Recommendations of the Intergovernmental Committee of Experts on Sustainable Development Financing

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The Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF) held its fifth and final plenary session from 4-8 August in New York. At the end of the session, it adopted its final report proposing options on an effective sustainable development financing strategy, which will be presented to the General Assembly in September 2014, as mandated by the Rio+20 Outcome Document.

On 5 August, the ICESDF held the last in a series of multistakeholder dialogues, organized by UN-NGLS, to receive a final round of inputs and feedback from stakeholders, based on a public briefing that the ICESDF Co-Chairs provided on 18 July. The archived webcast of the dialogue can be viewed here.

The Advance unedited version of the final report was released soon after adoption. The following article provides a detailed summary of some of the main analysis and recommendations contained in this 48-page report.

Challenges are enormous but surmountable

Part of the mandate that the Committee received from Rio+20 was to assess financial needs. However, given the methodological difficulties in quantifying sustainable development financing needs, the report provides only orders of magnitude. For example, the cost of a “global safety net” to eradicate extreme poverty (measured below the US$1.25/day) is estimated at US$66 billion annually. Annual investment requirements for infrastructure (including water, agriculture, telecommunications, power, transport, buildings, industrial and forestry sectors) amount to US$5-7 trillion. The unmet credit needs of micro-, small- and medium-sized enterprises are estimated at around US$3.5 trillion globally. In terms of additional investments for “climate-compatible” and “sustainable development” scenarios, the estimates are in the order of several trillion US dollars per year.

The Committee estimates that global public and private savings (estimated at around US$22 trillion a year) would be sufficient to meet these needs. However, financing and investment patterns in their current form will not deliver sustainable development. Expected returns on investments associated with sustainable development are often less attractive than other opportunities, while governments have not been able to mobilize adequate public financing to undertake necessary investments that profit-seeking investors eschew. At the same time, there are “fractures in the global economic architecture” that will undermine the global project to deliver sustainable development.

The Committee asserts that there is no one simple policy solution to change course, proposing instead a “basket of policy measures,” that encompass a toolkit of policy options, regulations, institutions, programmes and instruments from which governments can choose appropriate and cohesive policy combinations. While the design and implementation of policies will be at the national level, the
Committee also emphasizes that sustainable development will require international support and cooperation and an enabling international environment.

From this standpoint, the Committee proposes two main strands of recommendations:

• Options for an integrated sustainable development financing strategy; and

• Global governance for financing sustainable development.

Options for an integrated sustainable development financing strategy

The options put forward by the Committee relate to all sources of finance, domestic and international, public and private, as well as so-called “blended finance” between public and private sources. These options are informed by a set of nine precepts that underpin its strategic approach – including the need to mainstream sustainable development financing in national budgets; to adopt a multi-stakeholder, people-centred and inclusive approach; and to ensure transparency and accountability of financing at national, regional and international levels (see pages 18-19 for the other six).

Domestic public financing

The Committee outlines three primary roles for domestic public finance, namely: (i) increasing equity, including through poverty reduction; (ii) providing public goods and services that markets will eschew or under-provide and enacting policies to change incentives of private actors; and (iii) managing macroeconomic stability.

Particular emphasis is placed on the need to improve domestic tax systems in developing countries in a manner that is fair, efficient and transparent. The Committee recognizes that there are limits on what individual governments can accomplish on their own in a globalized economy. It notes that tax competition among countries to attract and retain employers can be harmful, and there needs to be international cooperation among competing countries to reverse this trend in regional and international fora. (The Committee also discusses international cooperation on tax matters under its recommendations on global governance, see below.)

The Committee sees a role for increased official development assistance (ODA) to build capacity in domestic resource mobilization. It also emphasizes that fiscal rules governing the extractive industries should ensure that the public interest is appropriately compensated. At the same time, there is need to ensure good financial governance and public financial management, notably by advancing the fight against corruption and ensuring that budgeting is consistent with national sustainable development strategies. Planning and execution of budgets should be based on transparency, legitimacy, accountability and participation of citizens (consistent with? country capabilities and circumstances.)

