation of the Millennium Development Goals (MDGs), the changes in the Financing for Development (FFD) landscape and practical analyses of key enablers of transformative development which combines economic, social and environmental dimensions.



This report analyses the **considerable changes in the FFD landscape since the 2002 Monterrey Consensus**. It notes that the implementation of the Consensus came to focus largely on the role of Official Development Assistance (ODA) and paid insufficient attention to the importance of increasing domestic tax revenue and encouraging private finance. Yet in some of the countries that were achieving the greatest progress in reducing poverty, domestic tax revenue carried the main burden. This calls for adopting a **more comprehensive view of FFD that takes fully into account the crucial role of public finance and private finance, both domestic and international**. This will set the scene for international public finance to be a valuable complement to other flows of FFD.

The **European Report on Development 2015's** main message is that **finance alone will not be sufficient to promote and achieve the post-2015 development agenda. Policies also matter. Indeed,**

they are fundamental. Appropriate and coherent policies will ensure that finance is used effectively to achieve results and that it is not wasted or underused. Good policies will also help to ensure that more finance is mobilised as success breeds further success. The Report identifies many examples of governments that are making effective policy choices in mobilising and using finance for major **enablers of transformative development**, including local governance, infrastructure, green energy technology, biodiversity, human capital and trade.

Given the challenges encountered in the follow-up of the Monterrey Conference, it is crucial to develop an **appropriate system of monitoring and accountability** that covers as many flows of finance as possible and that stimulates the right actions in the finance and policy framework, nationally and internationally. This accountability system must cover both the Sustainable Development Goals (SDGs) and their targets and the finance and policies required to achieve them. It can then guide implementation of the post-2015 agenda in a way that covers finance, policies and partnerships.

Overall our analysis suggests that it is not an overall shortage of funds that will be the constraining factor in achieving a transformative post-2015 development agenda. Rather, it is the way finance is mobilised and used that will determine success in achieving the goals that the agenda enshrines. This in turn will require efforts to improve the effectiveness of each category of financing by drawing on its unique characteristics in support of particular enablers of development, to expand the range of possible sources of finance through appropriate policies and also to combine different flows as effectively as possible. This will call for reform of national finance and policy frameworks, as well as concerted efforts at the international level.

Introduction

This Report addresses ‘combining finance and policies to implement a transformative post-2015 development agenda’. The experience of pursuing the MDGs has provided lessons in terms of countries’ successes and failures that can be applied to using finance and policies to achieve a post-2015 development agenda. This Report draws out some of the lessons that could help to inform a new finance and policy framework for development (FPFD) that highlights the role of both policies and finance in supporting the long-term enablers (or drivers) of sustainable development.

The policy context

The vision of global development is at a critical juncture, and the need to move beyond ‘business as usual’ is stronger than ever. Representatives of the world’s nations will come together in September 2015 to agree on a new post-2015 development agenda. In the words of UN Secretary-General Ban Ki-moon, the post-2015 development agenda ‘offers a unique opportunity for global leaders and people to end poverty, transform the world to better meet human needs, and the necessities of economic transformation, while protecting our environment, ensuring peace and realizing human rights’. It will thus mark a transformative ‘paradigm shift for people and planet’ (UN Secretary-General Synthesis Report, 2014).

The post-2015 development agenda stems from two converging processes: the follow-up to the 2010 Millennium Summit, which mandated the UN Secretary-General to initiate a process to succeed the Millennium Development Goals (MDGs), and the follow-up to the 2012 United Nations Conference on Sustainable Development (‘Rio+20’), which launched the process to develop the SDGs.

In parallel, but closely linked with these processes, two strands on FFD have also converged: the follow-up to the 2002 Monterrey Conference on Financing for Development and the follow-up to Rio+20, which gave the mandate to prepare options for a sustainable development strategy, as set out in the report of the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF).

The Third International Conference on Financing for Development to be held in Addis Ababa in July 2015 is expected to discuss ‘an ambitious agreement on policies, financing, technology transfer, capacity-building and systemic issues’ (Financing for Development Co-facilitators’ elements paper, 2015) to underpin the post-2015 development agenda.

The policy challenges

The development agenda is ambitious and the challenges it poses seem enormous. In the post-2015 context, therefore, mobilising additional financial resources to pursue development goals will not suffice. Such efforts need to be complemented with improved national and international regulatory and policy frameworks, along with investments in absorptive capacity in order to make more effective use of FFD. Indeed, finance and policy are synergistic: better policy-making is needed to make the most effective use of finance but also to attract and channel new financial resources to where they are most needed.

The global policy processes for designing and implementing an ambitious and transformative post-2015 agenda are taking place in a context that differs significantly from when the MDGs were agreed. Some policy challenges are well-known, but there are also new ones with respect to public and private finance.

Take the following examples:

- ▶ While domestic tax revenues are growing in all country income groupings, systems of domestic revenue mobilisation (DRM) in developing countries are immature, leading to low or inefficient tax collection, high levels of tax evasion, and capital flight. The key challenge therefore is to **raise domestic tax revenues in a way that can best support sustainable development**.
- ▶ Concessional loans and grants are stagnating (although ODA reached a record high in 2013) and are also selective in where they flow. They do not systematically prioritise the poorest economies, can be unpredictable and are not always as effective as they might be. The challenge is how to **make use of ODA in a more transformative way and to tap into new aid resources from emerging economies**.
- ▶ Private capital, which often appears to be in abundant supply, is highly selective in where it flows, what it funds and on what terms. It favours financial markets in developed countries, fast-growing emerging economies, the extractive sectors and the formal economy, including larger, established firms. It requires large lending margins, and often bypasses small and medium-sized enterprises (SMEs) in productive sectors, and people living in poverty, of which 2.5 billion do not use banking services. Achieving the SDGs will require the mobilisation of resources from private sources including foreign direct investment (FDI), bank loans, bond issuance, equity and other risk capital and private transfers as well as the use of risk-mitigation instruments. **The mobilisation and effective channelling of private resources requires a supportive investment climate and complementary use of public policies and finance**.
- ▶ Developing and emerging economies have been driving global growth over the past decade, but the world economy remains vulnerable to financial shocks, with the risk of volatile and

unpredictable trading conditions and financial flows. While there has been modest progress in developing global trade and climate rules in recent years, the challenge remains to **promote a global and stable financial system that encourages the mobilisation and effective use of global savings** to support sustainable development. Although the global community is placing the spotlight on international tax rules, these remain poorly regulated, with too much scope for tax avoidance, tax evasion and transfer pricing, which permits the extensive use of tax havens. **The challenge is to promote collective action on global tax rules.**

