



November 2014



Centre for Aid
& Public
Expenditure

The 2014 CAPE conference:

the role of finance in achieving the
Sustainable Development Goals

Framing Paper

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ISSN: 2052-7209

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Introduction



Goodbye MDGs, Hello SDGs.

Next year will see the finale of a protracted performance: the global cast of development actors will set the development agenda for the next fifteen years.

Rehearsals are already well under way, and from what we can see of the Sustainable Development Goals, ambitions are immense. Eradicating poverty everywhere and building environmental sustainability into the fabric of development are the loftiest goals, but there will likely be a shift across the board away from narrow targets (say, for primary school enrolment) towards the bigger picture (delivering a quality education and life-long learning opportunities for all).

So much for the rhetoric, what about the resources? The answers to that question should emerge in July 2015, at the Third International Conference on Financing for Development in Addis Ababa. That is where the SDGs will be translated into financial commitments. And this is the topic of the 2014 CAPE conference.

Goodbye Monterrey Consensus, Hello Addis Accord?

The Millennium Development Goals were accompanied by a consensus around development finance, much of which still resonates today. Domestic resource mobilization and international private capital flows were given starring roles, for example, as they will be again in 2015. But traditional foreign aid also received top billing. The UN Millennium Declaration called on industrialized countries to “grant more generous development assistance” (UN 2000) and the Monterrey Consensus was that “a substantial increase” in aid would be required to achieve the MDGs. Words were translated into action: net Overseas Development Assistance (ODA) jumped by around 70 per cent in real terms between 2000 and 2005 (since when the trend has been flat).¹

This time around a material increase in traditional development assistance does not seem to be on the table.² Everybody agrees the SDGs will require a major escalation of investment, but this time the main source of funding is expected to be the private sector. ODA still has a role, but is now thought to be a significant one only in the dwindling band of low income countries and fragile states. If these countries are to see significant increases in aid, it will be through reallocation away from richer recipients, and indeed a target for giving a certain percentage of aid to low income counties has been proposed.

To remain awhile on the topic of traditional aid, the SDGs are supposed to be “global in nature and universally applicable” whilst taking into account “different national realities, capacities and levels of development and respect national policies and priorities.” It is not clear what that will mean – or what that should mean – when it comes to net financial transfers between countries at different stages of development. Middle income countries are keen to assert themselves on the global stage, and many have nascent international development programs of their own. The majority of countries involved in negotiations over financing for development will not be aid dependent and beholden to donors. Whether this means they will happily accept dramatic reductions in net transfer receipts, whilst simultaneously signing up to the most ambitious set of development goals, will be one of the most contentious issues in Addis Ababa.

Traditional aid gets a lower billing this time around, simply because the scale of ambition embodied in the SDGs dwarfs the financial resources of public development agencies. According to UNCTAD, approximately \$4 trillion will be required every year from 2015 to 2030 in developing countries alone for the proposed SDGs to be achieved. Taking into account current levels of spending by both public and private bodies, they estimate a funding gap of \$2.5 trillion per year. Aid is a drop in that ocean. But the sum of global tax revenues and private financial flows is counted in the trillions. Achieving the SDGs hinges upon growing the pot of domestic resources available for development, and bending global private economic activity towards the purposes of sustainable development. The 2014 CAPE conference will examine the evidence base we have to guide public sector engagement with the private sector, and the scope for significant gains in domestic resource mobilization.

Are resources even the binding constraint on development? The importance of domestic political and economic institutions has always been acknowledged – the UN Millennium Declaration stated that achieving the MDGs will depend on good governance within each country and at the international level, and the Monterrey Consensus stated that “the role of national policies and development strategies cannot be overemphasized”. But the perception remains, in some quarters, that the MDGs fostered an overly simplistic view of the connection between financial inputs and development outcomes. This time around, the centrality of what the Intergovernmental

1 Net ODA in 2012 constant dollar was \$76bn in 2000 and \$129bn in 2005, based on the ‘all donors’ data for total aid to developing countries, from the DAC2a database.