Countries should also consider “rationalizing inefficient fossil fuel subsidies that encourage wasteful consumption” (while fully taking into account the specific needs of developing countries and minimizing the adverse impacts on their development in a manner that protects the poor and affected communities). Similarly, countries should eliminate “all forms of agricultural export subsidies and all export measures with equivalent effect” (as mandated in the Doha Development Round of international trade negotiations.)

The Committee also sees a role for public procurement in promoting sustainable development, such as defining minimum environmental and social standards for public sector suppliers, and using public procurement systems to promote the development of sustainable local businesses.
Other recommendations related to domestic public financing include: internalizing environmental externalities and mainstreaming environmental sustainability (for example through carbon taxes or direct emission restrictions on investments and incorporating environmental accounting techniques in assessing the economic performance of countries); addressing inequity and the “social protection imperative”; effectively managing public debt; and exploring the potential contribution of national development banks, notably in financing small- and medium-sized enterprises, infrastructure and innovation.

Domestic private financing

In considering domestic private finance, the Committee insists that while its profit-oriented nature makes it particularly well-suited for productive investments, “the quality of investment matters” and there “continues to be a dearth of domestic long-term investment necessary for sustainable development…. It thus sees a role for governments to develop policies that would incentivize a change to this pattern.

Among these policies are recommendations aimed at: providing access to financial services for households and micro-enterprises; promoting lending to small- and medium-sized enterprises; developing financial markets for long-term investment and enhancing regulations to balance access and stability (including the development of local capital markets in local currencies, which are not subject to exchange rate risks, and the use of capital account management tools to deter “hot money”); strengthening the enabling business environment (such as through easing administrative bottlenecks, promoting rule of law and human rights, and investments in infrastructure, essential public services and human capital); and strengthening economic, environmental, social and governance (EESG) and sustainability in the financial system (and in this regard the Committee poses the question as to whether largely voluntary corporate initiatives can change the way private financial institutions make financial decisions, or whether some of these practices should be made mandatory).

International public financing

The Committee identifies three functions of international public finance: (i) poverty eradication and development; (ii) financing the provision of regional and global public goods; and (iii) maintaining global macroeconomic stability within the context of the broader enabling environment. International public finance should complement and facilitate national efforts in these areas, and will remain indispensable in implementing sustainable development, the Committee stresses.

ODA remains an important source of external public financing for developing countries, in particular least developed countries (LDCs). The Committee notes that current ODA levels – averaging 0.3 % of gross national income (GNI) – are still well below the internationally agreed target of 0.7%, while ODA to LDCs amounts, on average, to 0.09% of GNI, despite commitments to allocate 0.15-0.20% of GNI to LDCs in the 2011 Istanbul Programme of Action.

The Committee insists that “Member States of the United Nations should honor their commitments in full and in a timely manner, and neither ignore nor dilute them.”

The Committee’s report also suggests that the international community should further explore innovative mechanisms to mobilize additional international resources, including a financial transactions tax, to finance global sustainable development. It further notes that international public finance should respond to the growing need for financing global public goods, “without crowding out traditional development assistance.”
The effectiveness of development cooperation is also mentioned by the Committee. In this regard, donor countries “should improve the management and coordination of international public support, through increased joint planning and programming on the basis of country-led strategies and coordination arrangements.” Likewise, the Committee makes recommendations to reduce the “fragmentation and complexity of environmental and climate finance, in particular rationalization of the overall architecture is needed.”

**International private financing**

The Committee notes that international private finance contains a wide range flows, including foreign direct investment (FDI), portfolio flows and cross-border bank loans.

While FDI remains the most stable and long-term source of private foreign investment and has a critical role to play, the Committee emphasizes that policymakers need to monitor the quality of FDI in order to maximize its impact on sustainable development. Governments could, for example, adopt policies that encourage linkages between multinational enterprises and local production activities, support technology transfer, provide local workers with opportunities for further education, and strengthen the capacity of local industry to effectively absorb and apply new technology. Host governments should further require all companies, including foreign investors, to meet core labour standards of the International Labour Organization and encourage EESG reporting.