What this Report aims to contribute

In order to formulate actions to overcome the policy challenges, the main research question addressed in this Report is: ‘**How can financial resources be effectively mobilised and channelled and how can they be combined with selected policies to enable a transformative post-2015 agenda?**’ Several academic studies and policy documents have discussed the role of finance in different dimensions of sustainable development. Most of the latter examine these questions from the starting point of finance. By contrast, this Report starts from sustainable development objectives (focusing on the enablers or long term drivers of sustainable development) and then presents a framework on how finance and policies can contribute to achieving them. The Report focuses specifically on the links between finance and policies and aims to encourage these to be discussed jointly. **This approach leads to three contributions to the literature:**

- ▶ First, the Report considers a range of financial flows rather than focusing on ODA alone.
- ▶ Second, it examines the role of selected enablers or long-term drivers of sustainable development.
- ▶ Third, it provides further evidence on the way in which finance and policy are interlinked in contributing to sustainable development.



Evidence used to inform the Report

This Report uses a **wide range of evidence** to examine the research question. It reviews (a) the lessons from the MDGs with regard to FFD, including the importance of the policy context in relation to a range of financial flows; (b) financial flows to different country income groupings from 1990 as well as innovative sources of FFD, emphasising the need to consider a wide range of flows; and (c) the role of domestic and international policy in mobilising and making more effective use of finance in six areas – local governance, infrastructure, human capital, biodiversity, green energy technology and trade - which we analyse in the Report as the key enablers that contribute to a transformative post-2015 development agenda.

A set of **ERD commissioned papers form** a crucial part of the evidence gathered for this Report: **Country Illustrations (CIs), Background Papers and Modelling Studies.**

Country Illustrations were commissioned on Bangladesh, Ecuador, Indonesia, Mauritius, Moldova and Tanzania. These provide country-based evidence on links between finance and policy for selected enablers of sustainable development, and how these affect social, economic and environmental dimensions in a transformative vision of sustainable development.

Background Papers were commissioned to provide further evidence on issues such as taxation and development, the roles of development finance, climate finance, the role of MDGs in low-income Countries (LICs), South-South Cooperation (SSC) and finance for agriculture.

Two types of **modelling studies** were commissioned in order to explore some of the relationships between finance and policies for the selected enablers (e.g. infrastructure) in greater depth: modelling on Bangladesh, Moldova and Tanzania and other modelling exercises based on global models.

The Report's approach to financing for development

Both the lessons learned from the implementation of the MDGs and the changes in the FFD landscape suggest that **we need a completely new approach towards finance for development:**

▶ A range of studies on finance needs supported the implementation of the MDGs. They emphasised financial gaps to be filled with ODA, but this represented only a partial vision of how needs could best be met. Furthermore, the context has since changed, making it necessary to move **from development aid as a 'silver bullet' to considering all available sources of finance.**

▶ The focus on finance needs associated with the MDGs often ignored the crucial role of policy. There is thus a need to think beyond only policies or only finance and **promote discussions that can foster joint thinking on appropriate policies and finance.**

▶ The MDGs successfully attracted ODA for specific social sectors, but in a post-2015 context with proposed SDGs that seek to be more comprehensive and transformative, it is important to consider long-term enablers for such a development agenda. This requires a new way of thinking about the role of different finance sources and a **better understanding of structural transformation and poverty eradication.**

This Report proposes a different way of thinking about finance and policies, based on four elements:



This framework contrasts sharply with the view that it is possible to achieve a transformative post-2015 agenda with finance, and ODA in particular, alone. It also takes the objective of sustainable development transformation as central, with finance flows playing a supporting role.

1 Consider all financial resources

Finance options have changed

FFD options have changed dramatically by country income grouping, and over time. For example, consider the following financial flows (expressed in 2011 constant prices):

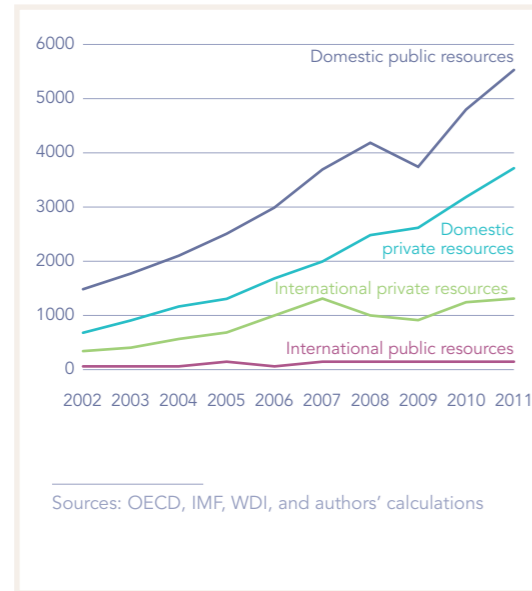
- ▶ Domestic public revenues (tax and non-tax revenues) rose by 272%, from \$1,484 billion (bn) in 2002 to \$5,523 bn in 2011
- ▶ International public finance (net ODA and Other Financial Flows (OOF)) rose by 114%, from \$75 bn in 2002 to \$161 bn in 2011
- ▶ Private domestic finance (measured as Gross Fixed Capital Formation by the private sector, less FDI) rose by 415%, from \$725 bn in 2002 to \$3,734 bn in 2011
- ▶ Private international finance (net FDI inflows, portfolio equity and bonds, commercial loans and remittances) rose by 297%, from \$320 bn in 2002 to \$1,269 bn in 2011

Thus, **since the 2002 Monterrey Consensus, in real terms (2011 dollars) developing countries have had access to an additional \$0.9 tr in private international finance, \$3 trillions (tr) in private domestic finance and \$4 tr in public domestic revenues. Public international finance increased by just under \$0.1 tr** (and the total is now less than 1.5% of the total resources available).

