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**Economic and Social Commission for Western Asia (ESCWA)**

## **Financing Sustainable Development (progress and prospects) Global Trends vs. Regional Realities**



United Nations  
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## Introduction

1. At its twelfth session held in Beirut on 4 and 5 December 2017, the Committee on Liberalization of Foreign Trade, Economic Globalization and Financing for Development ('the Committee') requested the Secretariat to continue monitoring the implementation of global commitments, including those arising from Addis Ababa Action Agenda as well as analyze their impact on the Arab region (Recommendation 4.a). In doing so, the Secretariat was requested to continue to participate in the United Nations Inter-Agency Task Force (IATF) on Financing for Development to advance financing development processes and concepts in defense of Arab interests (Recommendation 4.e).
2. The present report provides a synopsis of the first joint assessment undertaken by the IATF, comprising of more than 50 United Nations agencies, programmes, institutions, entities and regional commissions on the progress made in implementing financing for development outcomes. The second section of the report provides a regional assessment of these outcomes and their implications considering the key Arab priorities adopted in the run up to the Third International Conference on Financing for Development (Addis Ababa, 13 to 16 July 2015) and the particularities of the regions' geopolitical contexts and socio-economic idiosyncrasies and levels of development.

### I. KEY FINDINGS ON PROGRESS MADE IN FINANCING FOR DEVELOPMENT

3. The Inter-Agency Task Force reports that most types of development financing increased, and that progress has been made across all action areas of the Addis Ababa Action Agenda (AAAA). However, the IATF concedes that these findings mask several asymmetries as far as implementing the different action areas under scrutiny of the review processes of the AAAA. The fruits of development finance are not being shared evenly among countries and progress in achieving sustainable development has not fully materialized as contemplated.
4. The cyclical upturn in the global economy has been accompanied by the emergence of significant FfD risk factors. The disorderly tightening of financial conditions and associated increases in interest rates and debt vulnerabilities along with the adoption of inward-looking protectionist policies and escalation of geopolitical tensions impose considerable risks that may derail the progress achieved in mobilizing development finance. Persistently high levels of inequality, declining private investment in infrastructure and public expenditures on critical social infrastructure, increases in global carbon emissions, continue to exemplify the inability to align investments with long-term sustainable development requirements.
5. According to the 2018 IATF assessment, if these vulnerabilities are left unaddressed, structural impediments will continue to undermine sustainable development prospects. In assessing the achieved in implementing the AAAA, the following top-line findings emerge:
  - a- In terms of planning, integrated national sustainable development strategies and financing frameworks are deemed essential to guide long-term policies, plans and projects. These strategies should incorporate the policies, plans and regulatory frameworks needed to achieve the sustainable development goals (SDGs), as well as include a topology of the domestic and international financing flows available and those that need to be mobilized. These strategies and financing frameworks need to move away from the funding of project mindset towards broader financing approaches. However, the latter needs to be supported by a global enabling environment that can facilitate long-term and quality investments, particularly in developing countries.
  - b- In terms of operation, public policies and actions are at the heart of the agenda. Incentives for actors in public and private financial institutions need to be aligned with long-term sustainable development. However, while public and private finance play important roles in financing sustainable development, public leadership is indispensable to set rules and overcome structural constraints that impede sustainable-development-oriented structural transformation. In many areas, particularly for public goods, public financing remains indispensable.