The Committee notes that international institutional investors – such as pension funds, life insurers and sovereign wealth funds – hold an estimated US$80-90 trillion in assets, representing an enormous potential, but so far little of that money has been invested in sustainable development. According to the Committee, one of the reasons is that these investors do not have the capacity to do the necessary due diligence to invest directly in infrastructure and other long-term assets across a wide range of policy and regulatory regimes. Instead, they invest through financial intermediaries, whose liabilities and incentive structures tend to be shorter-term. The Committee thus calls for new instruments to overcome this problem, such as joint investor group platforms for sustainable infrastructure investments, which could be set up by public actors such as multilateral and bilateral development finance institutions.

As for domestic private finance, the Committee also recommends measures to manage short-term cross-border capital flows, including macro-prudential and capital market regulations, as well as direct capital account management.

**Blended finance**

The Committee notes that policymakers have recently shown considerable interest in so-called “blended finance,” which pools public and private resources and expertise, including through public-private partnerships (PPPs). “When well designed, blended finance allows governments to leverage official funds with private capital, sharing risks and returns, while still pursuing national social, environmental and economic goals in areas of public concern.” It suggests that there is a strong case for blended financing to facilitate investments that are just below the margin of real or perceived commercial viability (and cannot be unlocked by an enabling policy and institutional environment alone), but also serve the public interest.

However, the Committee also emphasizes that “poorly designed PPPs and other blended structures can lead to high returns for the private partner, while the public partner retains all the risks.” It further notes that there is a failure rate of PPPs of 25-35% in developed countries (due to delays, cost overruns and other factors) and even higher failure rates in developing countries. “It is therefore important for policymakers to engage in blended finance structures with careful planning, design and management in order to
strike a balance between economic and non-economic returns, and to ensure fair returns to citizens.” The Committee calls for capacity-building and policy dialogue to share experience on lessons learned on blended finance.

Global governance for financing sustainable development

To mobilize and effectively use the various types of financing mentioned above, the Committee states that “it is necessary to have an adequate enabling international environment and policy architecture that provides the policy space necessary to implement effective national sustainable development strategies.” The Committee describes the package of recommendations below (many of which would require some form of inter-governmental follow-up) as a “strengthened global partnership for sustainable development.”

Strengthen systemic coherence and global economic governance

Under this heading, the Committee states that the United Nations has the ability to serve as global forum to bring together the various separate and sometimes uncoordinated international bodies that oversee the global economic environment. Within the UN system there is also a need to reinforce the coherence of financing frameworks that developed out of two major strands of the development debate – the Post-Monterrey and the Post-Rio+20 means of implementation. It also calls on international financial institutions “to continue to take steps to align their own business practices with sustainable development objectives.” A further review of their governance regimes is also necessary to update their decision-making processes, modus operandi and priorities, and to make them more democratic and representative.

Adopt trade and investment rules that are fair and conducive to sustainable development

In terms of current negotiations at the World Trade Organizaton (WTO), the Committee notes that remaining disagreements have prevented formal adoption of the package of agreements at the last WTO Ministerial Conference in December 2013, and stresses that “it is time to address politically sensitive issues, such as agricultural export subsidies….”

In relation to international investment rules, the Committee suggests that “to achieve a better balance between investor rights and the sovereign capacity for recipient States to regulate within areas of public interest, the international community could consider, as appropriate, a further elaboration of standards for investment in areas that directly impact domestic sustainable development outcomes, and ensure that investments do not undermine international human rights standards.”

The Committee further observes that the proliferation of bilateral investment treaties and other trade agreements covering investment issues “renders the mainstreaming of a sustainable development perspective in investment regimes more difficult.” It refers to risks resulting from these agreements of curtailing policy space for countries, and calls for exploring steps toward a multilateral approach to international investment regimes “that more adequately balances investors’ preferences with the needs of residents of the countries in which they would operate, with a view to facilitating a more holistic approach in the interest of sustainable development.”

Strengthen global financial stability

The Committee takes note of the steps taken in the wake of the 2007-2008 global financial and economic crisis to address vulnerabilities in the financial sector through regulatory reform. It cautions that new regulations should not unintentionally stifle the availability of long-term financing. It also calls for
enhancing transparency in international regulatory bodies, such as the Financial Stability Board, as well as the representation of developing country interests in these bodies.