2 The need for a major increase in funding is centered on climate change, with a figure of \$100bn being mentioned without anybody being quite clear about how much of that will be truly additional. Climate change is obviously a huge issue, and an important part of what distinguishes the SDGs from the MDGs. We have whole research teams within ODI working on climate change, but not CAPE. We know that climate change can never be entirely separated from traditional development, but this conference will concentrate on the latter.

Committee of Experts on Sustainable Development Financing calls the “domestic enabling environment and policy framework” (ICESDF 2014) looks like receiving even more emphasis.

This raises some awkward questions about the scaling up of external assistance to the poorest countries which lack other sources of finance. The domestic environment is unlikely to enable effective externally-financed development progress in some poor and fragile states, which is a problem for the goal of eradicating poverty everywhere. International public financial resources are scarce and must not be wasted, yet withdrawing aid from poor performers is almost ruled out in the definition of the SDGs. How can these contradictions be resolved in Addis Ababa?

Doubts about the enabling environment could also be raised in some of the middle-income countries that may enjoy resource revenues, access to international capital markets or significant volumes of foreign direct investment. What does acknowledging the centrality of the domestic enabling environment imply for external interventions in development, via financial instruments beyond traditional aid? It is easy to say that catalysing private capital flows will be less effective at eradicating poverty in a weak local environment; harder to say what external actors can do about it.

The 2014 CAPE conference: the role of finance in achieving the Sustainable Development Goals

The purpose of the 2014 CAPE Conference is to assess the evidence base that should inform financing negotiations in Addis Ababa next year. In particular we will be asking whether commonly-held beliefs around development finance are really underpinned by good research evidence. Examples of such beliefs include the idea that aid is only important in the poorest countries, that using public development finance to catalyse private finance is the key to achieving the SDGs, and that increased domestic resource mobilization is something that precedes development rather than follows it.

This conference is the first milestone in ODI’s journey towards Addis Ababa; future steps will include a major ODI event to be held in Accra, in March 2015, which will introduce and debate a set of policy proposals for the role of international public finance in supporting the SDGs. This event will be followed by the publication of an ODI Flagship report in April, pulling together our main messages about the role of finance in development.

The 2014 CAPE conference will begin with introductory presentations from senior ODI researchers and development officials, designed to summarise the current state of play in the policy debates around financing for development, and set the scene for the more focussed sessions that follow. The first session will consider what the experience of the MDG era has to teach us about financing the sustainable development goals. There will be one session on each of the three main sources of development finance: domestic taxation, international public finance and private finance. A fifth session will look at the financing picture from the perspective of developing countries. The conference will wrap up by drawing out some potential policy lessons.

Running order

Framing session

Finance for development

Session 1

What lessons did the MDG era yield for development finance?

Session 2

Mobilising (and allocating) domestic resources for development

Session 3

What is the role of international public finance?

Session 4

Mobilising private development flows

Session 5

Managing external and domestic finance flows – the country perspective

Conclusions

Policy recommendations for financing for development and the SDGs



Session 1: What lessons did the MDG era yield for development finance?

Introduction

This session will look back at the era of the MDGs to trace the links between goals, financial flows and outcomes. Particular emphasis will be placed on reviewing financing choices – whether the allocations and modalities chosen by donor nations were well aligned with the MDGs, and whether governments in developing nations directed their spending towards MDG priorities – and their impact on development.

But the purpose of looking backwards is to peer into the future, so this session will be more than a post-mortem of MDG financing. It will ask what, if anything, have we learnt must change. There is plenty to say about the shortcomings of the MDGs and foreign aid more broadly, but this session will – as much as possible – limit its attention to the decisions on financing that will be taken at the Financing for Development Conference in Addis Ababa in July 2015.

Background

The MDGs were ambitious and whilst progress has been made on many fronts, too many of the goals will not be attained, particularly in Africa. Undeterred, the international community has upped the ante, and the ambition of SDGs makes the MDGs look modest by comparison.

