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Financing for Development: Emerging Modalities

Introduction

The Third International Conference on Financing for Development (FfD3) held in July 2015 in Addis Ababa was mandated by the UN to deliberate on issues related to finance ahead of the two crucial international meetings held that year namely, the UN Sustainable Development Summit and the 2015 Paris Climate Conference (COP 21). The UN Sustainable Summit adopted the Sustainable Development Goals through the launch of the 2030 Agenda for Sustainable Development. The FfD3 concluded with what is known as the Addis Ababa Action Agenda.

The scope of the Third International Conference on Financing for Development was set out in UN General Assembly resolutions 68/204 and 68/279:

1. Assessing the progress made in the implementation of the Monterrey Consensus and the Doha Declaration and identifying obstacles and constraints encountered in the achievement of the goals and objectives agreed therein, as well as actions and initiatives to overcome these constraints.
2. Addressing new and emerging issues, including in the context of the recent multilateral efforts to promote international development cooperation:
   - the current evolving development cooperation landscape;
   - the interrelationship of all sources of development finance;
   - the synergies between financing objectives across the three dimensions of sustainable development; and
   - the need to support the United Nations development agenda beyond 2015.
3. Reinvigorating and strengthening the financing for development follow-up process.

Against this backdrop, in the section following this introductory section we discuss the issues of domestic resource mobilisation in the Indian context ahead of presenting an critical overview of the Addis Ababa Action Agenda. In the fourth section in sequence we elaborately present the outcome of the FfD 3 with regard to international tax cooperation and reduction of illicit flows. We conclude this paper with a detailed take on the implementation framework and way forward.

Domestic Resource Mobilisation and Key Challenges in Indian Context

Medium-term macro fiscal framework

The Millennium Development Goals (MDGs) were institutional in a context where long term development results were identified and resources were provided through India's traditional five year planning process. Thus, the Central Government allocated resources for initiatives to secure MDG targets in successive five year plans. States, too, prepared complementary plans. Initiatives such as Sarva Shiksha Abhiyan (SSA), National Rural Health Mission (NRHM), etc., pertinent to the MDGs, were then co-financed by the centre and the states through a negotiated process. The picture has now changed with the abolition of the Plan and Non-plan distinction in the expenditure framework and the reconstitution of the Planning Commission as NITI Aayog. The NITI Aayog is not seen to be a resource allocation institution unlike the Planning Commission. The resources are now deployed for different objectives of public policy through a different framework.

The erstwhile Planning Commission had two important fiscal responsibilities: first, to allocate money to the states in order for them to finance their Plan expenditures; and second, to provide a five-year fiscal-resource framework for the central Plan. Much has been made of the first, which has meant centralisation and the use of discretion by the Centre. Over the last decade, however, with the financial position of the states improving sharply, this dimension has become more an irritant than a regrettable necessity for most states. It is still pertinent in the case of the so-called special category states, but that reflects the absence of a coherent policy to secure the fiscal sustainability of these states without recourse to discretion. With such a policy in place, the problem will abate. If not, then there are a number of entities that can be entrusted with this discretionary power.

The second responsibility was based on the implicit assumption that the central Plan would be the principal vehicle driving public investment. This has long been invalid. The share of capital expenditure in total Plan expenditure has fallen from 68 per cent in 1983-84 to 21 per cent in the current fiscal year. The Centre is no longer a major provider of budgetary resources for public investment.

The abolition of the Planning Commission raises an important fiscal question: will we continue to plan in the old-fashioned way with a range of output targets, and an expenditure programme to achieve these targets specified over the next five years? If so, the current Plan and non-Plan expenditure categories will continue to hold. But it will be necessary then to specify what "Plan" expenditure means in today's India.

If we do away with the "Plan" conceptualisation of public expenditure, then the strategic context would need to be defined. There would be a need of a multi-year macroeconomic framework that specifies: (a) the desired real growth rate; (b) the medium-term share of public expenditure in gross domestic product; and (c) the medium-term shares of investment expenditure, transfers and consumption expenditure.[1] These aggregates will be specified based on multi-year political decisions that derive from the government's growth and development vision. It is essential to specify these, so that annual budgeting can be predictable, strategic and transparent.

