



Intergovernmental Group of Experts on

# FINANCING FOR DEVELOPMENT

## THIRD SESSION

4–6 November 2019  
Palais des Nations, Geneva



## **Eurodad Submission to the UNCTAD Intergovernmental Group of Experts on Financing for Development**

*Eurodad (the European Network on Debt and Development) is a network of 50 civil society organisations from 20 European countries. Eurodad works for transformative yet specific changes to global and European policies, institutions, rules and structures to ensure a democratically controlled, environmentally sustainable financial and economic system that works to eradicate poverty and ensure human rights for all. More information: [www.eurodad.org](http://www.eurodad.org)*

*The views expressed are those of the author and do not necessarily reflect the views of UNCTAD*

**How can the commitment by the Addis Ababa Action Agenda to reverse recent declines in official development assistance be met and how can official development assistance play a more effective role in efforts to scale up development finance required to achieve the Sustainable Development Goals?**

- ***Recommendation 1: Donor countries should agree on a binding timetable to deliver on their 0.7% of GNI spending target***

Official Development Assistance (ODA) remains a critical resource, particularly for the world's poorest countries. However, its value has been severely undermined by failures of donor countries to meet the UN target to provide 0.7% of their GNI as ODA. The current ratio of 0.31% of GNI for OECD-DAC members brings with it a funding shortfall of \$184 billion annually.

- ***Recommendation 2: Donor countries should exclude all in-donor refugee costs from ODA***

The usefulness of the ODA figures as a measure of international development cooperation resources available to developing countries is weakened by the inclusion of several categories of in-donor costs, particularly refugee costs. Over the past three years, in-donor refugee costs (IDRC) amount to 10 per cent of DAC member countries' ODA. IDRC should not be considered as ODA as they do not constitute a flow of resources to countries on the DAC list of eligible ODA recipients and there is no direct link to the core purpose of ODA; the 'promotion of the economic development and welfare of developing countries'.

- ***Recommendation 3: Private Sector Instruments (PSI) should not artificially inflate ODA***

ODA accounting rules currently provide incentives that undermine its effectiveness. Current ODA reporting standards allow the inclusion of subsidies to the private sector and support to the private sector in developing countries on close-to-commercial terms. This undermines the fundamental principle that ODA should be concessional and risks creating incentives to divert scarce ODA resources to the private sector with unintended consequences such as increased aid tying, crowding out of the local private sector, supporting firms with poor environmental, human rights or tax practices and contributing to unsustainable debt levels. Donor countries should not include Private Sector Instruments as ODA until a comprehensive proposal is worked out to ensure PSI do not artificially inflate ODA and disincentivise other types of ODA with greater development impacts such as budget support.

- ***Recommendation 4: Donor countries should agree on a time-bound action plan to fulfil key development effectiveness principles from Paris to Busan***

The quality of development cooperation is further undermined by the lack of progress of the donor community to fulfil development effectiveness commitments agreed in a series of agreements started at the 1<sup>st</sup> High-Level Forum on Aid Effectiveness in Rome in 2003 and reaffirmed at the 4<sup>th</sup> Forum in Busan in 2011. Unfortunately, the commitments to make aid more effective by increasing developing country ownership stand in contrast to reality: the alignment of donor development strategies with partner country priorities is declining, forward visibility is decreasing and the use of country systems for aid delivery remains limited notwithstanding the increase in the quality of such systems.

The tendency to use ODA as a tool to mobilize additional (private) development finance poses additional risks to the quality and effectiveness of development cooperation. These risks include the diversion of ODA away from its core mandate of the eradication of poverty and promotion of sustainable development, a lack of clear added value (either in terms of financial or development additionality), unintended side-effects for development effectiveness

principles (such as democratic ownership, transparency and accountability), human rights, the environment, conflict and fragility, debt sustainability, illicit financial flows, and tax avoidance, an increase in informally tied ODA and privatisation or commercialisation of social sectors, including through the use of expensive and risky public-private partnerships, all of which undermine the development objectives of ODA.<sup>1</sup>