Figure 1 depicts the evolution of finance flows to developing countries.



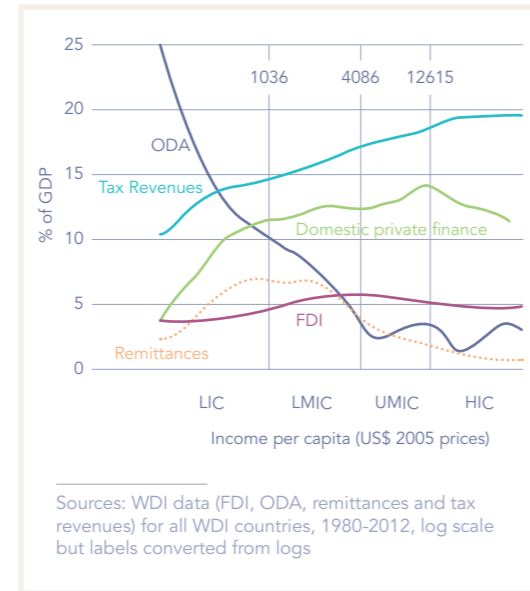
Figure 1 | Trends in finance (\$ bn, 2011 prices)



Sources: OECD, IMF, WDI, and authors' calculations

The data shows that **domestic public resources have grown rapidly and are the largest source of finance for all country income groupings.** International public finance has also increased but is declining in relative importance. Domestic private finance has shown the fastest growth, but is still much lower (as a percentage of GDP) in LICs than in lower middle-income countries (LMICs) and upper middle-income countries (UMICs), with rapid transformations continuing. International private finance has been highly volatile compared to the other flows. Innovative finance is promising but is yet to take off on a large scale. These trends set the context and also present a number of key challenges that need to be addressed in the post-2015 development agenda and PPF. For example, it is clear that there is both a need to think more about public resources 'beyond aid' and also to consider new approaches to ODA.

Figure 2 | Financial flows (% GDP) by income level

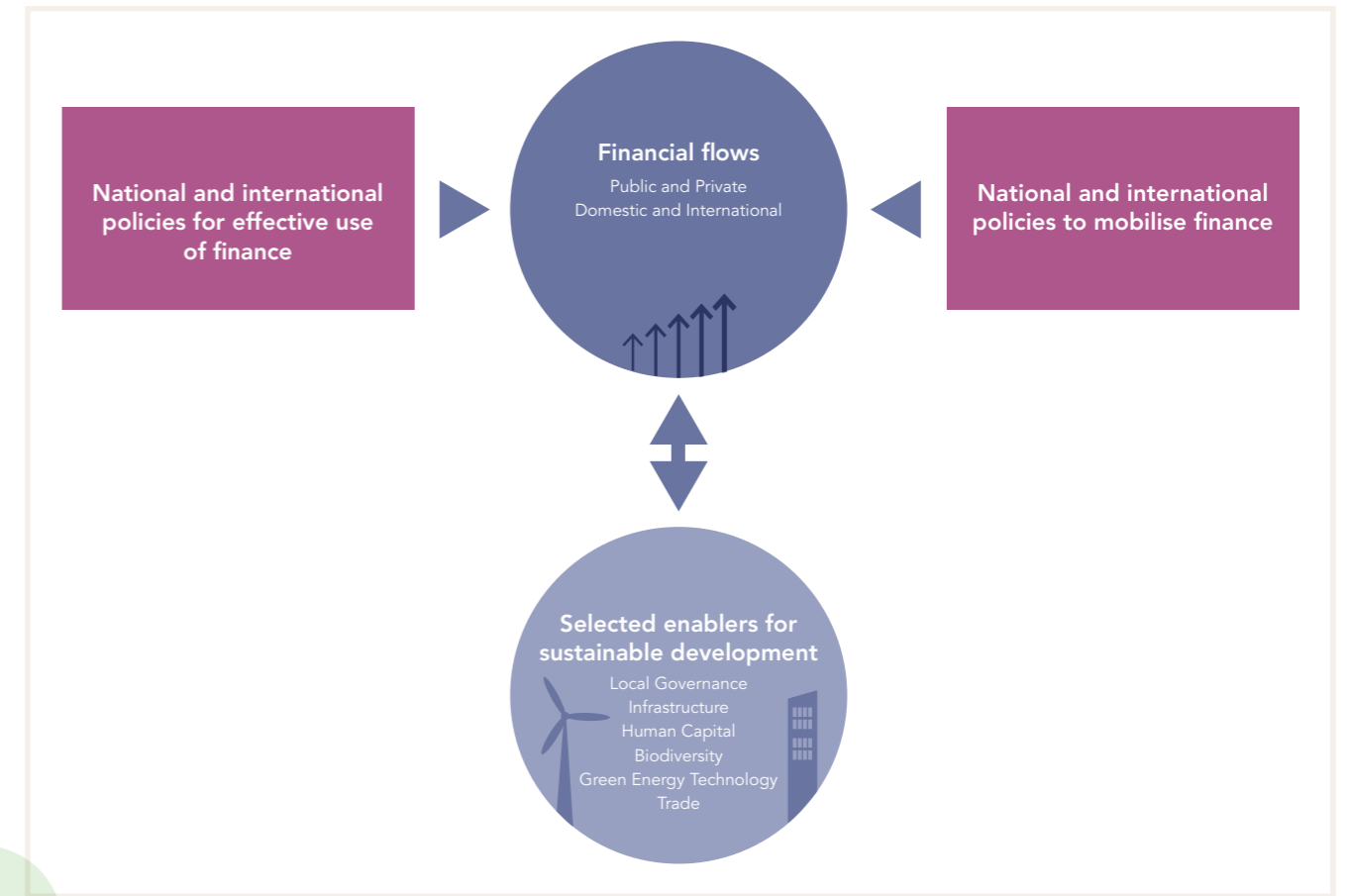


Sources: WDI data (FDI, ODA, remittances and tax revenues) for all WDI countries, 1980-2012, log scale but labels converted from logs

The composition of finance evolves at different levels of income

Figure 2 shows that as countries move towards higher incomes, they tend to experience: (a) declining ratios of aid-to-Gross Domestic Product (GDP); (b) increasing tax-to-GDP ratios (stabilising when countries approach LMIC levels), and within this, increasing shares of tax from incomes and profits and notably goods and services, but declining shares of international trade tax revenues; and (c) increasing private investment-to-GDP ratios.