- c- In terms of focus, there is a need to serve the poorest and most vulnerable to ensure no one is left behind. Financing gaps are greatest in least developed countries, yet international support for these countries has not been commensurate and the development finance made available to them remains insufficient to effectively help these countries achieve the SDGs.
  - d- In terms of governance, strong institutions, upholding the rule of law and establishing transparent, consistent and good quality regulatory frameworks are needed to ensure that private operators are encouraged to invest, natural monopolies are well managed, and to boost innovation and limit bureaucracy. Without an enabling environment, investment risks remain particularly high, and neither public nor private domestic and international financing is likely to ensue in a cost-efficient manner.
6. The action areas of the Addis Agenda continue to provide the building blocks for the implementation of the 2030 Agenda for Sustainable Development. In its 2018 assessment, the IATF conveyed the following recommendations to reinvigorate action to finance sustainable development:
- a- Mobilizing additional domestic public finance and spending it more effectively remains critical. Effective revenue collection and public service delivery form the basis of the new social contract. In many countries, however, fiscal space remains constrained and debt sustainability continues to be a major concern. This underscores the need for boosting public financial resources, both domestically, largely through improved taxation, and internationally, through official development assistance (ODA). International cooperation needs to complement national efforts (by increasing financial support for fiscal capacity building), and by ensuring developing countries benefit fully from new international standards on tax transparency standards. New technologies can both increase efficiency in revenue collection and eliminate, or at least, reduce the drainage in domestic resource mobilization capacities due to the magnitude of illicit financial flows.
  - b- Achieving the SDGs requires a shift in the financial sector toward long-term investment horizons. Long-term investment in sustainable development, especially in countries most in need, remains insufficient. There are both supply and demand constraints to greater private investment. Countries need to strengthen enabling environments, thus reducing investment risks, and develop project pipelines and investable projects. At the same time, effective regulation is necessary to monitor systemic risks that may arise from the digitization of finance.
  - c- Development cooperation remains central to supporting implementation of the agenda; international public finance is increasing, but critical funding gaps remain. ODA providers should continue to increase aid, with a view to meeting commitments they have made. Multilateral development banks and South-South cooperation providers are also scaling up their contributions to the 2030 Agenda. The international community should lend greater support to efforts of countries to manage transitions and graduation and should consider flexibilities that allow countries access to appropriate sources of financing.
  - d- Trade reinforcing policies should be considered to serve as an engine for sustainable growth. An open dialogue should be warranted to align new trade agreements with the SDGs. Trade finance plays a key role in helping developing countries participate in global trade; it can be enhanced by promoting greater standardization in rules, practices and relevant programmes.
  - e- Debt risks are increasing, raising the spectre of a renewed cycle of debt crises and economic disruption. Countries face pressing demands for additional public investments in the SDGs at a time when constraints on further debt financing are likely to become more binding. To lessen the financial stress on countries affected by shocks, the international community should work toward realizing the potential of state-contingent debt instruments. The changing composition of debt in developing countries also calls for a re-examination of creditor coordination mechanisms.

## II. REGIONAL CONTEXTS AND PERSPECTIVES ON PROGRESS MADE ON FINANCING SUSTAINABLE DEVELOPMENT

7. The 2018 IATF provides top-line assessments on progress made in implementing the different action areas of the Addis Ababa Action Agenda (AAAA). In tracking progress, however, some constituents note that there has been less emphasis on measuring implementation gaps and how they should be addressed. Regional dimensions are not consistently captured across the more than one hundred global commitments canvassed through the new global financing for development framework. Some observers take the view that the emphasis on monitoring implementation should have been placed on the combined Monterrey/Doha/Addis commitments, rather than restarting from Addis as the only reference point for global commitments on financing for development. Others highlight that FfD assessment should extend to the outcomes and recommendations of the ECOSOC FfD Forum and not confined to normative global dispositions made through the AAAA. While others continue to contend that GDP per capita growth is not a suitable indicator to measure FfD progress and propensities as tax per GDP ratio is not best suited to evaluate the efficacy of tax collection and revenues.
8. The main thrust of the 2018 FfD assessments lies in recognizing that asymmetric progress has been achieved in implementing the different action areas of the AAAA. Not many would refute the succinct conclusion, yet it still does not capture the entire spectrum of regional FfD dynamics and idiosyncrasies. In the case of the Arab region, FfD is witnessing a reflux as for every dollar in FfD inflows the region mobilized/received on average, it correspondingly loses \$2.5 dollars in FfD outflows. The situation poses an opportunity lost to finance the Arab regions' sustainable development imperatives. By overlooking country specific and regional dynamics, there is a risk of 'cherry picking' in assessing progress and neglecting the full range of interventions needed to realise the 2030 Agenda.
9. The IATF notes that escalated geopolitical tensions are derailing FfD progress. Indeed, by 2017 the Arab region became host to more than 41 per cent of the world's internally displaced people (IDPs) and 53 per cent of the global refugee population<sup>1</sup>. Today, the region maintains by far the highest ratios of refugees to total population in the world. Under the current conflict and instability trajectory, the region risks consuming more than half of the of the projected increase in global humanitarian aid budget by 2030<sup>2</sup>. A situation that can hardly be deemed sustainable, especially when the hefty reconstruction bill of war-torn economies is far from being factored into the FfD costing equation, although there continues to highlight selected reconstruction efforts in countries that have been affected by natural disasters.