The development community is caught between the “imperatives” of ending poverty and halting climate change, and scepticism about its ability to achieve these objectives. There has been progress towards the MDGs, but how much credit the development community can take for that is open to question.

The provisional SDGs and associated work on development financing emphasize the importance of domestic revenues and private finance, in recognition that ODA alone will not be sufficient. But the importance of the domestic environment and global policy environment is also stressed. As DFID chief economist Stefan Dercon likes to say, the sum required to buy the SDGs is infinity dollars. Money cannot buy development.

But such arguments risk underplaying the importance of official development assistance. Analysts have an unfortunate habit of totting up various financial flows and weighing their importance by the dollar. The importance of financial flows for development consists of their impact on the objectives embodied in the SDGs, and all dollars are not equal when it comes to reaching the most vulnerable and marginalized people on the planet.

Pessimism about official development assistance risks sending the wrong message to politicians and

citizens in donor nations as they set development assistance budgets and decide how to respond to the SDGs. Governments in developing countries are unlikely to genuinely incorporate the SDGs into domestic policy without the financial support they need from the rich world. This is what’s at stake.

Description

The MDGs saw agreement to improve both quantity and quality of aid. Although the agreed target of donating 0.7 per cent of GDP has been missed, by a wide mark, the MDGs galvanised donors to some extent. DAC members donated 0.22 per cent of aggregated GNI in 2000, rising to 0.32 per cent in 2005, since when generosity has stagnated.

Improvements in quality were pledged in numerous dimensions, primarily harmonization of operational procedures, untying aid, build capacity and make greater use of budget support where appropriate, country ownership, more pro-poor allocation and improved measurement (the Monterrey Consensus). These ideas were operationalised in the Paris Declaration on Aid Effectiveness in 2005, but since then progress has largely been slow (Wood et al 2011). In recent years harmonisation has been largely dropped as a reform priority, enthusiasm budget support has waned, and donors have increasingly been emphasising improved measurement and transparency in their operational policies.

The evidence suggests the MDGs have also affected resource allocation. Hailu and Tsukada (2012) found countries further from attaining the MDGs received more aid, as a proportion of GDP, and responsiveness increased over time. In terms of sector allocation, the proportion of aid going to the productive sector (not directly covered by the MDGs) has fallen, whilst the proportion to social sectors has risen, and many developing countries have incorporated the MDGs into their own economic planning (Manning, 2010). However the Government Spending Watch (GSW) database of MDG-related spending in 52 countries, shows real spending growth has slowed sharply since 2009.

Analysis of development success stories, from the Development Progress project hosted by ODI, show that progress was usually associated with a distinct increase in effort by domestic government, often with the involvement of overseas donors and with shifting burden from households to governments and donors (e.g. removing user fees). In richer countries, technical assistance from donors often played an important role, when outside funding was not important. Most success

stories took place in a wider context of strong economic performance .

Which brings us to the question of economic growth. The success of the MDG era, halving extreme poverty, is almost entirely thanks to China and India, where a combination of government industrial policy

and domestic and foreign investment, has delivered stunning growth rates. What did the MDG era teach us about the optimal balance between direct attempts to alleviate poverty via social sector spending, versus indirect attempts via stimulating economic growth?

Questions for discussion

- Did the MDGs lead to simplistic thinking about the relationship between financial inputs and development outcomes? Should we be calling for increased volumes of aid?
- To what extent did governments adopt MDG priorities, and how might the SDG process do a better job of engaging the intended beneficiaries?
- Can the poorest states absorb more aid? What did the MDGs teach donors about how to approach recipients whose policy and conduct might leave something to be desired?
- Greater emphasis is now being placed on growth and ‘leveraging’ the private sector – is that what the MDGs taught us is needed?