Figure 3 | Integrated conceptual framework for finance and policies in enabling a transformative post-2015 development agenda



2 Consider policy and finance together

The Report's framework for assessing the role of finance and policies together

Figure 3 sets out the **integrated conceptual framework that is central to this Report.** It describes the role of financial flows (public and private, domestic and international) in promoting sustainable development. It illustrates how finance flows that are mobilised with the help of policies can promote the enablers. One of the key

messages is that the role of finance in promoting sustainable development needs to be seen in the policy context. This framework is intended to promote the joint discussion of policies and finance (through the illustrative examples of sustainable development enablers, whose selection is explained above).

Policies are crucial for the mobilisation and effective use of finance

The Report demonstrates that **policies matter in financing for development**. Although there is considerable finance available for development at the global level, it does not follow that it is used appropriately. FDI does not reach the most vulnerable and poorer segments of society; tax-to-GDP ratios have changed very little in many LICs; SMEs and infrastructure are starved of capital; and much international public finance does not go to the poorest countries. Indeed, there is a need to overcome a number of market, governance and coordination problems in order to mobilise and channel financial resources to their most effective use. However, appropriate actions can effectively overcome these challenges by addressing market, coordination and governance failures.

The Report identifies a range of **specific policies that help to mobilise finance**. For instance, regulatory reforms (e.g. clear property rights, land titles or cutting bureaucratic red tape for licensing) help to mobilise private-sector resources as well as investment in infrastructure, human capital, trade or technology. The CIs show that **some countries have successfully mobilised more tax revenues (as a percentage of GDP)** by building administrations that limit rent-seeking and curtail the use of tax exemptions, enhancing compliance, renegotiating contracts with major foreign companies, computerising the customs-clearing process, and adopting a broad-based value-added tax (VAT) with a reasonable threshold. In such ways, countries can use policy frameworks to raise domestic finance and address otherwise low and stagnant tax-to-GDP ratios. Low levels of domestic public finance are neither predetermined nor insurmountable and are to a large extent a question of public policy. **Countries can also use policy to attract FDI and use it for development objectives**. The CIs show that when countries adopt better macro-financial policies, the volatility in foreign investment flows is markedly reduced, and that very small regulatory changes can make the difference in attracting foreign investment.

Figure 4 distinguishes between policies for mobilisation and policies for effective use of finance. We summarise the broad **principles for mobilisation of finance**, as follows:

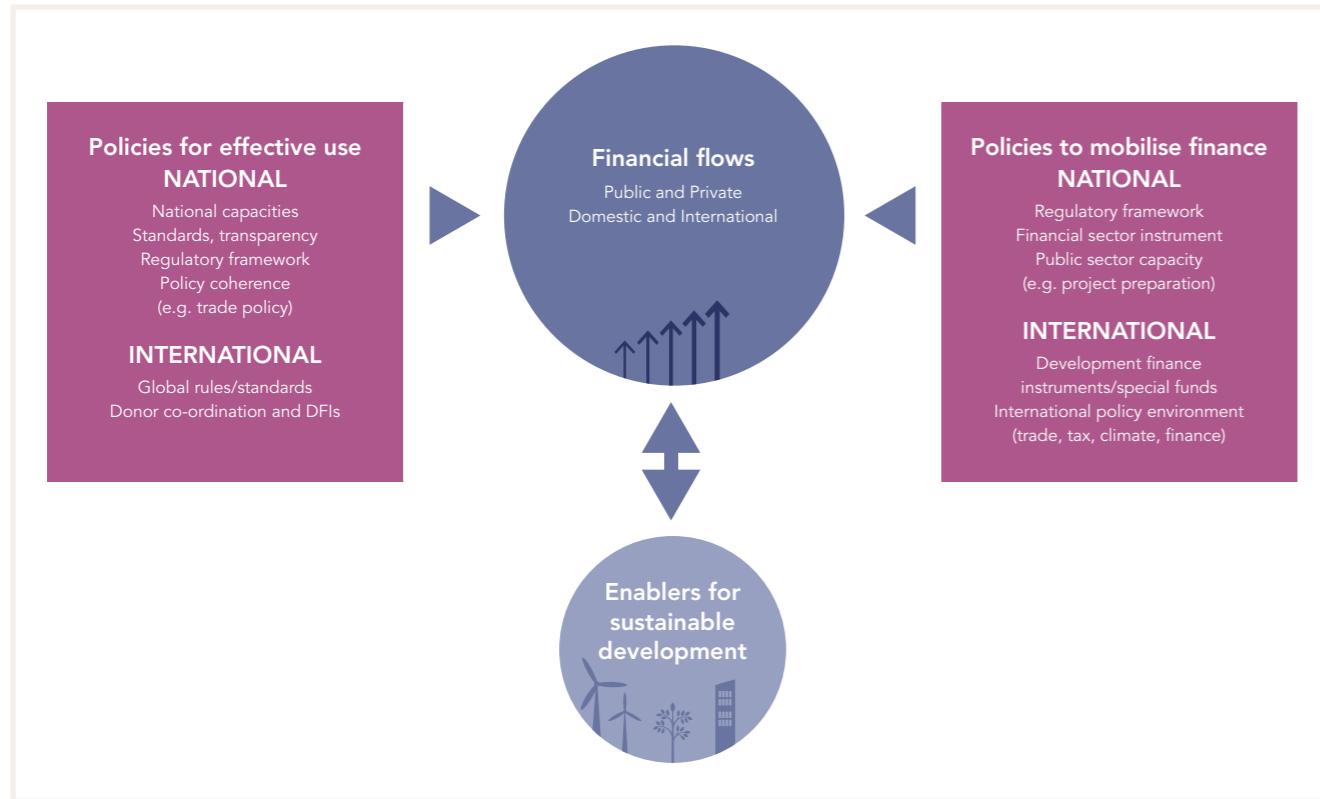
- 1 Finance can promote enablers (for example, **local governance, human capital, infrastructure, green energy technology and trade**), which in turn can also attract more public and private finance. This creates a virtuous circle between the enablers and finance: examples include mobile phone technology for mobile banking services, and human capital for FDI.
- 2 An **appropriate regulatory framework is of critical importance in order to attract private finance**. For example, clear property rights or land titles help to mobilise private domestic finance by providing collateral, and an improved and more transparent and efficient investment climate can unleash more finance. Enhanced competition in transport services and benchmarks in contract provision promote finance for and investment in infrastructure. Rules that create incentives for institutional investors to finance infrastructure in developing countries or green technology, rather than in liquid assets, help to channel international private finance to sustainable development purposes.
- 3 Development of **financial-sector instruments** and the capacity to apply them can mobilise private resources. Blending instruments or public-sector guarantees, for instance, can enhance credit availability, which in turn leverages more private-sector finance.
- 4 **A conducive international policy environment** can be critical in setting the right conditions, e.g. transparent global financial rules and standards for global finance, appropriate trade policies for investment in agriculture in developing countries (abolishing harmful trade distortionary subsidies), tax regulations for tax havens, or appropriate climate-mitigation deals to set a carbon price that will mobilise climate finance.