### A. DOMESTIC RESOURCE MOBILIZATION

10. The 2018 IATF report recognizes that mobilizing domestic public finance and spending it more effectively remains of critical importance to finance development. Effective revenue collection and public service delivery form the basis of the new social contract. However, there is a need to consider the following cross-sectional factors and regional contexts:
  - a- Unlike the situation of developed countries, the structure of the tax base in developing countries remains far less reliant on income taxes, and more on corporate income tax (middle-income countries) and trade taxes (Least Developed Countries). However, raising regressive value added taxes is still seen as a quick win to raise domestic revenues. Indirect taxes continue to be the dominant source of tax revenue in Arab 'oil-poor' countries. A simulation exercise for the GCC countries suggests that, a 5 per cent value added tax rate could generate fiscal revenue of 2 per cent of GDP.
  - b- Achieving progressivity through income taxes on the other hand may improve equality but needs to be weighed against the broader socio-economic conditions of a country. The income tax legislation

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<sup>1</sup> Estimates based on Internal Displacement Monitoring Centre (IDMC) data and Office of the United Nations High Commissioner for Refugees (UNHCR, 2016).

<sup>2</sup> UN, 2016.

proposed by the Government of the Kingdom of Jordan in the summer of 2018 and ensuing unrest is a stark reminder of the implications that may be triggered by introducing such reforms under constrained fiscal and macro-economic conditions. In the Arab region, public budgets are under pressure and the fiscal space across the region masks significant disparities between the *oil-rich*, *oil-poor middle-income*, and *low-income countries*. Even for the oil-rich countries, financing through oil revenues remain volatile and unpredictable. More so, it should be noted that raising income tax revenue remains negatively correlated with the size of the shadow economy. Generic recommendations advocating for such reforms should be assessed carefully as they may discourage labor supply and savings and induce greater incentives to evade taxes and push more activity into the informal sector.

- c- It is generally deemed that, Arab countries need to raise taxes to mobilize additional revenues, in particular by improving progressivity, compliance and broadening tax bases while taking into account equity. Thus, as a first step there is a need to broaden the tax base by reducing informal activity and tax evasion so as to put more economic activities under the coverage of the personal income tax and a broad-based consumption tax. Recommendations for the optimal design of tax policy typically ignore, though, the complications created by the presence of an informal economy and problems arising from tax evasion. More so, taxes can discourage labor supply and savings and induce greater incentives to evade taxes and push more activity into the informal sector.
- d- Profit shifting, aggressive tax planning and ‘tax-treaty shopping’ practices are providing pathways to multinational corporations to avoid paying corporate income tax rate in the countries where they do business. Corporate tax exemptions and/or incentives which are regressive in nature adversely impact domestic revenues mobilization efforts, complicate tax administration and provide opportunity for corruption and rent-seeking. The global corporate tax race to the bottom continues to erode the capacity of developing countries to raise domestic revenues, especially under increased international capital mobility conditions.
- e- Proposals to capitalize on sub-national financing requires reflection as municipalities and governorates need to enjoy a minimum threshold of decentralization to allow them to administer ‘own resources’ or raise capital through markets. Such proposals overlook the fact that these levels of decentralization may not be prevalent in many developing countries as security and considerations continue to determine the degree of decentralization, especially in conflict afflicted economies where precedence resides in ensuring authority over territory.
- f- Equally, proposals to phase out water and fossil fuel subsidies may hold considerable socio-economic implications. Rationalizing subsidies could offer a more suitable and measurable alternative to safeguard that SDGs 1 and 2 are also realized. Taxes on congestions, in essence, are regressive in nature and adversely affect vulnerable populations. Enhancing public transport systems and networks, traffic management and investing in infrastructure development offer other plausible alternatives. Pricing water, air pollution and carbon emissions pose a critical concern and remains debatable as such measures could adversely affect competitiveness and structural transformation of Arab constituents. Providing incentives on the other hand to invest in green transformation related investments would increase access to clean and affordable energy.
- g- Considerable potentials can be realized by enhancing domestic resources mobilization capacities through by eliminating illicit financial flows (IFFs). The 2018 IATF report acknowledges that to date there is no multilaterally agreed upon definition of IFFs, but the need to track their various motives and delivery channels and provide estimates thereof was emphasized. There is however some disagreement whether corporate tax spill over, abusive tax practices should be part of IFFs. According to the IMF, taxation powerfully affects the behavior of multinational enterprises and tax evasion. The treatment of base erosion and profit shifting practices (BEPS) independently gives rise to the impression that these practices are separate from other types of IFFs. Yet, the policies and measures used to combat each tend to overlap and are mutually reinforcing.