A particular challenge to increase the ownership of developing countries is to tackle aid tying, both in principle and in practice. In 2016, over 15 per cent of ODA was reported as formally tied. In reality, the true level of tying is even higher, since ODA that is reported as untied can still be tied ‘informally’, through procedural restrictions that give companies from the donor country an unfair advantage. No official estimate of informal tying exists, but the best available proxy – data on donors’ ODA contract awards – shows that more than half of all reported contracts in 2016 were awarded back to firms in the donor country (analysis by value of contracts).<sup>2</sup>

As donor procurement of goods and services accounts for a significant amount of ODA (an estimated US\$55 billion in 2015 alone), opening up donor contracts to companies in partner countries has a strong potential for maximizing the catalytic impact of ODA for development. ODA procurement can build local supply chains for essential goods such as foods and medicines; it can incentivise local companies to act in equitable, socially responsible and environmentally sensitive ways; and it can start a chain reaction of local economic growth and increase productivity of local SMEs. Urgent action is therefore needed to untie all ODA and improve procurement processes and make these more aligned with the principle of democratic ownership of development priorities. The UN could consider developing an ambitious time-bound proposal for the steps governments can take to end informally tied aid and to enhance qualitative reporting on untying ODA, by including increased emphasis on where contracts are actually awarded, on perspectives from governments in the global south, and on the implications of the increased use of blended finance.

- ***Recommendation 5: Ensure that any new measures that are developed to increase transparency on resources for sustainable development do not undermine ODA commitments***

We note the work of the OECD and UN on a new framework for monitoring and measuring all external financial flows from traditional and emerging donors that are delivered to support global public goods and the SDGs in developing countries (TOSSD). There is a risk that this measure undermines ODA as donor countries replace ODA with other forms of financing that are part of the framework. Additionally, including resource flows without demonstrated development impacts in these measures risks to undermine key internationally agreed social, environmental and development effectiveness standards even further. Actions to address these risk include applying differentiated reporting for official flows and mobilised flows, establishing an adequate oversight and governance mechanisms that includes developing countries on equal footing and CSOs.

**How can the quality and impact of both concessional and non-concessional official flows be improved and coordinated to support these efforts, including through innovative financing models and tools?**

- **Recommendation 6: Increase efforts to address the need for new and additional public sources of financing for development in line with past FFD-commitments**

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<sup>1</sup> Eurodad (2018), History RePPeated. How Public Private Partnerships are failing, <https://eurodad.org/Entries/view/1546956/2018/10/03/History-RePPeated-How-public-private-partnerships-are-failing>

<sup>2</sup> Eurodad (2018), Development Untied : Unleashing the catalytic power of ODA through renewed action on untying, <https://eurodad.org/files/pdf/5ba3a41be1899.pdf>

The Doha declaration (2008) encouraged ‘the scaling up and the implementation, where appropriate, of innovative sources of finance’ and said that ‘these funds should supplement and not be a substitute for traditional sources of finance’. However, as the term ‘innovative’ has since been used for a wide variety of different mechanisms that use public resources to crowd-in private finance, development partners should focus on its original meaning: the need for new and additional public sources of financing for development. New public sources of finance can provide much needed additional resources for development, which should be above and beyond the 0.7% commitments of GNI to ODA. In particular, we recommend using the revenue from the implementation of a levy on financial transactions carried out by finance firms, rather than individuals, on assets such as shares, bonds, currency and their derivatives. Adoption of such a measure will serve to enhance the stability of the world’s financial system to the benefit of both developed and developing countries by incentivising long-term investment over short-term trading. Development partners could increase efforts with the Leading Group on Innovative Financing for Development to take this work forward.

➤ **Recommendation 7: Adopt a cautious and evidence-based approach towards blended finance**

Blended finance is portrayed by some development actors as a key tool to leverage private finance for development, and there are concrete attempts to increase its use to deliver ODA (for instance, the EU External Investment Plan). Recent evidence, however, shows that high expectations of these leverage effects are unrealistic and blended finance operations are playing only a marginal role in scaling up investment in many developing countries. As blended finance projects are primarily materialising in Middle-Income Countries, blended finance risks skewing public concessional finance away from those countries most in need. Moreover, there is a growing body of evidence on the challenges that existing blended finance modalities face to reduce poverty and contribute to leaving no-one behind, with some cases showing adverse impacts on communities and people living in poverty.<sup>3</sup> The assumptions around how the impact of blended finance will materialise must be addressed.

