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Financing poverty eradication

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Financing poverty eradication

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Abstract

This paper provides a review of various sources of finance for poverty reduction. Some salient findings are: declining significance of aid, especially for middle-income countries; aid remains a major source of finance for LDCs; improved government revenue efforts in most developing countries. The paper also highlights revenue losses through trade liberalization, corporate tax concessions and through illicit flows of funds, and provides empirical evidence to debunk negative views about counter-cyclical macroeconomic policies. Some key recommendations are: countries should examine the costs and benefits of corporate tax concessions and the equity impact of indirect taxations, such as value added tax; strengthen tax administration; enhance tax progressivity; international and regional tax cooperation; fulfilling aid commitment and ensuring additionality of aid while dealing with humanitarian crises and climate change.

Keywords: Poverty, Vulnerability; Aid (ODA); Tax revenue; Social protection; Counter-cyclical policies

JEL classification: E5, E6; F35; H2; H6; I3; O23,

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Financing poverty eradication[2]

I. Introduction

Since the adoption of the Millennium Development Goals (MDGs) in 2000 poverty reduction became the main focus of both donors and developing countries. This was also in recognition of the fact that after four United Nations Decades of Development beginning in 1961, and many developing countries achieving the growth targets of the respective development decades, extreme poverty remained entrenched. In light of this shift, this paper looks at the changing role of different sources of development finance, in particular foreign aid and tax revenues.

The paper begins with a brief discussion of why poverty eradication matters and why there should be an on-going effort towards the poverty eradication goal. The rest of the paper is organized as follows: Section III provides an overview of the shift in development discourse from growth to poverty eradication, especially within the United Nations and how it changed the focus of development aid; Section IV discusses how countries have been financing their poverty eradication efforts, in particular the changing role of external and domestic financing sources; Section V examines developing countries' domestic resource mobilization, especially government revenue efforts, and how that can be further improved; Section VI discusses some interesting approaches that countries have used to reallocate expenditure towards poverty eradication efforts; Section VII looks at how developing can countries expand fiscal space for counter-cyclical macroeconomic policies, including social protection schemes; Section VIII focuses on how donors can assist developing countries through coordinated policies in order to contribute to poverty eradication; Section IX contains concluding remark.

II. Why poverty eradication matters

A distinction needs to be made between poverty reduction (alleviation) and poverty eradication. The MDGs were concerned with poverty reduction – halving the world's poverty by 2015. The Second United Nations Decade for Eradication of poverty aims at zero poverty, and hence is much more ambitious.

Substantial success has been achieved during the MDGs era, and the poverty rate globally has declined to less than half of what it was in 1990. According to the most recent estimates by the World Bank, in 2012, 12.7% of the world's population lived at or below $1.90 a day – the revised international poverty line. This figure was 37% in 1990 and 44% in 1981.[3]

Additionally, 173 million fewer people worldwide suffered from chronic hunger in 2011-13 than in 1990-92 and stunted growth in children under five has decreased globally since 1990 from 40% to 25%. What is particularly impressive is that these gains have been made while global population has continued to rise, from 5.28 billion people in 1990 to 7.1 billion people in 2013.

Nevertheless, at the global level, close to 900 million people lived in extreme poverty (at or below $1.90-a-day) in 2012. Considering the fact that the Second UN Decade for Poverty Eradication considerably overlapped with the MDGs era, this outcome appears disappointing from the perspective of poverty eradication.

However, this also shows the difficulties in achieving the zero poverty target. Two issues need to be made clear in this regard. First, harvesting fruit from the higher branches of a tree is

[2] This paper is prepared for an Inter-Agency and Expert Group Meeting, organized by United Nations Department of Economic and Social Affairs, held in Bangkok on 4-6 May, 2016, as part of the preparations for the seventy-first session of the UN General Assembly.

[3] http://www.worldbank.org/en/topic/poverty/overview

always more difficult than picking the low-hanging ones. MDGs' target of reducing the global poverty rate by half was not an easy task, requiring concerted national and international efforts.

Yet it appears akin to harvesting the low-hanging fruit when compared with eradicating poverty. Addressing hard-core poverty to achieve the zero poverty target is much more difficult. Such poverty relates to structural issues, e.g., the context and where the poor live, as well as their socioeconomic status, gender, ethnicity, etc., which determine their access to good schools, healthcare, electricity, safe drinking water and other critical services.

Second is the issue of vulnerability and sustainability. Over 2.1 billion people in the developing world lived on less than $3.10 a day in 2012. That is, over 2 billion people lived between $1.90 and $3.10 poverty lines, making them vulnerable. They risk falling into extreme poverty due to shocks – either adverse personal circumstances (debilitating sickness or death of the sole earning member in the family) or economic insecurity (financial crises, soaring food prices, etc.), largely relating to both domestic and global macroeconomic conditions. For example, in the wake of the 2008-2009 global financial and economic crisis, the World Bank estimated that lower economic growth rates would trap 46 million more people to extreme poverty (on less than USD1.25 a day) than was expected prior to the crisis. This was on top of the 130-155 million people who were pushed into poverty in 2008 because of soaring food fuel prices.[4]

The threat of climate change is adding an extra dimension to vulnerability. For example, about 3.76 billion people were affected by natural disasters in Asia between 1970 and 1999.[5]

Thus, the poverty eradication efforts have to be ongoing; there has to be some permanent institutional architecture in place to ameliorate vulnerability of the near poor. Here lies the importance of universal social protection as well as counter-cyclical macroeconomic policies. Thus, financing for poverty eradication has to encompass both short-term and long-term measures, dealing with creating opportunities, expanding capabilities, providing social protection, as well as strengthening counter-cyclical and climate change adaptation and mitigation measures.

III. From economic growth to poverty reduction and poverty eradication

Poverty reduction began receiving explicit mention in the development discourse in the 1970s. Prior to that, development was growth-focused, with the assumption that the rising tide of economic growth would raise everybody and lift the poor out of poverty. Thus, the first United Nations Development Decade (1961-1970) did not have any specific target for poverty reduction or eradication. Instead, it set a target of accelerating economic growth in developing countries as a whole to a minimum of 5% per annum by 1970. The accelerated per capita income growth was supposed to reduce widespread poverty in the developing world.

However, despite well over 60 countries exceeding the 5% growth target by 1970, resulting in an average growth rate for developing countries as a group of 5.6% over the decade, the impact on poverty reduction was not that impressive. Thus, in his 1970 report, *Poverty and Minimum Living Standards: The Role of the ILO*, the ILO Director-General noted that "the immense—and in global economic terms, not altogether unsuccessful—efforts for development during the past two decades have not so far resulted in many perceptible improvements in the living standards of the majority of the world's population."

Yet the overall focus still remained on economic growth. The Second UN Development Decade (1971-1980) set a goal of a minimum 6% growth per annum, with a minimum per capita income growth target of 3.5% for developing countries as a whole. It was hoped that such rise in income would, "provide increasing opportunities to all people for a better life, ... achieve a

[4] World Bank (2009)
[5] OECD (2013a)

greater degree of income security, ... expand, and improve facilities for education, health, nutrition, housing and social welfare, and … safeguard the environment."[6]

While the primary role of domestic resources was recognized, a target for transferring 1% of economically advanced countries' GNI (at market prices) to developing countries with the official aid component target of 0.7% of GNI to be achieved by the middle of the decade was also set. None of these financing objectives was achieved in the 1970s. Instead, most countries were hit by unexpected commodity, in particular oil, price shocks, and a number of developing countries faced serious balance of payments problems and external debt crises.

Thus, debt and structural adjustment gained prominence in the 1980s. Poverty reduction remained subservient to supposedly growth re-igniting structural adjustment programmes aimed at reducing public debt and making markets more efficient. While aid flows declined during the 1980s, most developing countries did not have fiscal space to finance specific poverty reduction programmes.

A few countries, especially in East and Southeast Asia, experienced rapid growth during the 1970s and 1980s and they achieved spectacular success in reducing poverty. Their experience was used to promote "growth-mediated" poverty reduction paradigm of the structural adjustment programmes.

However, by the end of 1980s, the failure of the growth-oriented "trickle-down" approach became abundantly clear. The former President of the World Bank, James Wolfensohn acknowledged sombrely, "… if we take a closer look, we see something else – something alarming. In developing countries, excluding China, at least 100 million more people are living in poverty today than a decade ago. And the gap between rich and poor yawns wider."[7]

Thus, in 1996, following the historic 1995 Social Summit, the United Nations adopted a resolution declaring the First Poverty Eradication Decade (1997-2006). It expressed "serious concern that more than 1.3 billion people in the world, a majority of whom are women, live in absolute poverty, especially in developing countries, and that the number of such people continues to increase," and welcomed "the formulation of direct programmes of poverty eradication by some developing countries at the national level".[8]

Poverty reduction also became an explicit concern of donor countries in the 1990s. For example, in 1996 Development Ministers and Heads of Aid Agencies in the OECD's Development Assistance Committee (DAC) adopted poverty reduction as a key objective of their aid. In the same year (1996), the World Bank and the International Monetary Fund (IMF) launched the debt relief initiative for Heavily Indebted Poor Countries (HIPC) that freed resources to support poverty reduction strategies.