In all modern economies fiscal budgeting is essentially a rolling medium-term exercise that specifies the above in the expenditure dimension. Together with a resource-mobilisation strategy, this constitutes a medium-term fiscal framework, with annual budgets reflecting largely the articulation of the medium-term in the immediate present. Policy attention is focussed on the framework, not on the budget. In India, it is exactly the opposite. The media, commentators and general public derive great entertainment from anticipating and discussing the annual Budget. For years, with fiscal planning essentially being a gestural exercise, this has meant that there has been no multi-year basis to fiscal planning. We have "Plan" and "non-Plan" expenditure categories, but these have no strategic or operational relevance. As a consequence, our fiscal performance has suffered in terms of predictability, effectiveness and credibility, and this has meant that governments have been punished by those who have borne the adverse consequences – from the rating agencies to the electorate. The previous National Democratic Alliance government and successive Finance Commissions recognised this challenge. The implementation of their recommendations means that an adequate apparatus to change this is at the disposal of the government. For more than 10 years, every annual Budget presents a medium-term macroeconomic framework, a medium-term fiscal policy and a fiscal-policy strategy statement. But the time and attention afforded to these is a fraction of what is afforded to the preparation of the annual Budget. Thus, the accounting exercise dominates the policy and strategic exercise. The political impetus to deliver change, that is at the heart of every new government, gets stymied when the cumbersome and antiquarian budget-making exercise commences its lumbering annual process.

The Scope for South-South Cooperation

South-South cooperation is an important complement for the resource mobilisation initiatives of the SDGs. As Chaturvedi (2016) shows, the development compact underpinning South-South cooperation has five pillars two of which are directly pertinent for the question of development financing.[2] A good example of this is cooperation in the health sector.

India has collaborated extensively with Brazil and Bangladesh to undertake joint research projects to contain cholera and HIV (Chaturvedi, 2016). In the case of science and technology, India has collaborated with its neighbours in construction of microwave links with Nepal and Bhutan. So, by being an important provider of South-South cooperation to other countries in the region there is enough scope for India in areas where its own domestic efforts face challenges (Box 1). Examples include education, health, sanitation, urbanisation, gender equity and communication.

Addis Ababa Action Agenda: An Overview

The Addis Ababa Action Agenda (AAAA) is regrettably vague about actions to secure domestic public resources to address the development financing agenda for the Sustainable Development Goals (SDGs). There is no underlying analytical framework as to how:

- Gaps in Domestic Resource Mobilisation (DRM) for public spending are a constraint to securing the SDGs; and
- Whether the major challenges are to raise the level of public spending as percentage of Gross Domestic Product (GDP) or to implement expenditure switching policies that change the pattern of spending, or both.

It appears from Para 22 that the agenda seeks to enhance the tax-GDP ratio but this is not a definitive statement. This is important because, in effect, that is a normative decision to be taken regarding the size of the state. In India, for example, total tax revenues accruing to general government (General Government (GG) = Centre + states) are approximately 17 per cent of gross domestic product or GDP. The total GG fiscal deficit is 7 per cent. This means that GG accounts for about a quarter of GDP. Is this just right, too small or too big? The higher the tax-to-GDP ratio, the lower the amount available for firms and households to consume and save. The more GG borrows, the lower the savings available for private investment. This important policy question has been long ignored. It is time a clear policy

Box 1: Multilateral Cooperation and the International Solar Alliance (ISA)

India and France launched an International Solar Alliance (ISA) to boost solar energy in developing countries at the UN Climate Change Conference in Paris on 30 November 2016. International Solar Alliance is conceived as a coalition of solar resource rich countries to address their special energy needs and will provide a platform to collaborate on addressing the identified gaps through a common, agreed approach. The Paris declaration on International Solar Alliance states that the countries share the collective ambition to undertake innovative and concerted efforts for reducing the cost of finance and cost of technology for immediate deployment of competitive solar generation, financial instruments to mobilise more than US$ 1000 billion of investments needed by 2030 for the massive deployment of affordable solar energy and to pave the way for future solar generation, storage and good technologies for countries' individual needs.

ISA will work with partner countries in the identification of national opportunities to accelerate development and deployment of existing clean solar energy technologies, the potential for which largely remains untapped. To achieve the objectives, ISA will have five key focus areas:

a) Promote solar technologies and investment in the solar sector to enhance income generation for the poor and global environment;

b) Formulate projects and programmes to promote solar applications;

c) Develop innovative financial mechanisms to reduce cost of capital;

d) Build a common Knowledge e-Portal; and

e) Facilitate capacity building for promotion and absorption of solar technologies and R&D among member countries.

The Government of India (GoI) will support ISA by hosting its Secretariat for an initial period of five years and thereafter it is expected to generate its own resources and become self-financing. The total Government of India support, including putting normative cost of the land will be about Rs. 400 crore (US$ 62 million). The Government of India support of Rs. 175 crore (US$ 27 million) will be utilised for creating building infrastructure and recurring expenditure. It will be provided over a five year period from 2016-17 to 2020-21.