**Session 2: Domestic
revenue mobilisation and
international priorities
– do all good things go
together?**

Introduction

Domestic resources are expected to be the largest contributor to financing the delivery of the SDGs. Public revenues have dramatically increased in developing countries since the adoption of the MDGs in 2000. They amounted to \$7.7 trillion in 2012, having grown by 14 per cent annually since 2000, and are projected to reach \$10.7 trillion by 2017 through a combination of rising natural resources revenue, growing economies and improved tax collection (IMF, 2012; WB, 2013). This growth contrasts with the trajectory of traditional development aid, which is expected to remain flat at best, although it will still remain a significant source of finance for the poorest states (Greenhill and Prizzon, 2012). While also growing strongly, other sources of finance such as foreign direct investment and remittances can never be a source of discretionary and flexible expenditure for national governments in the same way as general tax revenue. As a result, the most abundant and predictable source of development finance for any country is almost always found within its own borders.

Background

Whilst some older research reported a negative relationship between aid and taxation, more recent research has concluded there is no evidence for such a relationship (Morrissey et al., 2014). Aid may actually support domestic tax systems, but a recent OECD report concludes there is no “best” aid instrument to support effective resource mobilisation (OECD, 2013). Instead each type of support (stand-alone bilateral aid, South-South regional programmes, pooled financing and other joint donor approaches right through to sector or general budget support) has a distinct role to play in promoting tax-governance linkages. There is still much to learn on the ways in which donors can support domestic resource mobilization for development.

Tax experts and state building advocates, for example, often disagree on a number of key issues. Should tax reform should start with large companies, or should it include the small taxpayers from the outset? Should tax reform in fragile states use existing country systems or should it take a radical approach that redesigns the system from scratch? Is it acceptable to tax regressively, but spend progressively? Ultimately, there is no one-size-fits-all blueprint approach for supporting tax administrations. It is often the context that dictates the different elements that can be combined to reduce a country’s dependence on external resources in a way that is socially acceptable and politically viable.

The political economy of taxation is also important. Countries raising their revenue from a wide but shallow tax base using direct taxes (‘fiscal states’) are expected

to have a stronger implicit social contract than those who raise revenue from taxation of a narrow base of economic rents, often natural resources (‘rentier states’) or trade taxes (e.g. Moore, 2004; OECD 2014). The specific source of domestic finance may affect the degree to which governments feel obliged to provide public goods to their populations, including SDG-related services.

Certain incentive effects from revenue can also be actively created and managed by governments themselves. Special fiscal institutions to encourage responsible management of natural resource wealth are increasingly common (e.g. Sharma and Strauss, 2013). Hypothecation of tax revenue for certain sectors or earmarking of ‘special funds’ from extractives wealth have often been used to create a closer link between domestic revenue and selected expenditures (e.g. Prichard, 2010). Tax expenditures can sometimes deliver public goods through revenue administration that might difficult to deliver through public expenditure systems (IMF et al 2011). The incentives created by specific links between revenue and expenditure could potentially be used to support financing of the SDGs.

Description

The post-2015 agenda offers a particularly interesting set of revenue and expenditure incentives. The SDGs will be agreed internationally based on an assessment of global development priorities, with the offer of some limited international financial support. Delivery of the SDGs will be the responsibility of national governments working in a local context using predominantly domestic resources, with the arguable exception of some very low-income countries. How can a rhetoric of global ambition be reconciled with the reality of domestic financing? How (and why) would the SDGs become part of national development strategies – particularly investments in global public goods, whose benefits are felt outside national borders?

Regardless of high-level incentive structures, the mechanics of revenue collection in many developing countries remain challenging. There is a risk that international debates on the domestic financing of development goals overestimate the ease with which national governments can legitimately and effectively separate citizens and businesses from their money in order to fund post-2015 priorities. Donors emphasize the role of domestic revenue mobilization but so far have not considered it to be an area in which to invest large sums (only a tiny share of aid is directed at DRM projects). The desirability of raising more tax revenue for development is plain, but its feasibility, and the role of external actors, are less obvious.