Developed countries should adopt a **cautious and evidence-based approach towards blended finance**, especially in the Least Developed Countries where investment constraints are particularly challenging and increasing fiscal space for public investment remains critical. Specific attention needs to go the **debt implications of blended finance** as even if such finance is initially extended to private actors, it can rapidly create public liabilities if projects fail. In the absence of compelling evidence of effective mitigations for all the risks mentioned, we believe that any moves to scale up blended finance are premature and problematic.

Eurodad notes the ongoing work of the OECD on the Blended Finance Principles for unlocking commercial finance for the SDGs and of the GPEDC on the Kampala Principles on effective private sector engagement in development cooperation. In addition, Eurodad suggests more **rigorous and binding guidelines and safeguards are developed to mitigate the risks and opportunity costs of using ODA for blended finance projects**. The UN could consider to mandate the **Development Cooperation Forum to examine the interaction between international public finance and private sector development**, which examines both the

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<sup>3</sup> Eurodad (2017), Mixed messages : the rhetoric and the reality of using blended finance to ‘leave no-one behind’, <https://eurodad.org/files/pdf/1546844-mixed-messages-the-rhetoric-and-the-reality-of-using-blended-finance-to-leave-no-one-behind--1511464491.pdf>

impact of international public finance on the local private sector, including how best to tackle informal tying of ODA to firms in provider countries; and the knock-on impacts and opportunity costs for public services in the global south if international public finance is used to support the private sector.

**What institutional, policy and regulatory changes at the international level will be helpful to ensure that global economic governance appropriately supports effective international development cooperation, to facilitate domestic public resource mobilization?**

Meeting ODA spending commitments and ensuring effectiveness principles for all aid flows, including blended finance, may achieve little if developing countries continue to face systemic failures of the global economy that undermine domestic public resource mobilization. These systemic failures relate to a multitude of issues such as financial sector regulation, global financial and monetary reform or trade and investment agreements. In this contribution we focus on the need for global tax reform, debt management and increased policy space through IFI conditionality reform.

➤ ***Recommendation 8: Establish a fully inclusive intergovernmental tax commission in the UN***

In the first place, tax evasion and avoidance are major reasons why developing countries are facing financing gaps that are being filled with borrowed monies: UNCTAD has estimated that the tax revenue losses related to inward investment stocks linked to offshore centres (tax havens) alone amount to an estimated US\$100 billion a year. An agenda to tackle tax dodging must include work on base erosion and profit shifting, tax and investment treaties, tax incentives, taxation of extractive industries, beneficial ownership transparency, country by country reporting, automatic exchange of information for tax purposes, alternatives to the 'arm's length' approach, promotion of progressive tax systems, and minimising the harmful spillover effects of tax policies. Eurodad calls for a fully inclusive intergovernmental UN tax commission to be established.

➤ ***Recommendation 9: Agree on a legal framework for debt restructurings and a debt workout mechanism***

The international community should ensure responsible lending by official and private creditors and responsible borrowing by sovereign borrowers and the private sector. Most regulation focuses on the borrower side and on the sovereign. There is an urgent need to better regulate lenders, and the private sector both as borrower and lender. Most debt crises start in the private sector, and only eventually spill over to the sovereign. The few existing tools, such as the UNCTAD Principles on Promoting Responsible Sovereign Lending and Borrowing should be strengthened through monitoring mechanisms for responsible lending and borrowing.

The absence of an international debt resolution mechanism remains a gaping hole in the international financial architecture. Sovereign debt crises are difficult to manage, as there is no insolvency law to give guidance and no insolvency court to make decisions on necessary debt restructurings. This leads to avoidable delays, collateral damage and unfair outcomes. Restructuring official loans from multilateral development banks is particularly difficult. There is an urgent need for the international community to agree on a legal framework for debt restructurings and to create a debt resolution forum or debt workout institution, as already suggested in the UNCTAD Roadmap and Guide on Sovereign Debt Workouts. This framework should also allow states to take unilateral measures based on international law, including the suspension of payment, carrying out debt audits with the participation of civil society, as well as the repudiation of illegal, odious and/or illegitimate debt as recommended among others by the recent European Parliament Resolution of 17 April 2018. We suggest that UNCTAD should continue to work on the concept of a sovereign debt resolution mechanism with a special focus on countries whose debt situation risks being severely aggravated through