The Report also identifies five general **principles for the effective use of finance**:

- 1 The ability to implement, manage or facilitate finance effectively requires the presence of **sufficient national and local public capacities**. In domestic public finance, this relates to identifying and implementing sound investment projects (including those with co-benefits across the economic, social and environmental dimensions of sustainable development) and for ensuring that there are good social systems (e.g. health and education) supported by significant expenditure on them.
- 2 The **design and implementation of public and private standards** facilitates the effective use of finance. While standards need to be defined nationally, global coordination and benchmarking can help. Standards can relate to public procurement, accountability in public revenues from natural resources, public financial management, PPP contracts and standards for green technologies or resilience to climate change. Global standards can help in raising standards at the country level.
- 3 An appropriate and **clear regulatory framework** allows competition and provides better incentives for the diffusion of technology in addition to directed finance. Financial and prudential regulation is required to avoid financial crises at the global level, and especially in developed countries. There is also a need for better regulatory frameworks and supervision of banks, more innovation and competition in the banking sector and better regulation of the non-banking sector – such as corporate bonds, stock markets and pension funds – in order to improve the terms on which finance is made available.
- 4 Improving **transparency, information and accountability** contributes to the effective use of finance. For instance, a lack of transparency regarding government taxes paid by investors hampers the quality of public investment. Transparency concerning the large-scale acquisition of land by foreign interests could improve the governance of natural capital.
- 5 Finally, **policy coherence** towards specific development objectives is vital to the effective use of finance. It is important to ensure that policies in different sectors do not undermine policies to promote sustainable development and to take an integrated approach. Lack of policy coherence will lead to wasted finance. Investing in ‘white-elephant’ projects or inefficient productive capacities behind closed borders will not promote transformation in the long run. Financing the development of technologies without building the human capital required to employ them will be a half measure. Providing more capital to development finance institutions (DFIs) or raising credit without the prospect of projects in which to invest can lead to excessive ‘financialisation’ and indebtedness. Improving access to credit without improving the terms on which it is available can still be prohibitive for firms. Policy coherence also applies at the global level, e.g. through the global rules on trade, finance, climate, migration and technology.



Figure 4 | Summary of policies for mobilisation and effective use of finance



Finance cannot be treated independently from policy

Policy is crucial alongside finance to implement a transformative post-2015 development agenda. Poor or adverse policy can stop the potential of finance, but **appropriate policy can:**

- ▶ **Generate, attract and steer finance** - the design of clear policy frameworks for transformation helped Mauritius to attract and steer both public and private finance (CI Mauritius).
- ▶ **Unleash more public and private finance** - reductions in tax exemptions helped to raise public finance in Tanzania, but weaknesses in the energy regulatory framework limited investment from private finance for renewable energy (CI Tanzania).

- ▶ **Increase the stability of international private finance** - an ERD modelling study (Fic, 2015) shows that global banking (Basel III) rules lead to benefits for sub-Saharan Africa (SSA) that are ten times greater than the costs.
- ▶ **Pull finance from less productive to more productive uses** - better tax policies such as reducing bad transfer pricing or tax-avoidance practices can lead to large benefits. The ERD modelling study (Fic, 2015) suggests this could release \$ 3.5 bn in Africa; similarly a relaxation of restrictions on sovereign wealth fund (SWF) investment can lead to more finance for infrastructure in developing countries.
- ▶ **Lead to more results with the same amount of finance** – for example, measures that boost

the productivity of infrastructure by scaling up good practice and making better use of existing infrastructure could help countries to improve infrastructure productivity by 60%, estimated to be worth annual savings of \$1 tr. As another example, better competition policies improve the terms under which banking finance is available. It is estimated that private investors across Africa face additional costs of around \$15 bn (2% of credit extended) compared to the average interest rate spread, simply to obtain finance. More competition and innovation aimed at lowering the interest rate spread in SSA to the average of LICs and MICs would increase the availability of finance by more than 1.2% of GDP and increase investment by 6%.

- ▶ **Reduce the need for finance** - the finance gap for renewable energy is estimated to be between \$400 bn and \$900 bn. This is similar to the current level of fossil-fuel subsidies (more than \$500 bn in 2010), which means that reducing such subsidies could free up finance for other purposes. Lower subsidies are also likely to reduce the need for additional green investment since there would be fewer incentives to use fossil fuels. As a further example, Duty-Free Quota-Free (DFQF) access to the markets of the G20 countries (beyond the European Union, which already provides such access) could increase LDCs' national incomes on average by 0.5% of GDP (World Bank, 2013). This is similar to the \$30–40 bn provided in Aid for Trade (Aft) each year.