Questions for discussion

- Does aid (and other external financial flows) displace domestic tax effort?
- Does the breadth of the tax base need to be addressed first, before we can expect to see patterns of expenditure align with the SDGs?
- Are the global public good elements of the SDGs inherently incompatible with financing from domestic taxation?
- Should donors dramatically increase assistance to domestic revenue collection, and how is that best delivered?

A group of people, including children, are gathered around a table. In the foreground, there are several banknotes and coins on a document. A mobile phone is also visible on the table. The scene is overlaid with a semi-transparent teal filter.

Session 3: What is the role of international public finance?

Introduction

What is the role of international public finance (IPF) in achieving the SDGs? IPF may be defined as ‘financial interventions by a nation state, or by a multilateral organisation acting on behalf of nation states, to secure desired public policy outcomes outside the boundaries of that state (Glennie and Hurley, 2014). IPF can consist of grants, loans (on both concessional and non-concessional terms), equity investments (often directed at the productive sectors) and guarantees. IPF need not be purely altruistic; it may be motivated by mutual benefits, or even self-interest. In what situations is international public finance the best option? What forms should it take? The session will tackle these questions.

Background

The international development landscape has changed rapidly since the Millennium Development Goals were adopted in 2000. The number of actors and instruments has multiplied. We have seen the emergence of South-South cooperation, triangular cooperation and lower-middle income country donors. In terms of instruments, there has been a number of evolutions and innovations, including public-private partnerships, blended finance, new types of guarantee, shock facilities and export credits. Aid donors should consider whether and how the mix of instruments they use should change if they want to remain relevant actors in an increasingly diverse and competitive environment (Kharas and Rogerson, 2012). Recipient countries will need to assess their needs and make strategic choices. International organisations will have to find a role, now that many of their traditional clients have other options.

Although IPF flows have increased over the last decade, they represent a rapidly falling share of external financing accessed by developing countries. By contrast, levels of domestic finance, both public and private, have grown rapidly in developing countries. At the same time, rich countries are suffering economic slowdown and face budgetary constraints. Global concerns such as security (Ukraine, Syria, Iraq), health (Ebola) and climate (El Niño) place new demands on the funds that countries have available for spending overseas.

These trends raise important questions with regard to the role of international public finance in supporting sustainable development and its evolution in the

future. To date, the discussion has mostly focused on ODA. Other forms of international public finance are now growing in importance and their potential for supporting sustainable development deserves greater scrutiny.

Description

Even though IPF is shrinking in comparison with private capital flows, there is a number of reasons why it may continue to add value. Glennie and Hurley (2014) identify a series of characteristics and benefits specific to IPF which include: the lack of profit-driven motives, the availability of resources in situations where private funding would not venture (e.g. situations of uncertainty or risk, counter-cyclical function in times of economic slowdown); the long-term nature of IPF and its willingness to invest in long-term projects; and its catalysing effect used to leverage other funds. While IPF is not the solution to all the problems, it nonetheless has defining features which make it irreplaceable.

But whilst IPF has some particular advantages, it suffers from some particular problems: the political economy of donor countries, and organizational incentives within aid agencies, can see IPF fall short of its potential. A diversity of views is not always a bad thing, but fragmentation can be a problem and sometimes donors undermine each other. More generally, public finance may be slow to act, and its allocation inefficient. In some respects this simply reflects the fact that public finance has so many potential roles; capital allocation decisions are easier if all you are trying to do is make money. However, if the potential of IPF for sustainable development is to be realised, the efficiency with which it is allocated delivered must be addressed, and this may require reform within development agencies. Arguably, the Intergovernmental Committee of Experts on Sustainable Development Financing might have paid more attention to the “domestic enabling environment and policy framework” within donors, as opposed to within recipients.

The past decade has seen growth rates accelerate in many developing countries and many countries have graduated from the low-income (LIC) to the middle-income country (MIC) status. One of the big questions that must be resolved is how to allocate scarce IPF resources across countries at different

stages of development, with different amounts of domestic resources. Questions of burden sharing are related to the idea of “universality” and common but differentiated responsibility will potentially distinguish the SDGs from the MDGs.