The adoption of MDGs in 2000 with Goal 1 of halving the global poverty rate was followed by a period of global growth until interrupted by the global financial crisis of 2008-2009. Most developing countries experienced rapid growth, and periodic business cycles seemed over in developed countries – termed as "great moderation". Aid flows – official development Assistance (ODA) from DAC – thus began to rise from 0.25% of donor GDP in 2003, peaking at 0.33% in 2010. ODA flows to least developed countries (LDCs) from DAC members increased to $44 billion in 2010, or 0.11% of their combined GNI. Flows of foreign direct investment (FDI), although skewed towards resource sector and emerging economies, also increased.

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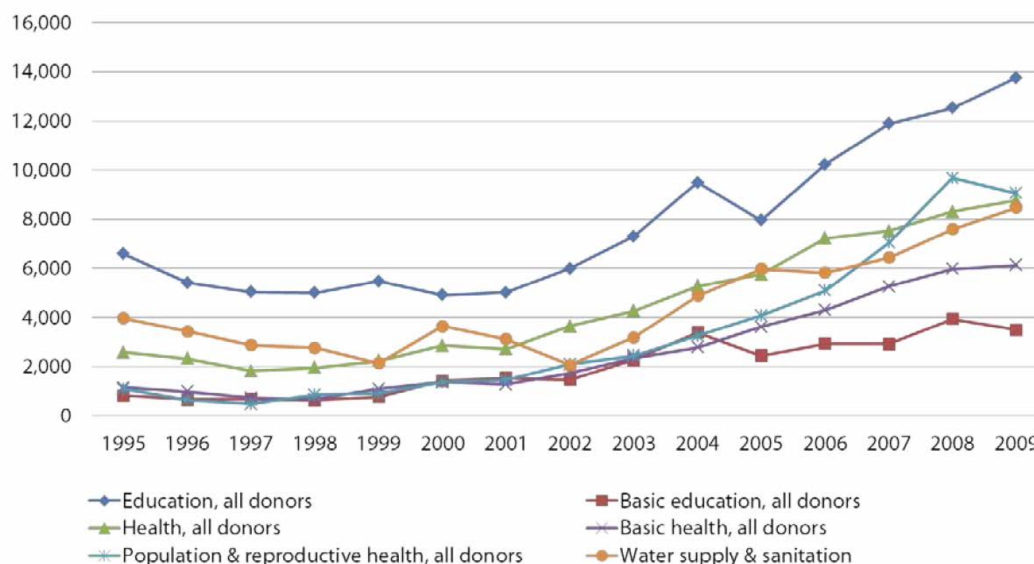
[6] General Assembly Resolution 2626 (XXV): International Development Strategy for the Second United Nations Development Decade, paragraph 18.

[7] Foreword to Thomas, et al. (2000). William Easterly, a former World Bank economist, described the experience of 1980-1998 as "lost decades" for developing countries. He noted, "In 1980-98, median per capita income growth in developing countries was 0.0 percent, as compared to 2.5 percent in 1960-79. Yet …policies like financial depth and real overvaluation, and initial conditions like health, education, fertility, and infrastructure generally improved from 1960-79 to 1980-98. Developing country growth should have increased instead of decreased ... The stagnation seems to represent a disappointing outcome …".

[8] General Assembly Resolution 51/178: First United Nations Decade for the Eradication of Poverty, preamble.

The adoption of poverty reduction focused MDGs has also been instrumental in directing aid to social sectors to enhance wellbeing as well as expanding capabilities of the poor. For example, ODA to the health sector more than quadrupled between 2000 and 2009, from $2.8 billion in 2000 to $8.7 billion in 2009, while ODA to education as a whole almost tripled over the same time period, from $4.9 billion in 2000 to almost $14 billion by 2009.[9] In dollar terms, the volume of resources channelled into the social sectors has been unprecedented (Fig.1). There have also been increased aid flows to sectors where the poor work and live. For instance, ODA to agriculture, forestry and fisheries tripled over the last decade, from $3.5 billion in 2000 to $9.7 billion in 2009.

Fig 1: ODA to social sectors (current US$ millions)



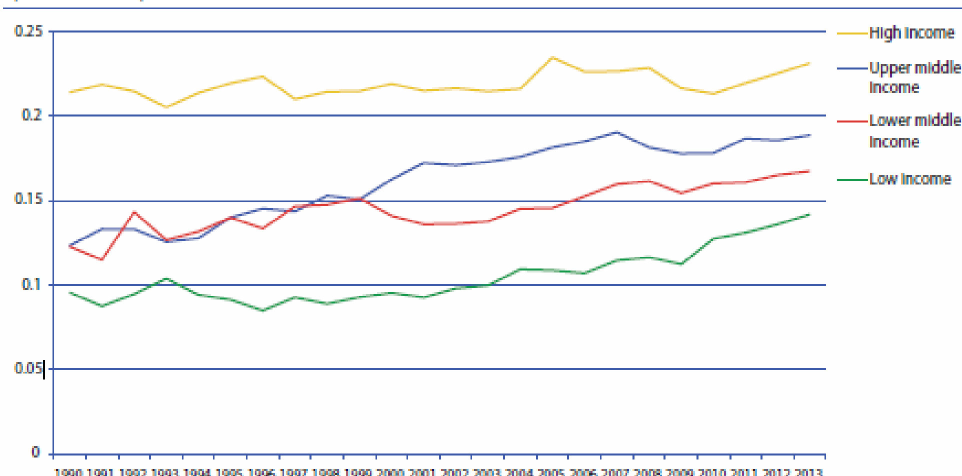
However, this changed as the global financial crisis prolonged, and with it, developed countries encountered fiscal crisis with mounting public debt. ODA flows declined for two consecutive years (2011-2012). Although ODA flows rebounded in 2013 to $134.8 billion, in 2014 the total ODA ($134.38 billion) given by all OECD member was only 0.29% of GNI.

IV. How have countries been financing poverty eradication efforts?

Domestic resources are far larger than all external financing sources for developing countries, with domestic investment reaching over 33% of GDP and government revenue over 18% in 2012.[10] Most developing countries have also been able to raise their tax revenues (Fig. 2).

[9] UNDP (2011), p. 168.
[10] Griffiths (2014).

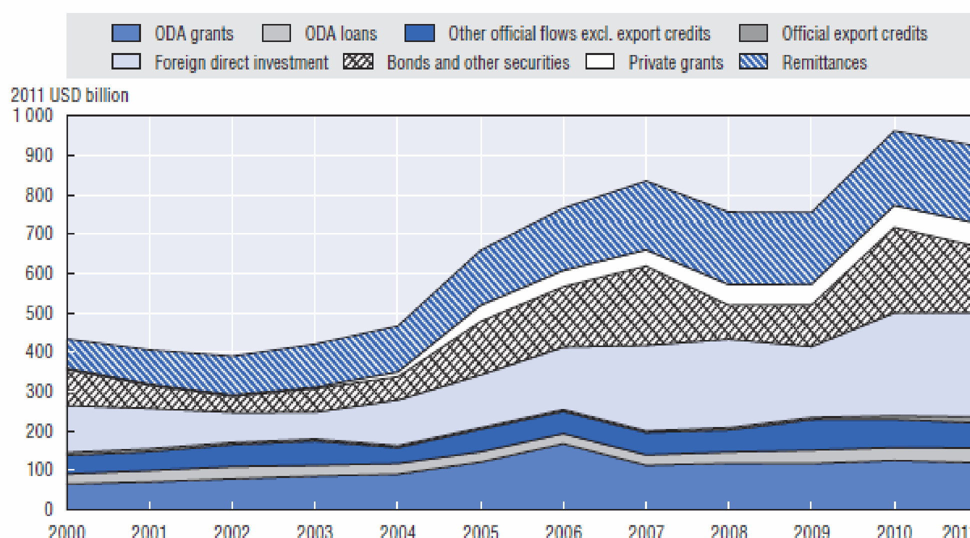
Fig 2: Median tax/GDP ratio (%) by income grouping, 1990–2013



Source: United Nations Department of Economic and Social Affairs calculations, based on International Monetary Fund World Revenue Longitudinal Data (WoRLD), 13 July 2015. Note: Tax revenue as a percent of GDP, country classification according to World Bank Group country income groups 2015.

As can be seen from Figure 3, external finance flows to developing countries began to rise only since the mid-2000s. Again, it was driven by FDI, remittances and borrowing, while ODA – both grants and loans – from the OECD DAC members remained flat at around $150 billion (in 2011 price) a year since peaking close to $180 billion in 2006.

Figure 3: External financing to developing countries, 2000-11



Notes: Total external financial resources include bilateral ODA, other official flows (OOF), private grants, private flows at market terms and remittances from DAC countries, and concessional and non-concessional outflows from multilateral agencies. From 2005 onwards, private grants are based on estimates from the Hudson Institute's Centre for Global Prosperity, which uses a more generous definition than DAC statistics, including, for example, the imputed value of volunteer time.