3 Focus finance on the enablers of sustainable development

Six selected enablers for sustainable development

The Report argues that action to achieve sustainable development should focus on

the drivers or enablers of change. Sustainable development cannot be achieved without improving and financing **six key areas:**

Local Governance. Governance generally is the most fundamental enabler of development, and we focus on local governance because of its importance in the provision of many critical functions and because few other reports focus on the financing aspects at this level.



Infrastructure, which econometric studies show is important for all dimensions of sustainable development, a conclusion supported by an ERD commissioned study modelling infrastructure scenarios, and by the CIs.



Human capital, whose importance in development is supported by a range of empirical studies, also has a direct link with the eradication of poverty.



Biodiversity is important for all dimensions and most directly for environmental progress. The Report yields new insights with respect to financing because biodiversity is often referred to as a public good.



Green Energy technology and its dissemination lie at the heart of a move from a high-carbon to a low-carbon economy.

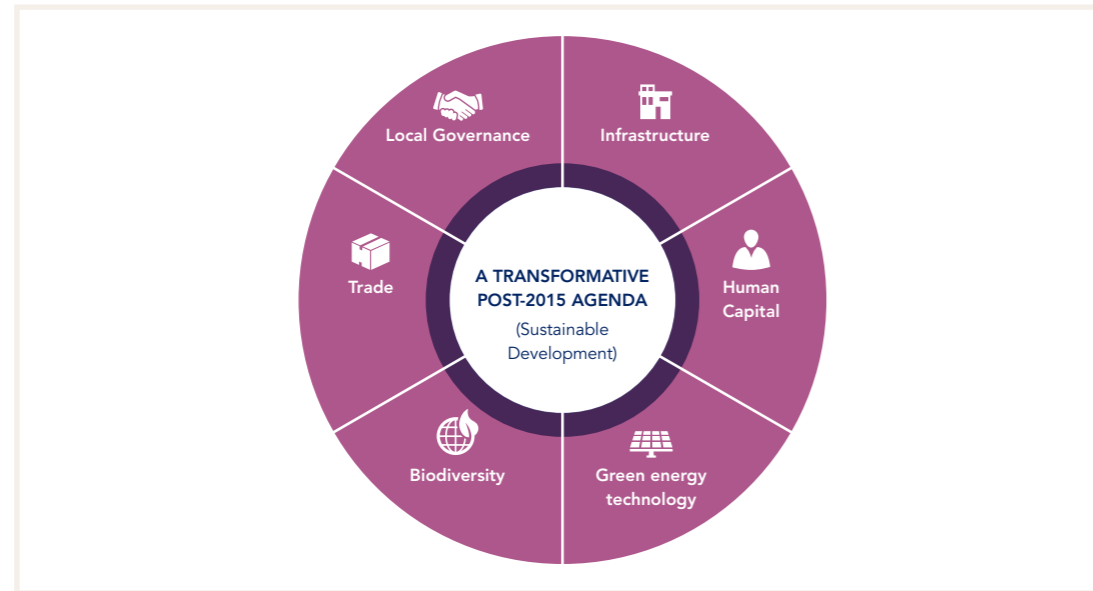


Trade, whose importance as an enabler comes out very strongly from the CIs and yields differential insights, especially with respect to the role of private-sector finance.



The Report's focus on enablers contrasts starkly with outdated views that ODA or finance alone can directly achieve sustainable development outcomes.

Figure 5 | Selected enablers for sustainable development



The finance mix varies by enabler

The composition of finance differs markedly by enabler. Finance for institutions and governance seems to be largely public, mainly provided through tax revenues, and international public finance can play a part, particularly in LICs, as shown in the ERD commissioned CIs.

Patterns of finance for human capital vary across education, health and social protection, although all depend heavily on domestic public finance. In the education sector, finance varies by level of education although most comes from public sources, including ODA, for primary and secondary schooling. Private spending by richer households and migrants' remittances is also important. Formal training, such as Technical Education and Vocational Training (TVET) schemes, is financed mainly from private sources, although this approach can be regressive. There is also evidence of public-private partnerships (PPPs) (as in Malaysia) or tax levies for training being allocated and used according to private-sector interests (as

in Mauritius). Funding for health systems comes mainly from public sources, although private out-of-pocket (OOP) expenses can also be critical. While the reliance on OOP expenses tends to make it harder for poorer people to obtain access to health care, this could also create opportunities for private-sector insurance and micro-insurance schemes to complement public funding. Well-designed, publicly funded social-protection systems are essential to safeguard investment in human capital, especially in times of turbulence.

Finance for infrastructure and green technology tends to come from a mixture of public and private sources, although national government expenditure is the principal source for infrastructure. There is a clear progression in the use of private finance, including bond financing, as country income levels rise. Due to the large upfront requirements, large infrastructure or renewable energy projects usually depend on the blending of private finance, ODA grants, technical assistance and OOF. Such blending has increased since the 2007–2008 global financial

crisis in the context of the rising presence of development finance institutions (DFIs) and multilateral development banks (MDBs). Public funding has been used primarily to alleviate risks and attract private investment. MDBs from emerging economies also increasingly use blended instruments. Although significant ODA-backed concessional and non-concessional loans are common in LICs, public grants remain the main source of finance. While private expenditure on research and development (R&D) for green technology is rare in LICs, there is often private investment in renewable energy (generally supported by some form of public finance).

Trade finance is largely provided by private banks through the extension of Commercial Letters of Credit, although this is changing rapidly in the wake of the global financial crisis. In Bangladesh, for instance, exporters of ready-made garments, especially SMEs, are starting to bypass the banking system by developing and negotiating trade directly on 'Open Account' terms with their trading counterparts (Bangladesh CI), and DFIs and MDBs are creating Special Purpose Vehicles to support private-sector development by pooling private and public funds. LICs continue to have very limited access to trade finance and rely on AfT finance to build trade-related capacity.

DFIs are playing an increasing role in leading transformations in key areas such as infrastructure, green energy and trade, by leveraging private finance, supporting the selection of appropriate projects and policies, and providing technical assistance, credit and risk-mitigation instruments and blended finance.