In these uncertain economic times, donor countries are under pressure to cut back aid budgets. However, this period has been accompanied by the continuing development of innovative mechanisms to ‘leverage’ scarce funds and potentially have a greater impact on development at less cost to the taxpayer (blending, PPPs, guarantees). There are potential innovations on the resource generation side too: a financial transaction tax and a carbon taxes being popular candidates. The donor community must decide what proportion of its funds to channel through new instruments, which in turn requires a rigorous assessment of the evidence base, separating hype from reality.

Questions for discussion

- What evidence do we have that international public finance is particularly important for future sustainable development efforts?
- What can be done to improve the ‘enabling environment’ within donors?
- What is the right balance between promising but largely untested new instruments and traditional modalities?
- What does the principle of universality in the SDGs mean for IPF?

A group of people, including men and women, are gathered around a table in what appears to be a meeting or training session. In the foreground, a person's hand is visible holding a pen over a document. On the table, there are several banknotes and coins, and a mobile phone. The background shows several other people, some looking towards the camera and others looking towards the group. The overall scene suggests a focus on financial literacy or community development.

Session 4: Mobilising private development flows

Introduction

In recent years private sector flows to developing countries have begun to dominate the development finance landscape – expanding more rapidly than official sources. To take the example of private lending, in 2001 public sources lent \$31bn (net) to developing countries against \$20bn from private providers. In 2011 the picture was quite different: public lending stayed more or less constant (\$30bn) whilst flows from private sources skyrocketed to \$434.6bn.³

The landscape of private financing is quite broad: in this session we will focus on flows that serve some explicit development purpose or which provide funds to the public sector, which in turn funds development. So we will not consider FDI or remittances, but will look at sovereign debt, flows from Development Finance Institutions (DFIs), and instruments such as public-private partnerships and guarantees for development. Although together FDI and remittances account for enormous sums of money, they are less directly influenced by the development community. To keep the topic manageable, we also disregard private charity and philanthropy.

Background

Development finance from private sector sources is high on the agenda of national authorities and international development agencies alike, both because it is understood that private flows are essential for meeting sustainable development goals and because facts on the ground have changed. In particular, the private sector has finally embraced Africa. International and national public finance is not sufficient to meet financing needs in several developing countries, especially for infrastructure development. Shortfalls are estimated to be in the trillions, and without the private sector that gap will not be filled. The role of private sector can also offer expertise, and may have advantages over the public in terms of moving quickly and being adaptable.

That explains why development actors are interested in the private sector, but equally the private sector is now more interested in the developing world. Several formerly heavily indebted poor countries that benefited from debt relief in the 2000s (like Ghana, Mozambique, Rwanda, Senegal, Tanzania and

Zambia) have issued sovereign bonds in international markets in the past few years, especially to promote large infrastructure projects. Others countries like Ethiopia countries are planning to do so. Access to international capital markets reduces the government's cost of borrowing, as terms and conditions are usually more favourable than alternative public external debt instruments (IMF, 2013). On the lending side, there is growing appetite for investment in Sub-Saharan Africa frontier markets (IMF, 2014). There is also a 'savings glut' in OECD countries, and African countries with expanding markets and growing middle class can offer risk diversification and higher returns.⁴

At the same time international development agencies are looking for better results and increasing value for money for their assistance, including ways through which international public finance can catalyse private sources and correct market failures. Examples are public-private partnership (PPP) agreements, guarantees for development and blended finance (i.e. grant resources mobilising non-concessional loans and equity) in particular from cash-strapped development agencies and/or agencies aiming to maximise their portfolio, financial and project viability.

There are, however, some risks associated with private flows which partner countries will have to manage to maximise their effectiveness whilst maintaining sustainable public finances.