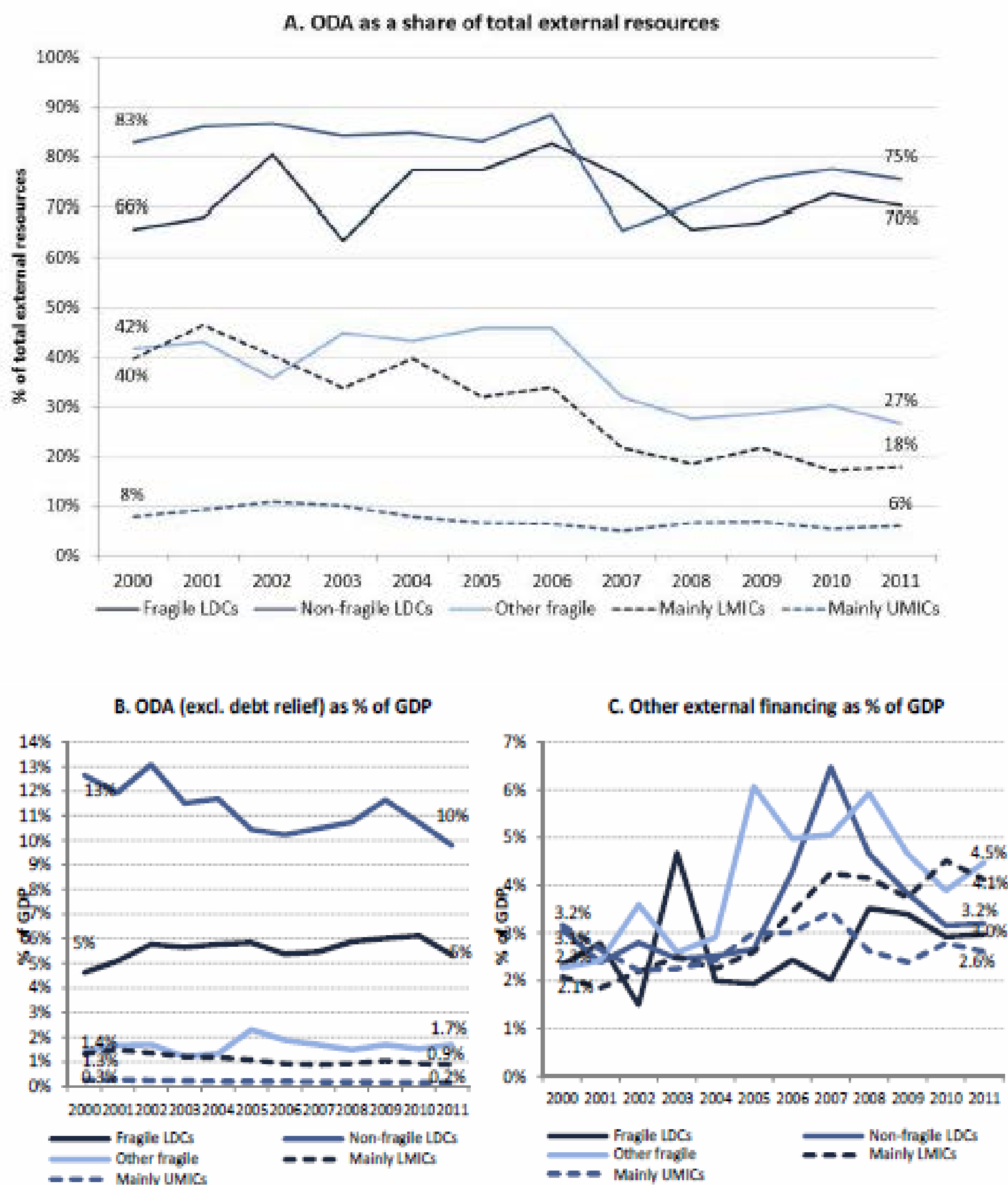
Notes: ODA= Official Development Assistance from OECD's DAC members
OOF = Other official flows, e.g. from development banks, bilateral development finance institutions and multi-lateral organizations.
Source: OECD (2014)

Nevertheless, ODA's share in total external finance, though diminishing, remains high (70-75%) for LDCs (Figure 4). Commensurate with the rise in domestic resources, ODA's importance as an external source of finance for low middle-income countries (LIMCs) declined significantly; its

share in total external finance declined roughly by half, from around 41% in 2000 to slightly over 22% in 2011.

ODA – excluding debt relief – from OECD's DAC members constituted less than 10% of GDP for the majority of developing countries; only non-fragile LDCs received ODA slightly over 10% of their respective GDP. Other external finance constituted less than 5% of their respective GDP (Figure 4).

Figure 4: Importance of ODA as a source of development finance

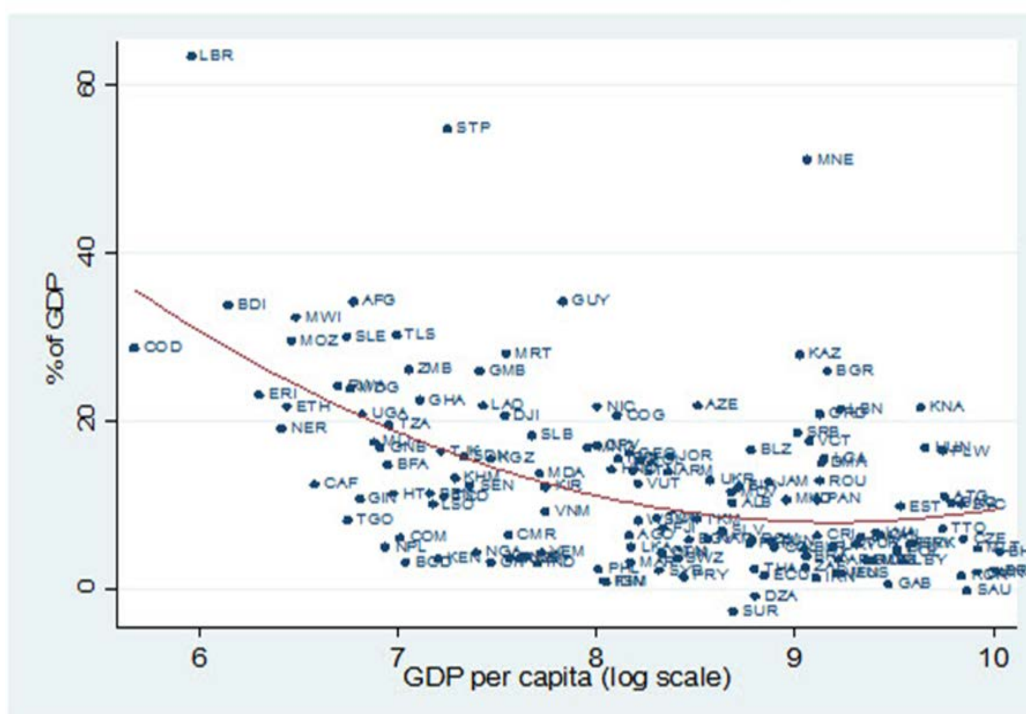


Source: OECD (2013)

Development finance: Variations among developing countries[11]

Generally, external financing declines with the level of development measured in per capita income (Figure 5). Many low income countries receive considerable external financing support, often amounting to over 20% of GDP, but that financial flow taper off as countries' per capita income levels start to rise.

Figure 5: External finance and per capita income



Source: Kharas (2014)

However, there are wide variations in development finance across different groups of developing countries. ODA still remains a significant source of external finance for LDCs in terms of its share in total external flows and domestically mobilized resources. In 2011, for example, ODA as a share of government tax revenues was over 40% for both fragile and non-fragile LDCs, while ODA as a share of government revenues (excluding grants) was 43% for non-fragile LDCs and 28% for fragile LDCs, compared to less than 1% in upper middle-income countries (UMICs).

Fragile LDCs[12] rely heavily on ODA as a major source of external finance, accounting for 72% of all external financial resources in 2000-11, compared to 45% for all ODA recipients over the same period (Figure 4). In real terms, ODA to these countries nearly tripled since 2000, from $14 billion to $39 billion in 2011 (Figure 6). In 2000-11, both ODA and other external resources have been on an upward trend, but other external financial flows have been more volatile.

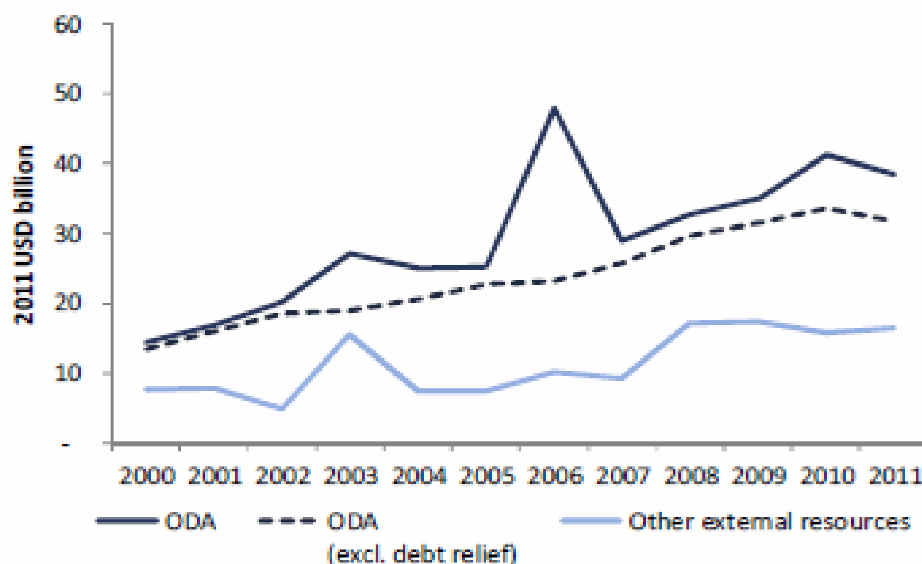
Within this group, ODA in 2011 was more than four times government revenues in Liberia, and larger than government revenues in Afghanistan, Burundi, Central African Republic,

[11] Data cited here are from OECD (2013).