## B. DOMESTIC AND INTERNATIONAL PRIVATE FINANCE

11. The 2018 FfD global assessment recognizes that high levels of inequality and declining levels of private investments remain a stark reminder of the inability to sufficiently align private investments with long-term sustainable development needs. There is an evident need to re-align economic and financial policy making with 2030 Agenda. The inter-governmentally agreed conclusions and recommendations adopted at the ECOSOC Follow-up and review conference on financing for development recommended that the ways to incentivize institutional investors to take a long-term approach be explored while considering public interests. Here three points are worth highlighting:
  - a- Public policies should remain at the heart of implementing the FfD agenda. While public and private finance play important roles in financing sustainable development, public leadership is indispensable to set rules and overcome structural constraints that impede sustainable-development-oriented structural transformation. In many areas, particularly those with public good characteristics, public financing remains indispensable. Yet, the report adopts the view that private funds could ease fiscal space to achieve sustainable development. While this may be true for revenue generating projects, it does not necessarily apply to public goods and projects unless they are for a philanthropic cause. The paradox lies in acknowledging that the necessary safeguards need to be in place to ensure the fiscal sustainability of public projects to preserve public interests, while guaranteeing access to private returns on investments.
  - b- It is worth highlighting that more than 150 international civil society organizations launched a PPP Global Campaign, expressing alarm at the use of PPPs to deliver public goods, and in particular the World Bank's role in promoting these contracts. These organizations called for an independent review into the development outcomes of PPP portfolio. They further indicated that where the public sector is a financial or tax incentivising agent, or provides other regulatory or contractual concessions to the private sector, there are less standards applied on robust transparency, accountability and impact assessment.
  - c- These positions broadly resonate with the Arab unified FfD position which recognizes that, "although there is a need to mobilize both public and private finance to achieve the sustainable development goals, private finance is not a perfect substitute for public finance, especially to deliver on vital public infrastructure". In fact, international private capital has been flowing out of the Arab region. According to "The State of Financing Development in the Arab Region" report, the Arab region became a net exporter of both capital and primary income, and for every \$1 of FDI the region galvanized, a corresponding \$1.8 left the region.

## C. INTERNATIONAL DEVELOPMENT COOPERATION

12. The 2018 IATF report submits that international development cooperation remains central to supporting implementation of the 2030 Agenda. International public finance is increasing, but critical funding gaps remain. ODA providers should continue to increase aid, with a view to meeting commitments they have made. Multilateral development banks and South-South cooperation providers are also scaling up their contributions to the 2030 Agenda, but these forms of international collaboration remain a complement (and are not substitutes) to ODA commitments. The international community should lend greater support to efforts of countries to manage transitions and reconsider graduation statuses.
13. There is also a need to recognize that ODA is becoming increasingly non-concessional and is being redirected from its initial intended usages to serve humanitarian action, cover in-donor refugee costs (i.e. ODA allocations are spent in DAC donor countries themselves to host refugees) and cover the costs associated with debt relief frameworks. This is gradually establishing new norms through changing the very definition of ODA and earmarking the rules and the manner by which ODA commitments are reported. ODA reporting should be sufficiently disaggregated to identify if any increases are attributed to humanitarian spending and covering in-donor refugee costs as well as to assess the level of concessionality of ODA disbursed, including through multilateral development banks.