Despite the attractive absence of conditionality, private finance is still more expensive than aid and private investors are flighty. Greater use of private finance can mean greater risk of financial crisis. Blending instruments that use grant support to promote public borrowing for development investments can aggravate the debt situation, since they can encourage countries to take on more debt. Sovereign bonds (notably Eurobonds) bring interest rate and exchange rate risks.

The risk of getting trapped in onerous (and odious) PPPs deals is high. Even developed countries cannot avoid it. Caliri (2014) points out that PPPs may appear less onerous by being off balance sheet and bypassing controls, but that can make them more dangerous. PPPs finance more than a third of infrastructure for IDA-eligible governments, and their costs are hard for parliaments and civil society to monitor.

3 International Debt Statistics, 2013, World Bank.

4 Standard Bank (2014) blog Rise of the middle class in Africa.

5 A rare exception in the case of the Queen Mamohato Memorial Hospital in Lesotho, opened in 2011 – with PPPs delivering all clinical services. A review by Oxfam (2014) revealed running costs that were three times higher than for the old public hospital and not matched by improved outcomes. The hospital consumed an estimated half of the government health budget.

Managing flows from private sources requires civil servants to acquire new skills. Capacity to serve obligations may be affected by limited state capacity and investment projects may be poorly selected or executed and fail to yield anticipated returns. With private investors, the debt resolution mechanism will be much more painful than bilateral and multilateral debt relief processes.

So whilst there is great promise, there is also danger. Before the development community puts too many eggs in the private sector basket, it must take a hard look at the evidence around the efficacy of its engagement. Some indications are not positive. A study commissioned by the European Parliament's Committee on Development (EU 2014) found that many publicly-backed private sector investments replace or supplant pure private sector investments.

Questions for discussion

- What are the motivations and decision-making criteria of private actors to invest in low-income and fragile countries?
- What evidence do we have that IPF can catalyse private sector investment, and how should donors proceed where evidence is lacking?
- What can international development agencies do to make private investment better serve sustainable development ends?
- How do individual countries balance debt sustainability and reaching development objectives?

A group of people, including children, are gathered around a table. In the foreground, there are several banknotes and coins on a document. A mobile phone is also visible on the table. The background shows a group of people, some with their arms raised, suggesting a community meeting or a public event. The overall scene is set in a bright, outdoor environment.

Session 5: Managing financial flows: the challenges for governments

Introduction

With the focus on who will finance international development goals, it is easy to forget how they will actually be delivered, and by whom. There is a consensus that public institutions are central to development and reducing poverty. Certainly, it is hard to deny the centrality of the ‘state’ to collecting and distributing resources. It raises taxes, guarantees debts, directs economic policy, regulates the private sector, is responsible for the rule-of-law and distributes resources to its citizens. Therefore, it is only logical that expectations surrounding the SDGs should reflect the realities of national governance. To do this, it is necessary to think more critically about the political and technical issues that frame the appropriation and allocation of resources; and about the ways that national and international goals can be reconciled.

Background

A government faces many difficult decisions in determining how to finance its development agenda. All forms of finance can have unintended consequences, no matter how good the intentions. Potential incentive and macroeconomic problems with foreign aid have been well documented. Nor is appropriating more domestic resources a straightforward alternative. Higher tax rates can reduce competitiveness and distort economic growth, while the tax base is not easily expanded. Domestic borrowing can create inflation, crowd out the private sector and overwhelm future budgets with interest and principal payments.

Moreover, the allocation of resources to development priorities is a highly political process. At the heart of this lies the national budget process – an annual cycle of negotiations between political actors over incremental changes to public policy. As a confluence of political, economic and social interests, the national budget is at once a contract between the government and its citizens, a planning tool for ministries and an expression of economic policy (Schick, 2011). In many countries, the budget is accompanied by a national development strategy – a long-term vision or donor-supported poverty reduction strategy plan. Yet these processes are not always what they seem. Budgets can promise one thing, but deliver another (Simson & Welham, 2014), and many national development plans have little connection with actual spending decisions.