[12] This group clusters 33 LDCs and 20 of them are Low-income countries (LICs) in sub-Saharan Africa; it also includes four LICs in Asia and one in Central America, and eight MICs in Asia, Oceania and sub-Saharan Africa. This group of countries was home to 727 million people in 2011 (or 13% of the population in developing countries); nearly half live in the three largest countries: Bangladesh, Democratic Republic of Congo and Ethiopia. These countries generally have a low level of human development according to the HDI index.

Democratic Republic of Congo, Guinea-Bissau, Haiti, Sierra Leone, Solomon Islands and Togo. In Angola, where the ODA-to-government revenues ratio is about 0.55%, ODA represents half of total domestic revenue and is higher than total government tax revenue for fragile LDCs.

Figure 6: External finance in fragile LDCs



Source: Same as Figure 4

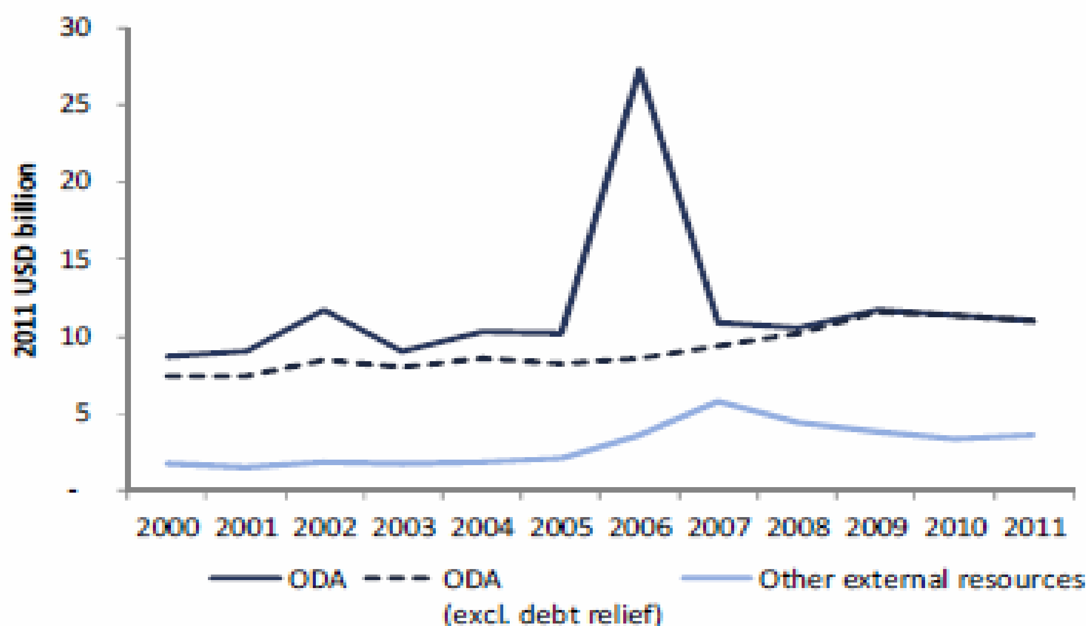
In 2011, nearly half of all inflows of private resources (at market price) were directed to Angola (44%; up from 34% in 2007), and more than one-third of remittances arrived in Bangladesh (37%; up from 33% in 2007).

Fragile LDCs received significant debt relief in 2006 and 2010-11 and their external debt stock declined from 93% of GNI in 2000 to 25% of GNI in 2011. In 2006, large debt relief operations were granted to several African countries (e.g. Ethiopia, Madagascar, Malawi, Niger and Uganda), reducing their external debt stock by two-thirds. In 2010 and 2011, significant debt relief operations were mostly focused on conflict-affected states such as Democratic Republic of Congo and Liberia, cutting their external debt by 75%. Despite increasing over the past decade, tax revenue as a share of GDP remains low in comparison to countries in the other groups.

For N**on-fragile LDCs**,[13] ODA is still the main source of external finance, but its weight declined since 2006. ODA accounted for 85% of all external financial resources between 2000 and 2006, but this share decreased to 75% in 2011 (Figure 4). Over the period 2000-2011, ODA in real terms remained virtually flat between $10 billion and $12 billion, except for a spike in 2006 when it peaked at around $28 billion (Figure 7). The volume of other external resource flows to these countries is small compared to that of ODA flows. Other external flows grew at an average annual rate of 6% a year since 2000.

[13] This group consists of 15 LDCs, mainly in sub-Saharan Africa, both LICs and LMICs, one LIC in Asia, and four LMICs, two of which are in Asia and two in Oceania. Together, these countries are home to 139 million people. The two most populous countries, Tanzania (42 million) and Mozambique (22 million), account for nearly half of the population. According to the HDI index, five countries in this group have a medium level of human development, while all the others have low human development.

Figure 7: External finance in non-fragile LDCs



Source: Same as Figure 4

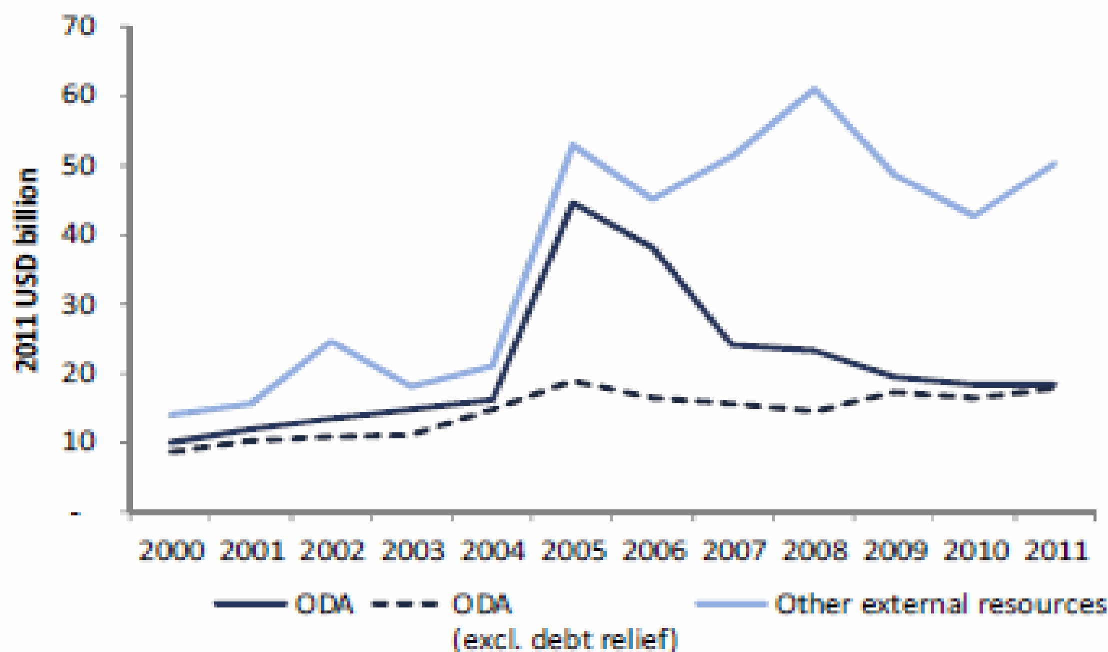
ODA represents three-fifths of government tax revenue and slightly more than one-third of total government revenue and expenditure, with the ODA-to-tax revenues at 59% and the ODA-to-government revenues and expenditures standing at 43% and 36%, respectively. ODA represents more than government tax revenue and 82% of total government revenue in Rwanda, while it represents around one-third of total government revenue in Zambia.

This group has the highest external debt stock (36% of GNI). However, this ratio is considerably lower than it was at the beginning of the period, when it stood at 107%. Significant debt relief over the past decade, especially in 2006, contributed to a substantial reduction in the external debt stock of these countries. The main beneficiaries of debt relief operations were Mozambique, Tanzania and Zambia. In these countries, external debt as a share of GNI declined by 40-70% between 2000 and 2011.

For **other fragile countries**[14] ODA was the largest external financial flow until 2006. Now remittances are the largest external flow, representing 37% of the total, while private flows at market prices are the third-largest external flow, representing 31% of the total. ODA made up 27% of total external financial resources in 2011. Excluding debt relief, ODA volumes doubled from 2000 to 2011, mainly because of a surge in ODA to Iraq following the Second Gulf War (Figure 8).

[14] This group consists of 16 countries that are fragile and eligible to receive concessional lending from IDA but are not LDCs. This group mainly covers 12 out of 16 low middle-income countries (LMICs). They are scattered across the world with two countries in Europe, four in North Africa and the Middle East, four in Asia and Oceania and six countries in Sub-Saharan Africa. Together, these countries are home to 597 million people. However, more than half of the population in this group are in Nigeria (160 million) and Pakistan (175 million). Countries in this group have different levels of human development, ranging from high (e.g. Bosnia, Herzegovina and Sri Lanka) to low (e.g. Zimbabwe and Cote d'Ivoire).

Figure 8: External finance in other fragile countries



Source: Same as Figure 4

Yet ODA represents 13% of government tax revenue and 7% and 6% of total government revenue and expenditure, respectively. However, with the exception of Egypt, the countries with a small ODA-to-government revenue ratio have a large ODA-to-tax revenue ratio (ranging between 15% to 193%), implying that much of their government revenue derives from sources other than taxes, such as public enterprises' revenue and grants other than those included in the ODA flows (e.g. from non DAC members).