**external economic shocks or the effects of natural disasters in regions that are most severely affected by climate change.**

➤ ***Recommendation 10: IFIs should refrain from imposing harmful economic policy conditionality***

As recent Eurodad<sup>4</sup> and academic research<sup>5</sup> has shown, lending with conditionality amplifies the asymmetric relation between the IMF/WB and a borrower country: exchanging financing in return of compulsory macroeconomic reforms undermines democratic decision-making. The IMF should refrain from promoting austerity as the default option through loan conditionality as it squarely shifts the burden of adjustment on the most vulnerable. The WB should refrain from promoting market-based solutions through loan conditionality and policy advice as it risks to adversely impact public service provision for the poor. The IMF/WB should respect democratic ownership of domestic policy-making by borrower countries and stop applying conditions to loans other than the repayment of the loan on the terms agreed.

➤ ***Recommendation 11: Donor aid architecture should place development and sustainability priorities centre stage***

We note with concern ongoing discussions to reform the EU development architecture for development. While there is a need to enhance and improve the development impact of EU development finance – a point that also applies to the global financial architecture – current proposals place too much emphasis on setting up new institutions without addressing the failures of existing ones (for instance, the EU has not been able to make existing institutions more transparent and accountable, with stronger environmental, social and Human Rights standards at its core).

A development finance architecture should be composed of institutions working at different levels – national, regional and global – with a clear development mandate, focused on delivering development additionality and targeting finance where it is needed most, avoiding competition for low-hanging fruit projects. A key reason to improve the functioning of development banks is that the commercial financial sector is unlikely, of its own accord, to provide the finance needed to support sustainable and equitable social, environmental and economic development, nor to support participatory, transparent and accountable governance. In addition, development banks at the core of EU development finance should ensure that development outcomes take precedence over profitability. The financial sustainability of the institutions should not undermine their ability to invest in higher risk areas, or focus on projects where development returns are high but profitability may be low.

The financial architecture for development should prioritise development impacts and adopt a pro-poor agenda with a strong gender lens, focusing on poverty reduction, tackling inequalities and leaving no one behind. The institutions part of this architecture should support the ability of countries to reach the Sustainable Development Goals, the Paris climate agreement and other international human rights and labour standards and not be seen as a means to deliver on commercial or foreign affairs objectives of any given country. It is key that this architecture is delinked to the political trend of using scarce ODA to focus on border management and migration control. Similarly, the concept of economic diplomacy should not be at the core of this architecture, since it may contradict development effectiveness principles and support of civic space for local actors. Alignment with development

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<sup>4</sup> Eurodad (2018), Unhealthy conditions: IMF loan conditionality and its impact on health financing, <https://eurodad.org/files/pdf/1546978.pdf> and Eurodad (2019), Flawed conditions: The impact of the World Bank's conditionality on developing countries, <https://eurodad.org/files/pdf/1547058-flawed-conditions-the-impact-of-the-world-bank-s-conditionality-on-developing-countries.pdf>

<sup>5</sup> Ortiz, I. & Cummins, M. (2019), Austerity, the new normal. A renewed Washington Consensus 2010-2024, <http://policydialogue.org/files/publications/papers/Austerity-the-New-Normal-Ortiz-Cummins-6-Oct-2019.pdf>

effectiveness principles is crucial; therefore, support for national strategies should be reinforced in future European financial architecture for development. Finally, climate action should be central to this architecture and funding should be fully aligned with the Paris Agreement's objectives to limit global warming to 1.5°C and avoid fuelling climate disasters through support of fossil fuels.

For more information, please refer to Eurodad's report "Public Development Banks - Towards a better model" which sets out an institutional and governance reform agenda which challenges existing institutions and the governments backing them, to get better at supporting development, become more accountable and learn from past mistakes.

Finally, we welcome the ideas included in the latest UNCTAD Trade and Development in relation to strengthening the role public development banks as a way of supporting a Global Green New Deal, which implies rebuilding "the rules of the global economy toward goals of coordinated stability, shared prosperity, and environmental sustainability, while deliberately respecting the space for national policy sovereignty".