Services rely on more than just the availability of financing. The process that turns money into a service is complicated. Just opening a school requires the wide range of public finance management systems to work in relative harmony – earmarking and transferring resources, preparing for delivery, procuring and paying contractors, verifying services delivered, training and hiring teachers, paying salaries. Of course, the public

sector does not always deliver acceptable results. Constraints on information, decision-making, delivery mechanisms and accountability can all result in poor performance (Pritchett & Woolcock, 2008). Some countries struggle to spend the resources they already have at their disposal effectively, which raises questions about the efficacy of greater external funding.

On top of these challenges, developing countries are expected to consider international development goals in their planning. It cannot be assumed that developing country governments will prioritise the SDGs. Most development is driven through using a mixture of domestic resources – that must reflect local preferences in order to maintain legitimacy – and international aid – that must satisfy taxpayers in other countries. By focusing on ‘extreme poverty’ the SDGs, and MDGs before them, fail to recognise the need for governments to have a broader national development agenda that cuts across the spectrum of household incomes and aspirations. For this reason, some have argued that the SDGs should reflect a more ambitious political agenda – such as targeting the number of people who have a hot shower, rather than just access to clean drinking water (Kenny, 2013). Focusing the aid architecture on distinct targets may also detract from the complexity of addressing poverty. It may also focus attention on short-term service provision in a context of poverty, as opposed to eradicating poverty via growth. To receive external aid, governments sometimes try to align national strategies to international preferences. In other cases, governments make strategic usage of the different financing options to satisfy (or signal compliance with) divergent interests. The results are not always satisfactory to all sides.

Description

The aim of the session is to understand what this all means for the sustainable development goals. While the set-up of international development goals is driven by discussions in international fora it is crucial to understand the challenges in developing countries to make informed decisions about modes of delivery, international development strategies and country programs. The goal of eliminating poverty everywhere implies that donors must continue to engage with countries even when the “domestic enabling environment” is unfavourable, at the risk of wasting scarce resources. What should the development community expect of countries with low state capacity and weak political institutions? This session aims to inform the SDG process about the challenges officials in finance and planning ministries face.

Questions for discussion

- Are the SDGs well aligned with development priorities at the country level?
- Are the SDGs well aligned with political priorities at the country level?
- Which is the binding constraint: financial resources or delivery capacity?
- How much should donors demand of fragile low-income countries?

A group of people, likely in a meeting or community gathering, are shown in a blurred background. In the foreground, a table is covered with financial documents, a mobile phone, and several banknotes and coins. The overall scene suggests a focus on financial management and sustainable development.

Conclusions: policy recommendations for financing sustainable development

The 2014 CAPE conference will wrap up with a session to evaluate whether we have answered the questions that we have posed, and what evidence remains to be found. To lend some structure to the conversation, senior ODI research fellows and associates will present some of the policy recommendations from recent and upcoming ODI research – including the forthcoming ‘2014 European Report on Development’ and ‘Financing the post-2015 Sustainable Development Goals: a Rough Road-Map’ – to see how well they stand up in the light of the debates that have taken place during the conference. We will also hear from some leading global voices in the debate.

This session will provide an opportunity to look ahead at some of the next steps in the policy process

around financing for development. The UN substantive informal sessions on mobilizing and effective use of resources will be under way by the time of the CAPE conference. The next sessions will cover the enabling environment and systemic questions, in mid-December. The first drafting sessions for the outcome document are scheduled to start in January 2015. December will also see the OECD DAC High Level meeting in which some of the questions around the measurement and definition of official development assistance may be hammered out. We may see new targets for ODA directed at low income and fragile states, and redefinition of concessional loans.

Questions for discussion

- What big decisions on financing for development need to be taken?
- What are the chances of reaching consensus on them?
- What influence do official actors have on the private ones who will supposedly deliver most of the SDGs.
- How will we know whether we are making progress, and who will be accountable for what?

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ISSN: 2052-7209

All ODI Reports are available from www.odi.org

Cover photo: Mikkel Ostergaard

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