In addition, it calls on the international community to strengthen the ability of the international system to respond to crises, notably by continuing to review the capacity of the IMF and other international organizations to provide early warning and quickly take “counter-cyclical action.”

At the same time, it calls for ways in which global and regional strategies can reduce the need for countries to maintain high stockpiles of reserves through alternative insurance mechanisms.

**Strengthen regional cooperation**

In this regard, the Committee notes that the recent financial and economic crisis has directed attention to the potential of regional financial stability mechanisms (citing the Latin American Reserve Fund and the Chiang Mai Multilateralization Initiative) to “serve as a first line of defense against contagion from global crises.”

More broadly, effective regional arrangements can provide financing for regional public goods, as well as facilitate trade flows and attract investments into key sectors, such as infrastructure, according to the Committee. They also provide opportunities for information exchange and peer learning in fiscal, financial and economic affairs.

**Enhance international cooperation on taxes and fight illicit financial flows**

As noted under the heading on domestic public financing, the Committee calls for enhanced international cooperation to combat harmful tax competition between countries to attract and retain investors. Such cooperation also extends to combating strategies by multinational enterprises to evade and avoid taxes by structuring international transactions to take advantage of different national tax rules, including by mis-pricing intra-group transactions (transfer mis-pricing). This cooperation effort must also encompass illicit financial flows, facilitated by jurisdictions with regulatory regimes that allow companies and individuals to effectively hide money.

The Committee suggests that such international cooperation could cover country-by-country reporting, publicly available company beneficial ownership registers, automatic exchange of tax information, transfer pricing regulations, lists of tax havens, standards for non-economic reporting, effective implementation of the Financial Action Task Force standards and asset recovery.

The Committee notes that the G-20 Leaders have endorsed the Organisation for Economic Co-operation and Development’s Action Plan on Base Erosion and Profit Shifting (BEPS) and automatic exchange of information; but adds that the United Nations, with its universal membership and legitimacy, “could be a catalyst for further strengthening international cooperation in this area…”

**Strengthen sovereign debt crisis prevention and resolution**

The Committee observes that sovereign debt crises severely impede nations’ efforts to finance sustainable development, with debt crises often leading to a spiral of capital flight, devaluations, rising interest rates and unemployment. These considerations were underscored by recent developments with regard to Argentina’s crisis with holdout creditors. It notes that there are calls for action on an effective and fair sovereign debt restructuring and debt resolution mechanism and that there is on-going work on this issue in the United Nations system, including in the IMF, the UN Department of Economic and Social Affairs.
(UN-DESA) and the UN Conference on Trade and Development (UNCTAD). “Given the importance of sovereign debt crisis and debt overhangs to financing sustainable development, it is important for the international community to continue ongoing efforts to enhance the existing architecture for sovereign debt restructuring,” the Committee recommends.

**Foster harmonized monitoring and accounting systems and a data revolution**

The Committee emphasizes that strong, relevant and comparable data is the basis for improved global governance and sustainable development follow-up. Yet, “current information flows, reporting standards and monitoring mechanisms are overlapping, contradicting, incomplete in coverage and often inaccessible to development actors.” In light of this, the Committee calls on the international community to “agree on suitable monitoring frameworks for the post-2015 development agenda that keep track of sustainable development financing flows from all sources, with transparent and separate reporting for development and climate finance commitments.”

**Toward the third United Nations Conference on Financing for Development**

The Committee concludes with the expectation that the recommendations and analysis in its report will stimulate discussions among all stakeholders and inspire new ideas and innovative solutions. “Many of our recommendations call for exchanging ideas and sharing experiences between countries and for enhanced international cooperation based on a renewed global partnership for sustainable development. The third international Conference on Financing for Development [to be held in Addis Ababa, Ethiopia, from 13 to 16 July 2015] and its preparatory process will bring together all stakeholders and provide an opportunity for advancing these discussions.”

The Report of the Intergovernmental Committee of Experts on Sustainable Development Financing is available online.

For more information on the work of the Committee, click here.