The external debt stock of this group decreased from 56% of GNI in 2000 to 21% of GNI in 2011, partially due to debt relief operations throughout the past decade, especially in 2006. The largest beneficiaries of debt relief were Nigeria, Iraq and Cameroon. Nigeria's external debt stock fell from 78% of its GNI in 2000 to 6% of its GNI in 2011, while in Cameroon, the external debt stock decreased from 112% of GNI in 2000 to 12% of GNI in 2011.

Low middle-income countries (LIMCs) [15] are home to the largest share of the world's poor, with nearly one-third of the population, or 425 million people, still living in extreme poverty, of which nearly all are in India (93%). An additional 475 million people, of which 405 million are in India, live on less than $2 per day. However, the share of the population living in extreme poverty drops to 18% if India is excluded.

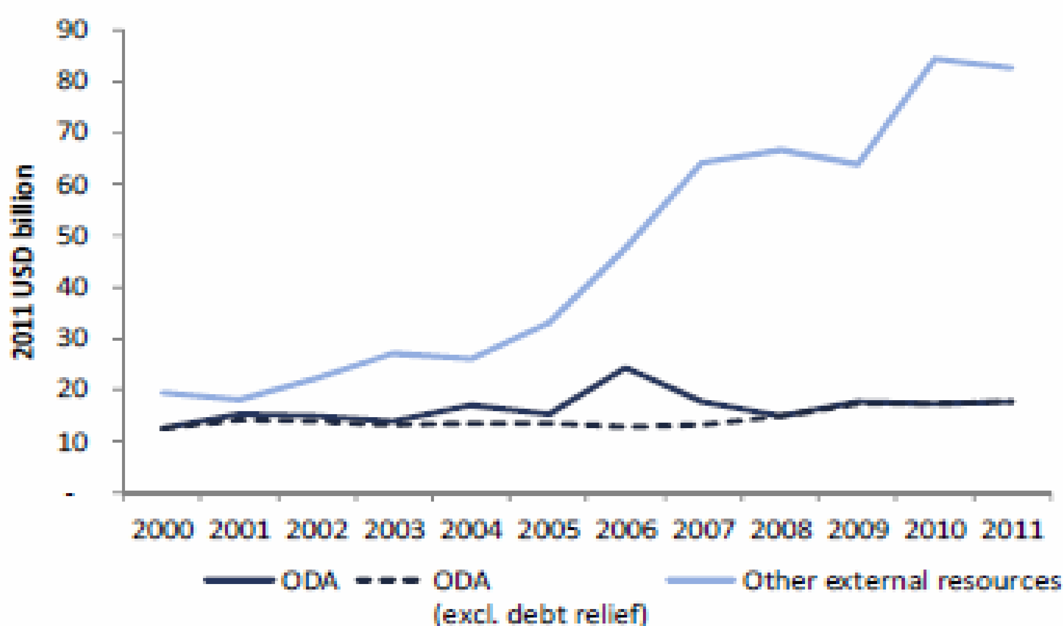
At the start of the millennium, the average external debt stock as a share of GNI of all countries in this group was considerably lower, standing at 30%. After reaching a low of 19% in 2008, the external debt stock as a share of GNI increased slightly, reaching 22% in 2011. Debt

[15] This group includes 22 countries; they are neither LDCs nor fragile, but eligible to receive concessional lending from IDA. Only two countries in this group are low-income countries (LICs) – Kyrgyz Republic and Tajikistan) – and five are upper middle-income countries (UMICs), while the bulk is made up of LMICs, almost half of which are in Asia. This group is dominated by the presence of India, by far the largest economy and the most populous country in the group. Together, countries in group 4 are home to over 1.4 billion people, of which 1.1 billion live in India alone. Vietnam is the second most populous country, with a population of nearly 84 million (or 6% of total population in the group). Nearly all countries in this group are so-called blend countries, i.e. eligible for IDA but also creditworthy for some IBRD borrowing. Most of the countries in this group have a medium HDI, with the exception of India and Papua New Guinea, which have a low HDI, and St. Lucia, which has a high HDI. Around 80% of the countries in this group are in either Asia or in the Americas.

relief operations, especially in 2006, contributed to reducing the external debt stock by 30%-70% for some of the most indebted countries in 2000 (e.g. Bolivia, Ghana, Honduras and Nicaragua).

ODA accounted for more than one-third (38%) of total external finance during 2000-2006; however, with a surge in private flows (mainly FDI and remittances) in recent years, ODA's relative weight declined to 18% in 2011. Other external flows in real terms increased from about $20 billion in 2000, to around $80 billion in 2011 (Figure 9). Remittances grew from $10 billion in 2000, to $35 billion in 2011. While most of the increases can be attributed to India, FDI and remittances to other countries also increased. For example, FDI to Vietnam tripled and remittances doubled between 2006 and 2011. As a result, the share of ODA in total external resources fell from 59% to 32% (excluding India) for this group. In volume terms, ODA was merely 5% (18% excluding India) compared to government tax revenue in 2011. ODA per capita is also low compared to all other groups.

Figure 9: External financing in low middle-income countries



Source: Same as Figure 4

V. How can countries improve domestic resource mobilization efforts? [16]

On average, developing countries have increased their tax revenue over the last 15 years. The median tax-GDP ratio in LDCs increased from less than 10% in 1990 to close to 14% in 2013. Over the same period, the median tax-GDP ratio for lower- and upper-middle-income countries rose from around 12% to around 16% and 18%, respectively. Yet in many developing countries, domestic resource mobilization remained insufficient to meet their sustainable development objectives.

The revenue-to-GDP ratio can rise in the following ways: the domestic tax base is widened; tax avoidance and evasion are reduced; and new sources of international taxation are found.

There is no reason to be overly pessimistic about direct taxation, as tax reform has significantly improved the contribution of direct taxes to overall revenue in many countries. A number of developing countries have reduced income tax rates on the wealthiest groups. In terms of individual income taxes, 34 of the 149 countries with data (or 22% of the sample) had

[16] Draws on Ortiz, Isabel, Matthew Cummins and Kalaivani Karunanethy (2015)

lowered the tax rates for the highest income earners in 2014, compared to the 2010-13 period. Thus, it is certainly possible to raise the share of direct taxation of the wealthy in developing countries and thereby enhance tax revenue through more progressive income taxes.

Many countries are considering special taxes on the profits and remuneration of financial institutions. For instance, Turkey taxes all receipts of banks and insurance companies, and, in the United Kingdom and France, all bonus payments in excess of €25,000 are taxed by 50%. Another example is a bank debit tax in Brazil, which charged 0.38% on online bill payments and major cash withdrawals; before its discontinuation in 2008, it raised an estimated $20 billion per year and financed healthcare, poverty alleviation and social assistance programmes.

Excise taxes are another important source of revenue in developing countries as they have a buoyant base and can be administered at low cost. Many countries, however, either abolished or reduced exercise taxes with the introduction of value-added tax (VAT). But from a revenue perspective, excise duties are more convenient, involving few producers, large sales volumes, relatively inelastic demand and easy observability. Excises may be levied on quantities leaving the factory or arriving at ports, thus simplifying measurement and collection, ensuring coverage, limiting evasion and improving monitoring. Excise taxes currently amount to less than 2% of GDP in low-income countries, compared to about 3% in high-income countries.

Raising VAT has become a common approach for many countries. For example, a recent ILO review of IMF policy discussions found that 94 governments in 63 developing and 31 high income countries were considering raising VAT or sales taxes.[17] Given their regressive nature, raising VAT or consumption taxes can only be a prudent policy if targeted to the products that the better-off consume disproportionately more. For example, it is possible to exempt necessary basic goods that many low-income families depend on while setting higher rates for luxury goods that are principally consumed by wealthier families (e.g. luxury cars). In this manner, progressively designed consumption taxes can increase public resources and protect the most vulnerable.

An IMF study concluded that scope to raise revenue "by simply raising standard VAT rates is becoming limited, so the potential lies largely in better improving compliance and scaling back preferential treatments. Not least, and important too for the wider legitimacy of tax systems, greater efforts can be made—requiring political will as much as technical capacity—in taxing elites and high-income/wealth individuals".[18]

A government may raise revenue either by directly extracting natural resources through a state-owned enterprise, joint-ventures or other forms of co-extraction, or by selling off the exploitation rights and taxing the profits, both of which can provide transitory revenue for social investment. A number of countries have effectively managed their natural resources through public companies, including Botswana (diamonds), Brazil (oil), Indonesia (oil and gas) and Malaysia (forestry, tin, oil and gas).

In many countries, however, the private sector takes the lead in exploiting natural resources. In these situations, the state is indirectly included in the rents since it receives a portion via taxes. This can include: (i) production-based taxation (per unit or ad valorem royalties, sales taxes, export and import duties, VAT, payroll tax, stamp duty, etc.); (ii) profit-based taxation (corporate income tax, resource rent taxes, taxes on windfalls, profit tax on dividends, royalty based on profit, etc.); and (iii) environmental taxes to compensate for negative environmental externalities caused by the activities of mining companies.

There are a miscellaneous set of other taxes that can also be considered. They include property and inheritance taxes; airline and hotel taxes, tourism taxes; international transportation taxes; levies of taxes for social programmes; carbon or pollution taxes; "sin" taxes (e.g., on cigarettes, alcohol or even sugary products that contribute to obesity), etc.

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[17] ILO (2014)
[18] IMF (2011, p. 5)

At the international level, it has been estimated that applying a 0.005% single-currency transaction tax on all four major currencies could yield up to $33 billion per year for developing country assistance. And if applied more broadly to cover all financial transactions globally, a 0.01% tax could raise over $1.0 trillion annually (Leading Group on Innovating Financing for Development 2010).Taxing financial sector transactions is a feasible option to fund social protection.