Source: http://isolaralliance.com/pdf/ISA-Working-Paper.pdf , and http://pib.nic.in/newsite/backgrounders.aspx?relid=0 stance on the size of GG is enunciated. If the size of GG is not too small, then this means, in effect, that the question for India is not how to mobilise incremental resources but;

- How to reduce the draft by the government on domestic savings by raising the tax-GDP ratio; and
- To explore possibilities for expenditure switching policies that target money towards SDGs by spending less in other areas.

This question is entirely side stepped by the AAAA and will, therefore, have to be addressed nationally.

The document elaborates considerably on international tax cooperation and reduction in illicit flows. We, therefore, address this separately in the next section.

Para 31, which is essentially a wordy jargon filled sentence, recommends reduction in "inefficient" fossil fuel subsidies. This is a laudable objective, but one that has substantially been achieved by India. What remains are targeted subsidies to incentivise use of cleaner fuels like natural gas and to phase out energy used for domestic cooking, etc., by the poor (Box 2).

Para 32 speaks of non-communicable diseases in one section and then focusses on a single topic-tobacco. India faces enormous epidemiological challenges from both communicable and non-communicable diseases. International cooperation on vaccines, retro-virals and other means of reducing the incidence of such diseases is of first importance. This will require substantial financing and the case for South-South and broader development cooperation to address this challenge is quite considerable. In this context, assessments will be undertaken by think-tanks in India in conversation with, among others, the Bill and Melinda Gates Foundation.

In the case of tobacco, India is already pursuing a fairly aggressive taxation policy. Other than as a standalone risk to health, this cannot be viewed as a proxy for overall health issues in India and in other developing countries as well.

Paras 33 and 34 essentially provide a wish list of things to be done and commitment to work on this wish list. Within this list, there are three areas of focus for India: Infrastructure, intergovernmental fiscal relations and the role of national, and regional and global development banking institutions.

International Tax Cooperation and Reduction in Illicit Flows

More than international aid, tax is important for development. The Addis Ababa Action Agenda (AAAA) uses the word 'tax' 35 times as compared to its use just four times in the Monterrey consensus.

AAAA says that governments will improve fairness, transparency, efficiency and effectiveness of the tax systems of the member's countries by broadening the tax base and continuing efforts to integrate informal sectors into the formal sectors of the economy. All this

Box 2: Direct Benefit Transfers (DBT) in Fuel Subsidies

The PAHAL (Direct Benefits Transfer of LPG – DBTL) scheme was earlier launched on 1 June 2013 and finally covered 291 districts. It required the consumer to mandatorily have an Aadhaar number for availing LPG subsidy. It covered nearly 10 crore consumers with over 3770 distributors across the three PSU Oil Marketing Companies with an aim to achieve the objective of efficient subsidy administration. An amount of Rs. 5400 crore was successfully transferred to more than 2.8 crore LPG consumers across the country. While preliminary results indicated that the scheme met its primary objective of curbing leakages in the distribution system, the speed at which it was rolled out and inclusion of low Aadhaar districts gave rise to consumer grievances. The modified scheme was re-launched in 54 districts on 15 November 2014 in the first phase and launched in rest of the country on 1 January 2015. The economic survey 2015-16 notes, "...the PAHAL scheme of transferring LPG subsidies via DBT reduced leakages by 24 per cent and seems to have excluded few genuine beneficiaries…" With DBT in place, the government identifies beneficiaries by linking households' LPG customer numbers with Aadhaar numbers to eliminate 'ghost' and duplicate households from beneficiary rolls.

Source: http://petroleum.nic.in/dbt/whatisdbtl.html ; Ministry of Petroleum and Natural Gas; and Economic Survey 2015-16, Government of India.

is proposed to be done through capacity building as part of Official Development Assistance (ODA). AAAA also promises to reduce illicit financial flows by 2030 again with a promise of its eventual elimination. This is proposed to be achieved by combating tax evasion and corruption. It also talks of opportunities for tax avoidance by inserting anti-abuse clauses in tax treaties. All these seem like declaration of pious intentions. It is unlikely that the Addis outcome will be able to solve the current problems of the developing countries in any significant manner.

Contrary to popular perception that capital flows from the developed world to the developing ones, that compete with each other in receiving such flows, several studies have shown that capital actually flows in the opposite direction. Although there may not be a particular fix on the quantum of such flows, it is reasonable to assume that the quantum is humongous (Global Financial Integrity (GFI) estimates that developing and emerging economies lost US$ 7.8 trillion in illicit financial flows from 2004 to 2013.) Much of such flows represent loot of natural resources, corruption, tax evasion and systemic tax avoidance through transfer pricing and other means.