4 Steps towards a Global Partnership to implement a transformative development vision

The UN Secretary-General's Synthesis Report (2014) discusses establishing a new Global Partnership for the post-2015 development agenda at the Third International Conference on Financing for Development (para. 24 ff) in July 2015. This renewed Global Partnership would establish a common foundation and contribute to new ways of thinking about collective action in much the same manner as previous non-binding agreements have done. The Conference outcome could therefore provide a set of common principles on the nature and value of different types and combinations of finance and policy, and how these are best used to enhance the enablers of transformation. There are four steps to consider.

Financing for development as an on-going process

A finance and policy framework under such a Global Partnership would steer global collective action up to 2030 by stimulating domestic and international efforts by all countries, commensurate with their capacities. Moreover, as our analysis shows, private sources of finance that lie beyond the direct control of national governments are gaining in importance, especially at higher levels of country income level. It is important to seek a formula that encourages their engagement and participation in the financing and implementation of the post-2015 development agenda.

Keeping core principles in mind

The post-2015 development agenda is expected to be 'universally applicable' while 'taking into account different national realities, capacities and levels of development', building on the two principles of universality and differentiation (UN Secretary-General Synthesis Report, 2014). Both principles would make the new framework very different from the MDGs and would help to move the debate away from the donor-recipient model, which most stakeholders seek to put behind them.

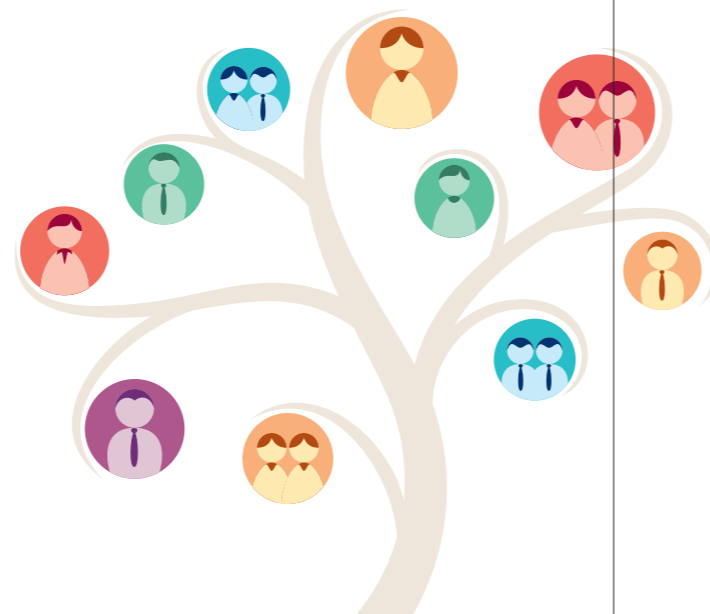
► **Universality** - implies that the new framework will apply to all countries and governments and not only to developing countries. On this basis, each government will be expected to pursue the agreed goals in a manner that is appropriate for their country, and to contribute resources (finance and other means of implementation (MOI)) to the global effort commensurate with their means.

► **Differentiation** - this concept is an important complement to the notion of universality (UN, 2014, para. 84) in that it clarifies that while the new framework should apply to all countries, given the differences in capacities and needs, not all can or should be expected to contribute to its achievement in the same way. This implies firstly, that, although contributions may differ, each is important. All contributions are valued. Secondly that these responsibilities do not apply only to governments, but call for all stakeholders to contribute according to their capacity.

A useful and relatively simple way to distinguish between roles and responsibilities with respect to finance and policies for development is to look at three main groups of countries by income levels: (a) LDCs/LICs and fragile states; (b) MICs; and (c) HICs or developed countries. It also needs to be recognised that small and vulnerable economies face special challenges, which implies that they cannot be easily categorised as LICs or MICs (e.g. some small MICs have very large debts). The broad distinctions between what each of these groupings would be able to do in terms of mobilising and making effective use of finance are identified in Box 1 but further differentiation is possible.

Involving multiple actors

The Global Partnership that is expected to be part of the universal post-2015 development agenda implies that all governments should make an explicit commitment to it. Relevant actors, each with a distinct role and responsibility, include national governments and their various departments, country income groupings, autonomous state bodies (e.g. export credit or export promotion agencies), and non-state actors such as business organisations or associations, financial and non-financial firms, and other national stakeholders such as academic institutions, think tanks, CSOs and labour unions. Multilateral institutions such as the World Bank, the International Monetary Fund (IMF), Regional Development Banks (RDBs) and other DFIs are also key stakeholders.



Box 1 | Illustrative stylised roles and responsibilities of country income groupings

For LICs/LDCs, fragile and small and vulnerable states:

- **Mobilisation** requires an essential, often tough, domestic effort to improve the regulatory environment and administrative capacities, to build up the tax revenue system, combat tax evasion and to start to mobilise private capital flows, including remittances. Ensuring effective regulation and supervision of the financial markets encourages private capital. Well-managed domestic public finance will tend to attract international public finance (including ODA and SSC) to fill development finance gaps. These may also have a catalytic role in helping to reform the domestic revenue system.
- **Effective use** involves focusing domestic budget allocations on transformative priorities and associated enablers, as well as channelling international public resources to invest in human capital, capacity-building and strengthening institutions, and creating specialised facilities or funds to direct public and private resources to specific enablers, most notably infrastructure and networks.

For MICs:

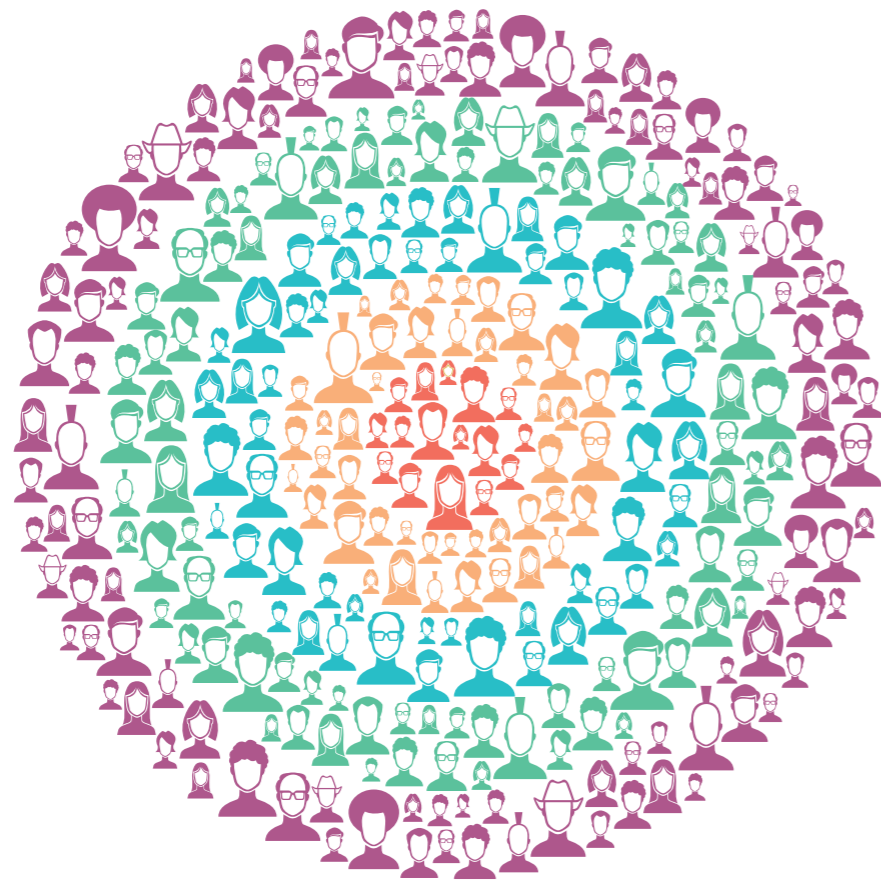
- **Mobilisation** at this level entails greater emphasis on DRM as the major source of FFD. Strengthening the tax effort and extending the tax base are important priorities. MICs can be expected to have a well-developed domestic private finance sector and should also be able to attract higher levels of international private finance (although small and vulnerable MICs face challenges in this area that are similar to those facing LICs). Small amounts of ODA may still be used in a catalytic fashion to stimulate other finance (including tax revenues). Development of stock exchanges and bond markets can mobilise additional private resources, as can PPPs, which might save resources over a project's lifetime. At the same time, as countries move to MIC status they also move into the league of potential SSC providers contributing external financing (international public and private finance) or concessional lending to other countries and to global public goods (GPGs). This effort needs to be acknowledged and encouraged. The UN Secretary-General Synthesis Report (2014) suggests that 'more countries will need to commit to increasing their contribution to international public finance, and set targets and timelines to do so' (para. 111).
- **Effective use** involves, among other things, allocating the domestic budget to transformative priorities and associated enablers, encouraging private investment to support public investment in key enablers such as infrastructure, reducing ODA to a minimum and using it mainly to pursue social or environmental goals and/or enhance leverage of other resources. At the national level, policy coherence for sustainable development (PCSD) and a serious commitment to establish and maintain a supportive international policy framework need to be major policy priorities. MICs can also be expected to play a growing role in global governance in helping to establish such a policy environment and through their willingness to accept and adhere to global standards, as is increasingly the case for the G20 and the UN.

For HICs/developed countries

- **Mobilisation** involves sufficient DRM to finance national efforts towards achieving the goals as well as providing the basis for sizeable ODA contributions and major concessional lending to the countries most in need. Given their developed domestic private finance markets, HICs should be able to attract large volumes of international private finance, although it is important to prevent illicit transfers, which among other things may undermine poorer countries' ability to mobilise finance.
- **Effective use** involves in particular ensuring that resources intended to achieve domestic and international goals are allocated most effectively and making serious efforts to adjust other internal and external policies to ensure greater policy coherence to support development objectives. In their role as major contributors to establishing a conducive international policy framework, they need to ensure by means of proper incentives, rules, regulations and oversight that GPGs – including an open trade regime, environmental sustainability, and financial stability etc. – are provided in a consistent and inclusive manner. Further, domestic policies in areas such as climate resilience and economic development also have important spill overs on other countries.

Introduce a monitoring and accountability framework

Part of the success of the MDGs was that they allowed for specific monitoring and follow-up. Yet in terms of the finance and policy provisions of the Monterrey Consensus it was really only international public finance that was assigned a target that could be monitored. A major challenge for a new finance and policy framework is to establish targets and other measures that can incentivise finance as well as other aspects of financing and implementation in the years ahead. This is not an easy task but it is vital in order to make genuine progress. Equally, it is important in terms of promoting transparency and the full participation of all those whose support will be required to make the framework a reality. A strong effort in this direction is ultimately what will give substance to the term 'global partnership'. Data will be crucial in order to achieve the necessary monitoring and ensure transparency. The main report provides an illustrative example table on what such a finance and policy framework might look like.



Conclusion

Three main findings inform a new finance and policy framework for development

1

The **pattern of finance for development evolves at different levels of income**. A key government objective should be to move the financing pattern to the next level and, as the volume of each form of finance changes, to ensure it is put to best use. This has implications for the mobilisation and use of all types of flow, including, for example, ensuring a more **transformative role for international public finance in the evolving pattern of finance**.

2

Policy matters. Finance is not enough on its own and it is essential to adopt appropriate and coherent domestic and international policies for its effective mobilisation and use:

- ▶ **Domestic policy and financial frameworks** that promote mobilising domestic resources and facilitating their effective use for sustainable development. This includes an effective regulatory framework to govern private sources and adequate capacity to raise public revenues, and applies to developing and developed countries.
- ▶ **A conducive global system** and policy environment that supports the mobilisation of finance and includes supportive agreements on climate change, an improved global trade regime, better global tax rules and the management of the global financial system

3

Accountability and participation. Given the new financing context, and within it the importance of using several different types of finance in synergy (domestic, international, public, private), it is essential to create a framework for on-going dialogue between the various stakeholders involved in each type of finance during the implementation of the post-2015 agenda. Participation in such a dialogue will allow stakeholders to monitor progress, hold each other accountable, jointly manage the evolving pattern of finance and make adjustments as required. The dialogue will need to be informed by real time data from appropriate monitoring and evaluation (M&E) systems, including on finance flows and on complementary policies.







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