#### D. INTERNATIONAL TRADE AS AN ENGINE FOR GROWTH

14. The report remains adamant on reinforcing trade policies to finance sustainable growth. However, it fails to make any reference to the ‘Doha Development Round-DDA’, although the DDA is factored in the Addis Agenda as a major source by which to turn international trade to an engine for growth. Addressing the intransigence in the DDA falls within the ambit of monitoring the implementation of the Addis Agenda and should be captured as such. Trade is not reviewed against the relevant commitments made under the AAAA. There is a sense of selectivity when analysing trade and trade-related measures. For example, the IATF reviewed progress made on removing agricultural export subsidies but avoids applying an even hand in so far as analysing the effects of introducing disciplines and other export measures having equivalent effect.
15. Labor conditions, empowerment of women and environmental sustainability in bilateral and regional free trade agreements (FTAs) should not inadvertently act as non-tariff barriers to exports from developing countries. Yet, the report calls for an open dialogue over environmental and social principles to be included in new trade agreements. In this context, further precision is required to qualify the purpose and format for the proposed dialogue as it remains bilateral/regional and non-preferential in nature and falls within the ambit of Free Trade Arrangements concluded outside the multilateral trading system (be it on the basis of Article XXIV of GATT or the Enabling Clause) unless there is a new mandate to be issued on the matter by the WTO (through the Negotiating Group on Rules). Reference to these proposed dialogues should be qualified, especially in relation to environmental and social principles over which the WTO does not necessarily have an exclusive mandate over.
16. There is a tendency to down play the effects of trade protectionism while over-emphasizing those that can be rendered from trade facilitation. In doing so, the 2018 IATF report illustrates that the trade coverage of import-facilitating measures (\$169 billion) has outpaced (more than two times) the value of import-restricting measures (\$79 billion)<sup>3</sup>. However, this narrative does not necessarily imply that all developing countries are better off. In the case of the Arab region, a substantial share of the regions’ exports is exposed to trade protectionism and is subject to deteriorating terms of trade. There is a need to qualify such assessments based on product coverage rather than employ aggregate trade values indistinctly from the nature of preferential arrangements regulating trade between Arab countries and their developed counterparts.
17. The accumulation of post-crisis trade and investment protectionism are further distorting the trade-growth nexus. Cumulatively, nearly 1,500 trade restrictive measures have been adopted with more than 1000 of them imposed by developed economies. Only 25% of these restrictive measures in place since the 2007 financial crisis, were removed<sup>3</sup>.

#### E. DEBT AND DEBT SUSTAINABILITY

18. The IATF finds that debt risks are increasing, raising the spectre of a renewed cycle of debt crises and economic disruption. Countries face pressing demands for additional public investments in the SDGs at a time when constraints on further debt financing are likely to become more binding. The changing composition of debt in developing countries calls for a re-examination of creditor coordination mechanisms. Iraq for example abandoned plans to issue sovereign bonds due to the prohibitive interest rates sought by investors. The prospects for tighter global liquidity associated with a normalization of US interest rates and a weaker growth outlook would raise the cost of market-based issuances. These conditions exacerbate the challenges facing the Arab region and may lead to a growth in sovereign borrowing spreads. According to the Global Sovereign Indebtedness Monitor, six Arab countries are vulnerable and likely to witness renewed debt distress/crises.
19. ESCWA had proposed a three-pronged strategy to ensure that debt remains a viable means of sustainably financing the region’s development. This strategy entails: a strong component of debt relief mustered

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<sup>3</sup> World Trade Organization (2016), a healthy trading system requires progress and engagement at all levels.

multilaterally to aid countries facing a heightened sovereign debt distress; a structural and deleveraging component for non-oil Arab economies (based on growth, raising consumption and a return to normal interest rates/inflation); and a balance sheet deleveraging component to avoid the crowding out of the private sector, underinvestment and tightening liquidity (through debt repayment, asset purchases and restructuring private debt), as well as to overcome de-risking practices that have compelled Arab banks to curtail CBRs with foreign banks, thereby hindering access to capital markets.