However, there should also be a greater effort to ensure better compliance with, and higher collection of existing taxes. Limiting the discretionary authority of tax officials could also help improve compliance and reduce evasion. Computerization of tax administration can help limit corruption, as it makes it harder to tamper with records.[19] But government computerization alone cannot ensure effective introduction of the much-touted VAT, an indirect tax largely responsible for facilitating the shift from direct to indirect taxation.

Improved tax administration can increase the share of personal income taxes in total tax revenue. Expansion of the scope for tax deduction at source has been very effective in taxing those otherwise hard to reach. Every individual who is a house owner, vehicle owner, club member, credit card holder, passport, driving licence or identity card holder and telephone subscriber can be required to file a tax return.

Box 1: Uzbekistan's innovative tax revenue measures

Uzbekistan has developed a new tax system that includes VAT and enterprise profit tax. In 1993, the combination of VAT, profit tax, and excise tax brought in 62.2% of tax revenue. It also introduced a very effective method for collecting taxes from enterprises *without* a tax collection agency. Each enterprise is required to have an account at a state-controlled bank, into which its sales revenues must be deposited. The government withdraws taxes due directly from the enterprise's account. By 1995, revenue collection had increased to a hefty 34% of GDP, enabling the government to finance a substantial public expenditure program while incurring only a limited deficit. Unlike in most former Soviet Republics, Uzbekistan was collecting over 40% of GDP in taxes and social security contributions (the latter accounting for some 9-10% of GDP) by the early 2000s, as opposed to 25-30% in the rest of the region.

Box 2: Brazil: A financial transaction tax to finance public health and social protection

The Contribuição "Provisória" por Movimentação Financeira (CPMF) tax was levied in Brazil from 1997 to 2007. The contribution took the form of deductions from accounts held by financial institutions. The maximum value of the CPMF quota reached 0.38% of the value of financial transactions. For accounting purposes and because the CPMF was designed mainly to finance social protection expenditure, the mechanism was classified as a "social contribution." During the period in which the tax was applied, 42% of the revenue collected was used for the public unified health system, 21% for social insurance, 21% for Bolsa Família and 16% for other social purposes. By 2007, total revenue from CPMF amounted to 1.4% of GDP, enough to cover the total cost of Bolsa Família and other non-contributory social protection programs. Although pressure from the financial sector led to its rescinding in 2007, a financial transaction tax was reinstated in 2009 at much higher levels (6%) in order to help curb liquidity in international markets and fast capital inflows/outflows that disrupted Brazil's development. It was repealed once again in 2013, after leaving significant resources to the Brazilian government to implement social policies, a reason driving the ongoing calls from civil society to adopt financial transaction taxes as part of social justice.

[19] As far back as in 1960, ESCAP, in its annual flagship publication, recommended to its member States to set up special tax courts to expeditiously deal with tax fraud cases.

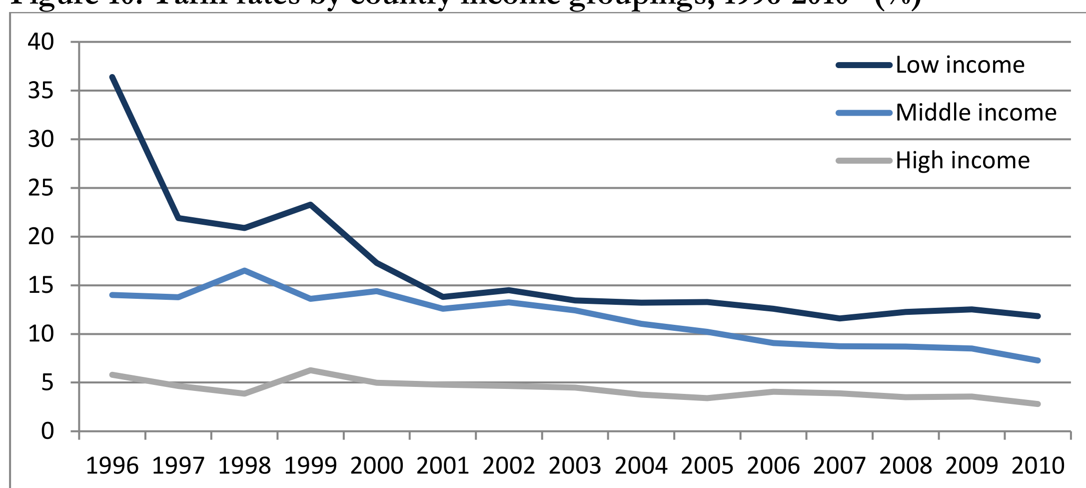
Box 3: Bolivia: Taxing hydrocarbons key for national development

Natural resources, including gold, tin, petroleum and gas, are the main pillar of Bolivia's wealth and key to the country's national development. As a result of orthodox neoliberal policies in the 1980s, the majority of production was privatized, often through foreign companies. In the process, royalty taxes were cut down to 18%, which led to extremely high profits for producers (82%) and very low returns to the Bolivian population. The widespread dissatisfaction with this situation led to an activist campaign named "Hydrocarbons are No Longer Ours." After violent repression of this movement during the so-called "Gas Wars," President Sánchez de Lozada resigned, and a national referendum led to a new regulation on the distribution of hydrocarbon wealth. The previous share of 82% of oil revenues for the producers and 18% for the state was equalized at a 50-50 split (and a reversed 82-18 split for the largest gas field). Renegotiation of former contracts led to an increase in oil and gas income for the state, from US$558 million in 2004 to US$1.53 billion in 2006. Such significant revenue increases allowed the government to expand/sustain social policies such as Renta Dignidad (Dignity Rent), a non-contributory pension to all Bolivians over 60 years old, or the Bono Juancito Pinto, a cash transfer for all children in public elementary schools (from first through eighth grade), which offsets the costs of transportation, books and uniforms to increase school attendance.

Globalization and tax losses[20]

Revenue losses due to globalization need to be addressed. There are four main reasons for revenue losses: first, trade liberalization and associated tariff cuts. Many developing countries' domestic resource mobilization, in particular of tax revenue, suffered setbacks due to trade liberalization and the abolition of trade-related taxes rarely compensated by the more regressive indirect taxes such as VAT. Developing countries have steadily reduced tariff rates since the 1990s, lowering their capacity to generate revenue from trade. The financial implications of this trend are likely greater for low-income countries, which sliced tariffs by more than half, from 36 to 12% between 1996 and 2010, on average, compared to a 7% average cut in middle-income countries (Figure 10). Some countries stood out, with India's average tariff rate falling from 71 to 13% between 1994 and 2009 and Brazil's from 51 to 14% between 1987 and 2009.[21]

Figure 10: Tariff rates by country income groupings, 1996-2010* (%)



Notes: * Values reflect unweighted average of applied rates, all traded products subject to tariffs
Source: World Development Indicators (2015)

[20] Draws on Jomo and Chowdhury (2016)
[21] WTO (2010)

An IMF study found that while rich countries have been able to offset reductions in tariff revenue by increasing their domestic tax revenue, this has not occurred in most developing countries. Middle-income countries were found to recover only up to 60 cents of each dollar of tariff revenue lost, and low-income countries recovered no more than 30 cents.[22] Therefore, in many developing countries there may be a good rationale to examine current tariff levels, at least until domestic tax collection mechanisms are strengthened, to sustain or increase levels of revenue.

Second, capital movements increase opportunities for tax evasion because of the limited capacity that any tax authority has to check the overseas incomes of its residents; evasion is easier as some governments and financial institutions systematically conceal relevant information. Where dividends, interest, royalties and management fees are not taxed in the country in which they are paid, they more easily escape notice in the countries where the beneficiaries live.

A December 2015 report from Global Financial Integrity, 'Illicit Financial Flows from Developing Countries: 2004-2013', found that developing and emerging market economies lost US$7.8 trillion in illicit financial flows from 2004 through 2013, with illicit outflows increasing at an average of 6.5% per year—nearly twice as fast as global GDP. The so-called Panama Papers hint at the extent of the problem, involving both developed and developing countries. A 2012 Tax Justice Network (TJN) report conservatively estimated that as of 2010, between $21 trillion and $32 trillion of global financial wealth from a sample of 139, mostly developing countries, has been stashed secretly, 'virtually tax-free', in more than 80 secret jurisdictions, with two thirds in the European Union, and a third in UK-linked sites. This has resulted in $189 billion in lost tax revenue annually.[23]

Third, avoidance (not evasion) may increase, given international differences in tax rules and rates, because of the choice of tax regime that international-tax-treatment of enterprise income commonly offers. This is more likely for taxation of profits from corporations' international operations. Transfer pricing for goods, services and resources – moving among branches or subsidiaries of a company – provides opportunities for shifting income to minimize tax liability.