And much of the blame for the current state of affairs may be laid at the doors of the Organisation for Economic Co-operation and Development (OECD), a club of 34 rich countries that, in effect, has been setting the standards of international tax for over half a century. OECD, in turn, had taken over the legacy from the work of League of Nations in the 1920s when the world was divided between the colonists and the colonies. Despite persistent criticism, the international architecture at the core remains the same with very little taxing power given to the source states and most of the taxing powers being retained by the residence countries. It is this state of affairs that results in most of the tax base erosion in developing countries, a fact recognised by the OECD, but ignored in the final suggestions for reforms following its base erosion and profit shifting project.

One of the most significant reasons for illegal financial flows, that drain the resources of the developing countries, is the existence of tax havens or international financial centres. These jurisdictions, as the Panama papers show, essentially trade in secrecy. International business companies are freely floated in these jurisdictions to help mask the identities of the real beneficial owners and OECD has done nothing to prevent the use of such companies. Its efforts are concentrated only on getting information. While information is important, it cannot be panacea for all the evils. Besides, as cynics have pointed out, the current system suits the developed world fine since the money ultimately ends up in their financial centres, be it London or Delaware. Moreover, some of the members of the OECD are themselves secrecy jurisdictions.

The OECD also continues to believe in the theory of multinational firms set up in different jurisdictions as separate entities, while the truth is that multinationals are multinationals because they can exploit the synergy. The arm's length standard set up by the OECD is, therefore, no longer fit for purpose, particularly when finding comparable for MNCS that deal with each other is next to impossible, in the context of growing importance of intangibles. The permanent establishment threshold set up by the OECD again can easily be avoided in the context of an international economy that relies more on services and intangibles. As a result, we are left with an international tax standard that is a patch up of complex rules and regulations and that benefit none except the big accounting firms that have a big say in determining any proposal emanating from the OECD.

From the perspective of the developing countries, therefore, the need of the hour is for a non-partisan organisation like the United Nations to take charge in setting the norms. What is actually happening now, as is shown by the Base Erosion and Profit Shifting (BEPS) work, is that standards are set by the developed nations through the OECD and the developing countries are then asked to enforce such standards and the ODA is often targeted at how these standards should be enforced. Developing countries are obviously unhappy with this state of affairs. The determined efforts of G-77 countries at the Addis conference to transform the current group of experts at the United Nations into a permanent body were, however, stymied by equally determined opposition from the developed world led by the USA, Germany and Japan on the ground that the same will duplicate the work done by the OECD and generate unnecessary bureaucracy. The OECD being responsible to its members, however, cannot be expected to be non-partisan.

A possible alternative could be some regional groupings to take the initiative and come up with models and solutions that suit their purpose and gradual expansion of the same in course of time as was done in the case of General Agreement on Tariffs and Trade (GATT). India being part of the BRICS and having its chair for 2016 can take a lead. There is a BRICS tax group set up in 2013 that promised to do a number of things, but seems to have gone in hibernation. May be it is time for us to reactivate the same.

Implementation Framework and Way Forward

To speak of an implementation framework for financing SDGs, prior to an elucidation of India's strategy for funding, is not appropriate. An implementation framework for the SDGs can only be worked out once the national SDGs strategy is complete. Transitively, a financing strategy for the SDGs can only be crafted once the implementation framework is in place. Therefore, in this section we set out five pillars around which such a financial strategy can be structured.

1. **A national medium-term macro fiscal framework that is consistent with the SDGs implementation framework:** As explained in the section II, the Government of India has moved away from the traditional distinction between plan and non-plan expenditure in the budgeting. There is a growing consensus that an integrated medium-term macro framework would need to be constructed as a modern fiscal rule.[3] There is, therefore, considerable opportunity to incorporate questions of SDGs financing into this framework. Areas of action would be:

   - The current target base system of revenue forecasting will be replaced with a medium-term revenue forecast. This forecast in turn will be based on the medium-term macro framework which would provide overall and sectoral growth and inflation consistent with the FRBM Act and the monetary policy framework.

   - It is unlikely that in India the Central Government will stop borrowing to consume even by FY 2020. Even so, investments made in the provision of peace and security relevant to the SDGs would continue to form the part of Central Government's current expenditure. Since these will be a hard budget constraint, the scope for public investment at the Central Government will continue to be limited. Public money will be leveraged through private financing for different purposes. It will be important, therefore, that such leverage also takes into account the need for financing SDGs.