20. Multilateral work should proceed to preserve debt sustainability, be it on the basis of the UNCTAD ‘Roadmap and Guide for Sovereign Debt Workouts’ or the UN General Assembly resolutions advocating the negotiation of a multilateral legal framework for sovereign debt restructuring<sup>4</sup> and the basic principles adopted on Sovereign Debt Restructuring Processes<sup>5</sup>, including exploring the value of establishing a Debt Workout Institution as had been called for. The debt implications arising from advancing proposals in the other chapters of the AAAA such as private and official loans, blending finance and PPPs should be congruently assessed, including GDP indexed bonds.

#### F. SCIENCE, TECHNOLOGY, INNOVATION

21. The report tackles the income-technology nexus and suggests that incentives be provided to invest in more productive technology and make imports of technology-intensive capital goods cheaper. However, this is a rather generic approach and provides one side of the argument to encourage developing countries to reduce their import tariffs on capital goods. A counter argument would require developed counterparts to provide such technology on preferential commercial terms (i.e. through a derogation or plurilateral agreement to achieve the 2030 Agenda). It should be recalled that the transfer of technology through traditional over-regulated routes, such as compulsory licensing, is still necessary to make the transfer a reality. Since innovation funds have been established well before the adoption of the AAAA, there is a need to assess the value of existing ones and to inform decisions on the development and operation of new ones to support the implementation of the AAAA.
22. The Paris Agreement emphasizes that its means of implementation (finance, technology, and capacity building) have to be provided by the industrialized countries to developing countries. However, the agreement did not prescribe how the transfer of climate-friendly technologies should be conducted, or how intellectual property rights should be handled. The minimalist approach that led to the implantation of many non-binding and in many cases aspirational technology transfer provisions have been an evident impediment to qualify the income-technology nexus, including in the case of many provisions of the Special and Differential Treatment (SDT) that is related to technology transfer.
23. To appreciate the technology-transfer and SDG nexus, there is a need to analyse a number of factors that interact to limit the flow of technology to developing countries. International flows of technology take three principal forms, namely embodied technology, tacit knowledge and codified knowledge. Embodied technology, such as the scientific and technological knowledge embodied in machinery and equipment, falls under the realm of the multilateral trading system. The tacit knowledge flows that enable imported machinery and equipment to function optimally, among others, take place through FDI as technology spillover through: (i) a positive demonstration effect; and (ii) labour mobility and establishing upstream and downstream linkages. In addition, technology also takes the form of knowledge codified in patents, blueprints, training manuals and books. However, with few exceptions, the majority of developing countries had a less positive experience in technology capability building and innovation. Increased flows of technology require more thorough review of international trade disciplines established in the context of the WTO.

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<sup>4</sup> UNGA resolutions A/68/304 and A/C.2/69/L.4.

<sup>5</sup> UNGA resolution A/69/319

### III. CONCLUDING REMARKS

24. Finally, proposals to articulate integrated financing frameworks to inform policies, plans and project pipelines surfaced to provide a topology of domestic and international financing flows. Nonetheless, to date there is no single tool or measure that establishes a comprehensive measure of the amount of financing available to finance sustainable development. There is also no single database that can document all FfD platforms and commitments. There is no one single methodology used to amalgamate financial (e.g.: official development assistance, foreign direct investment etc.) and non-financial means of implementation (trade, pro-poor and pro-employment macroeconomic policies financing enablers) along with their delivery channels (public and private; domestic and international; bilateral and multilateral; traditional and innovate) to provide an estimate of the fiscal space that could be rendered by governments to manage a sustainable path to development.
25. The complexity in devising such frameworks resides in determining how different means of financing interact with each other to create fiscal space available in country specific situations and within integrated national financing frameworks. The different FfD sources and channels tend to interact differently and render asymmetric outcomes under different regional and national contexts.

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