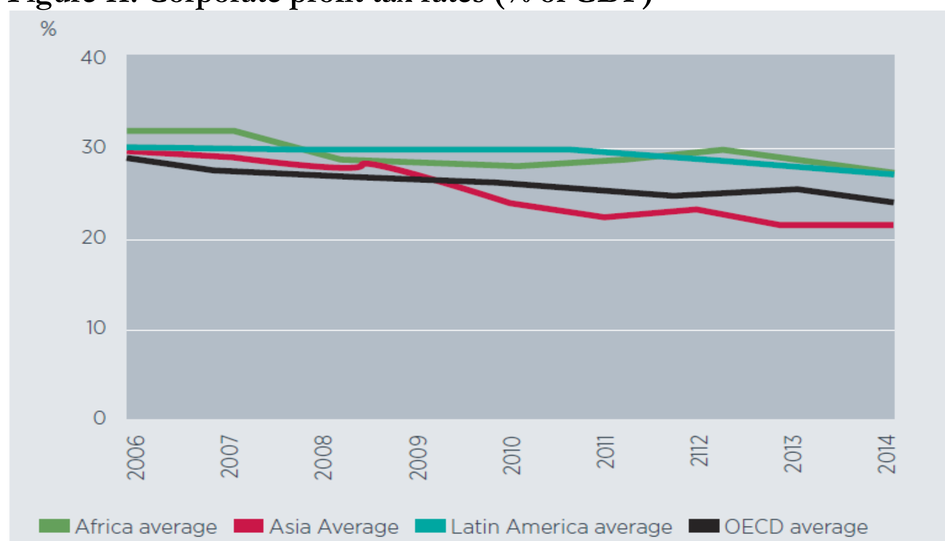
Fourth, international competition for inward FDI has led governments to reduce tax rates and to otherwise increase tax concessions to corporations (Figure 11). The tax rates that governments can impose are thus constrained by international competition. Hence, they are reluctant to raise rates or to tax dividend and interest income for fear of capital flight, although it is well known that direct tax concessions have little effect in diverting international investment,[24] let alone in attracting such flows. Therefore, such tax concessions constitute an unnecessary loss of revenue.

[22] Baunsgaard and Keen (2005)

[23] Henry (2012)

[24] OCED Policy Brief (February 2008) notes: "while tax is recognized as being an important factor in decisions on where to invest, it is not the main determinant. FDI is attracted to countries offering: access to markets and profit opportunities; a predictable and non-discriminatory legal and regulatory framework; macroeconomic stability; skilled and responsive labour markets; and well-developed infrastructure. All of these factors will influence the long-term profitability of a project." Similarly, a 2008 IMF research paper (Chai, Jingqing and Rishi Goyal) compared the costs of concessions in terms of revenues forgone with the benefits which were marginal at best in Caribbean countries. Forgone tax revenues ranged between 9½ and 16% of GDP per year, whereas total foreign direct investment did not appear to depend on concessions.

Figure 11: Corporate profit tax rates (% of GDP)



Source: Griffiths (2014)

Not surprisingly, income tax rates, both on corporations and on individuals, have fallen sharply since the 1980s. Beggar-thy-neighbour policies have led to loss of revenue for many developing countries in a larger race-to-the-bottom also involving labour and environmental standards and conditions, which also undermines the possibility of balanced, inclusive and sustainable development.

Finance ministries and tax authorities in developing countries need to cooperate among themselves and with their counterparts in the OECD economies to learn from one another and to close existing loopholes in their mutual interest. With the huge and growing size of public debt as well as the real and imagined fiscal constraints to sustained global economic recovery, such cooperation is more urgent than ever. Here it would be pertinent to draw attention to ESCAP's proposal to set up a regional tax forum to share best practices, avoid tax competition and stem illicit transfer of funds.[25]

VI. What are some of the interesting approaches that countries have used to reallocate expenditure towards poverty eradication efforts?[26]

Rethinking sector-specific allocations within existing budgets is one strategy to increase expenditure for poverty eradication. The re-prioritization of public spending is usually a contentious and therefore difficult approach, as different interest groups within and outside of government compete to influence public policies and budget allocations. Therefore, to be successful, there must be a strong political will and laser focus on feasibility.

There are ways of prioritising socially-responsive expenditures for poverty eradication even when overall budgets are contracting as long as governments have their budget priorities in place and the political will to carry them through with competence. Social dialogue involving relevant stakeholders and public debates can help minimize the possible influence of powerful lobbying groups on public policy-making to replace high-cost, low-impact interventions. The ILO has identified the following strategies to promote fiscal space and reduce political opposition to re-prioritization:

[25] ESCAP (2014)
[26] Draws on Ortiz, Isabel, Matthew Cummins and Kalaivani Karunanethy (2015)

- *Re-prioritising through Public Expenditure Reviews (PERs) and Social Budgets.* These are well-developed approaches to public financial management that bring evidence and rationality to public policy-making by showing the impacts of current budgetary allocations.
- *Replacing high-cost, low-impact investments.* New public investments can be re-examined; for example, the social impact of many large infrastructure projects or rescue of banking systems tend to be limited, but require large amounts of public resources. Budget items with large recurrent costs but small social impact should also be re-considered. For example, Costa Rica and Thailand reduced military spending to finance needed social investments.
- *Eliminating inefficiencies.* Although linked to the previous point, deeper analysis of sector investments is required to eliminate inefficiencies. In particular, the overall cost-effectiveness of a specific program or policy should be impartially evaluated according to various factors, including: (i) coverage (beneficiaries and benefits); (ii) total cost (as a percentage of GDP, public expenditure and sector expenditure); (iii) administrative costs (as a percentage of total costs and how the costs compare with other programs—for example, means-testing targeting is typically expensive.

Box 4: Thailand: Reallocating military expenditures for universal social protection

The 1997 Asian financial crisis severely hit the Thai economy and society. With the backing of the 1997 Constitution, civil society calls to address neglected social policies led the government to adopt the Universal Health Care Scheme in 2001. Given that approximately a third of the population was excluded from health coverage at that time, most of which belonged to the informal agricultural sector without regular income, achieving universal coverage through contributory schemes alone was not possible; it needed budget support. Most of the improvements in public health were financed through reduced spending on defence (from around 25% of total expenditures in the 1970s to 15% during the 2000s) and lower debt service payments. The government included the Universal Health Care Scheme as part of a more general fiscal stimulus plan; other measures increased the amount of money in the hands of people with a high propensity to spend, including the creation of a People's Bank, a debt moratorium for farmers and a village fund.

Box 5: Indonesia's fuel subsidy reforms and expansion of social protection

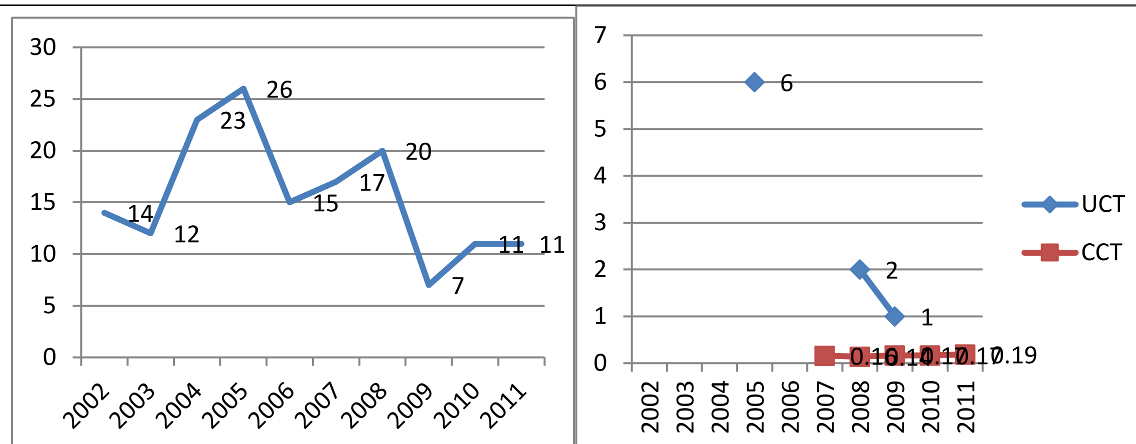
Indonesia's universal oil subsidy was initiated in 1967 to distribute the state's oil windfall to ordinary Indonesian citizens. But ironically Indonesia became a net importer of oil in 2004 at a time when international oil prices were soaring, and fuel subsidies began putting a great deal of pressure on the national budget. So, Indonesia had no choice but to reform its fuel subsidy system. As a matter of fact, the need for reform to expand fiscal space became apparent earlier as Indonesia was hard-hit by the Asian financial crisis in 1997-98.

However, it was not an easy task politically for a nation that became used to cheap fuel. When rioting broke out in 2005, the government responded quickly by introducing a compensation programme consisting of educational assistance, healthcare and unconditional cash transfers (UCTs) to the poor to offset the upward spiral of fuel prices following the reduction in fuel subsidies. The UTCs consisted of cash benefit of IDR100,000 (roughly US$10.50) per month to each target household, covering 15.5 million households or nearly a quarter of the population. But the programme was not sustainable over a prolonged period because of its financial burden. So, in 2006, the government prepared to switch to conditional cash transfers (CCTs) through a project, the Hopeful Family Programme.

It is important to point out that income support for the poor was only a secondary objective. The UCT t was introduced in the context of fiscal consolidation in the time of economic crisis, which was the primary concern for the government. As can be seen from the figures below, although UCTs and CCTs are still very insignificant, fuel subsidy cuts was substantial; its share in government expenditure dropping from 26% in 2005 to 11% in 2010-2011. Thus, the introduction of CCTs was not simply a new emphasis on human development, but formed part of an institutional reform to improve the nation's finances.

Share of total central government expenditure, 2002–2011

Fuel subsidy (% of govt. expend.) UCTs & CCTs (% of govt. expend.)



VII. How can developing countries expand fiscal space for counter-cyclical macroeconomic policies, including social protection schemes?