2. **Calibration of vertical and horizontal devolution between the centre and the states based on the relative responsibilities of these levels of government with respect to SDGs**: In the second part of the medium-term macro framework here, the emphasis would be on identifying committed expenditure and, subject to budget constraints, the total fiscal space in the form of freely allocable expenditure available over the life of the framework.

   - It is expected that both committed and allocable expenditure will be assessed on the basis of new outcome budget, which are already been commissioned from spending departments by the NITI Aayog. The SDGs focus, in this context, should be on the outcome budgets and action then can be derived by increasing allocable expenditure for such purposes and reprioritising committed expenditure. This exercise will be important for SDGs pertaining to peace and security, infrastructure, rural development, water and sanitation, and poverty reduction.

   - The states of India are increasingly important fiscal players. For the past ten years, the states as a whole have not been incurring revenue deficit and there is continuous efforts to incentivise states that do incur deficits to reduce it; there has been considerable success on this score. Thus states will be the key drivers of public investment till FY 2020 and the conversation on SDGs, that require public investment (as opposed to current expenditure), will need to focus on the states. The NITI Aayog is the appropriate institution to coordinate such a conversation and ensure that states both own and incorporate the SDGs into their future public investment plans. To do this, the Fifteenth Finance Commission will be an important institution since it will calibrate: a) the vertical devolution between the Centre and the States, and b) the horizontal devolution between the states of the divisible pool.

There is a huge opportunity to engage with Fifteenth Finance Commission to ensure that this calibration takes account of SDGs financing needs.

3. **In the case of social section spending, an urgent and fundamental review of factors underlying extremely low efficient outcomes in delivering universal health and education and clear identification of where such policy failures are a consequence of inadequate financing:** In the context of SDGs, a particularly acute problem in India is ensuring effective financing in the social sector (Table 1). It is well known that India has very low public spending on education and health. Despite the flurry of new initiatives by the current government, it remains low.

Table 1: Public Spending on Health and Education

Country	Public spending on education (% of GDP 2005-2014)	Health Expenditure (% of GDP, 2013)
Argentina	5.1	7.3
Brazil	5.8	9.7
India	3.8	4.0
Kenya	6.6	4.5
Nepal	4.7	6.0
South Africa	6.2	8.9

Source: World Human Development Report, 2015.

The outcomes, thus, achieved out of spending remains abysmally poor. Thus there is an urgent need to improve efficiency on the outcomes of public spending in the social sector. In a complex political economy like India, there could be several reasons why this may be the case. In the context of financing questions, we need to identify where inefficiency is directly related to insufficient public spending. It is important, therefore, that India confirms to spending significantly on general services to ensure that security and integrity of world's largest democracy is maintained and this is a necessity and desirable to secure the SDGs agenda. Political action to reduce the need to incur such expenditure can be explored through regional, bilateral and multilateral institutions which should be recognised as impacting SDGs. (What I try to say here is if world powers can persuade Pakistan to stop infiltration in India or China to stop supplying arms to Maoist movements, then this can be cool and give India extra money for spending.) In the absence of will, it should recognise that such spending is integral to SDGs for ensuring peace in the region.

4. **International cooperation to reduce illicit financial flows and other divergence of global finance away from sustainable development agenda**: On the AAAA tax cooperation, India can lead an initiative to come up with models and solutions to combat tax evasion that are better suited for developing countries. This is an important pillar for South-South cooperation and India should use every forum available in which it can share initiatives, including BRICS tax group, the G77, the G20, and South Asian Association for Regional Cooperation (SAARC).

5. **Remove obstructions to greater access to international finance for infrastructure and sustainable investment:** The need of the hour for many developing countries in securing SDGs is to magnitudinally increase infrastructure investment particularly sustainable infrastructure. To this end, there needs to be specific focus on ways to secure long term financing commercially, but without the excessive risk being in currently imposed international financial markets. Initiatives like International Solar Alliance is important, in this context, but more needs to be done to foster investment in the sectors like railways, urbanisation, water and sanitation, etc. In this context, India can leverage the recently set National Infrastructure Investment Fund as well as use its strong governance presence at the New Development Bank and the Asian Infrastructure Investment Bank to push for such institutions to expand investment in sustainable infrastructure. The SDGs can act here as powerful impetus for positive action on this score as it enables developing countries, like India, to show how the existing financing arrangements for investment in sustainable infrastructure detract from such countries availability to secure essential financing for the SDGs.

Endnotes

[1] Roy (2014).

[2] Chaturvedi (2016).

[3] Roy (2016).

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