Social protection and counter-cyclical measures are critical to prevent vulnerability of the near poor. A social protection floor itself acts as an automatic stabilizer and an important tool for counter-cyclical response to shocks. Although most developing countries did not have the fiscal space, a number of large middle-income as well as low-income countries also undertook large stimulus packages during the 2008-2009 global financial and economic crisis. More importantly, the stimulus packages in most countries involved either boosting existing social protection expenditure, including expenditure on health and education, or expanding the programme to protect the vulnerable. As a result, both the recession and its social impacts were less severe than initially feared.

Obviously the ability to pursue counter-cyclical policies, especially expansionary fiscal response to economic down-turns, would depend on the availability of fiscal space. However, this would also mean shrinking of fiscal space and may even result in budget deficits and rise in public debts. Governments can also respond with expansionary monetary policy which may have some inflation pressure.

For long, especially since the debt-crisis of the 1980s and the high inflationary experience of the 1970s and 1980s, the orthodox policy prescriptions, especially from the international financial institutions, have been pro-cyclical, aimed at keeping the debt level low (or fiscal budget in surplus) and the inflation rate at a low single digit level. Countries were advised to maintain an expenditure ceiling even when they had fiscal space – sometimes with large inflows of aid – for fear of fuelling inflationary expectations.

In this regard, it is critically important to examine the empirical foundations of a number of claims that supported pro-cyclical policy advice. First, that public debt is growth-inhibiting, and hence adversely affects the poor. Second, that public debt and monetary expansion

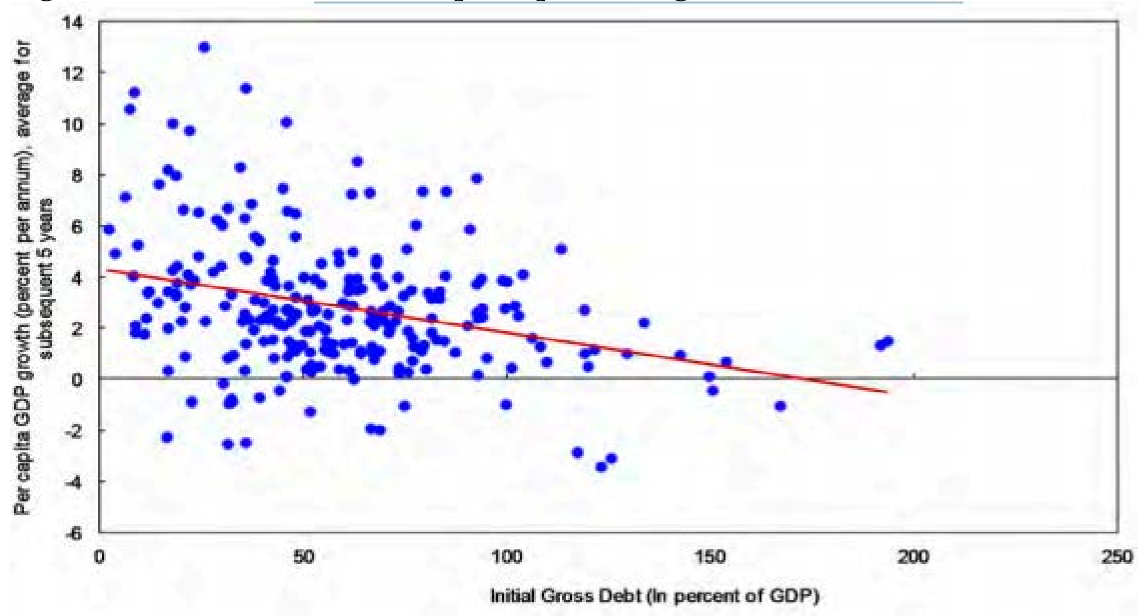
contribute to inflation, which is growth inhibiting and hence bad for the poor. Third, that large inflows of foreign aid cause exchange rates to appreciate to the detriment of exports and growth, and hence is unhelpful for the poor. Fourth, that fiscal austerity and monetary discipline lead to higher growth by positively affecting investor confidence; thus, the pro-cyclical stance only causes short-term pains for long-term gains. Interestingly, even research within the IMF, which has been at the forefront in promoting pro-cyclical policies, could not provide any robust evidence in favour of these claims.

Debt and growth

Using data on a sample of 40 countries (grouped into advanced and developing) over the 1965-2010 period, the IMF research found no evidence for a universally applicable threshold effect in the relationship between public debt and economic growth. It also found that provided that public debt is on a downward trajectory, a country with a high level of debt can grow just as fast as its peers in the long run.[27]

A closer look at the scatter plot (Figure 12) that the IMF used in 2010 to advocate fiscal consolidation reveals that the claim of a negative relationship between growth and initial debt-GDP ratio is influenced by a few outliers, characterized by either a debt-GDP ratio well above 100% or very high per capita GDP growth exceeding 8%. In 2012, the IMF concluded: "(T)here is no simple relationship between debt and growth. In fact, our… analysis emphasizes that there are many factors that matter for a country's growth and debt performance. Moreover, there is no single threshold for debt ratios that can delineate the 'bad' from the 'good'."[28] In its October 2014 World Economic Outlook, the IMF observed that "debt-financed projects could have large output effects without increasing the debt-to-GDP ratio".

Figure 12: Government debt and per capita GDP growth



Source: IMF, Fiscal Montor, May 2010

However, one needs to distinguish between domestic and external debt. Large external debt can drag an economy down as it struggles to service debt, especially when its export earnings are

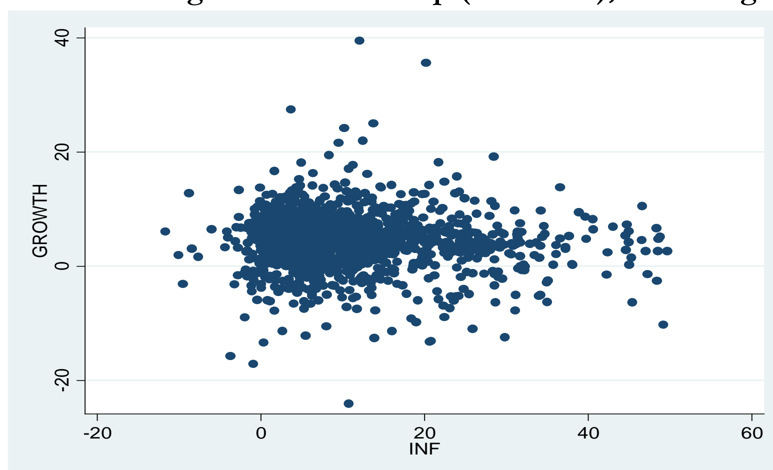
[27] Chudik, et al (2015)

[28] IMF (2012, p. 109)

falling or stagnating. Thus, external debt relief, such as HIPC initiatives and Multilateral Debt Relief Initiative (MDRI) are critically important for creating fiscal space.

Inflation and growth
The most cited IMF research on this issue reported a threshold level of 11-12%, beyond which inflation negatively affected growth.[29] Other academic research found higher threshold levels. As can be seen from Figure 13, there is virtually no relationship between inflation and growth if very high inflation rates are excluded. The evidence shows that many countries (e.g. Republic of Korea and Indonesia) grew at respectable rates even when inflation ranged between 15% and 20%. Thus, it is no wonder when the Nobel Laureate economist, Milton Friedman, the father of monetarism, observed, "Historically, all possible combinations have occurred: inflation with and without [economic] development, no inflation with and without [economic] development."[30]

Figure 13: Inflation-growth relationship (1960-2010), excluding outliers



Source: World Bank, World Development Indicators (various issues)

However, this does not mean very high and accelerating inflation is desirable. High and rising inflation does affect investment and consumption decisions and hence growth and employment. But there is no solid empirical support to target inflation at a low single digit level (usually less than 5%). Quite often inflation in developing countries is caused by supply shocks. In such a situation, restrictive macroeconomic policies aimed keeping inflation at a low level exacerbate declines in output and employment, harming the poor more than inflation itself would have.

Aid and growth ('Dutch disease')
To the extent that aid raises consumer or government recurrent expenditure, there will be some real exchange rate appreciation and a shift of resources away from traded goods production and into non-traded goods production. However, aid for investment in the traded goods sector can mitigate this effect. A relatively high level of productivity in the non-traded goods sector combined with a high level of investment will also tend to depreciate the real exchange rate.[31]

Moreover, the possibility of real exchange rate appreciation and adverse impact on the non-tradable sector (Dutch disease) occurs under the condition of full employment, the efficient use of production factors and perfect elasticity of the demand for tradables. None of these conditions are likely to hold in developing, especially low-income, countries. Thus, one IMF

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[29] Khan and Abdelhak (2001)
[30] Friedman (1973, p. 41)
[31] See Chowdhury with McKinley (2006)

research concluded, "the Dutch disease need not materialize in poor countries if they can draw on their idle productive capacity to satisfy the increased demand for nontradables that large ODA flows induce, while using ODA flows to ease supply bottlenecks that prevent them from producing at their full potential".[32]

Fiscal consolidation and growth

On the question of fiscal austerity and short-term pains for long-term gains, the IMF research notes, "Evidence from data over the past 30 years shows that consolidation lowers incomes in the short term, with wage-earners taking more of a hit than others; it also raises unemployment, particularly long-term unemployment...slamming on the brakes too quickly will hurt the recovery and worsen job prospects. Hence the potential longer-run benefits of fiscal consolidation must be balanced against the short- and medium-run adverse impacts on growth and jobs".[33]

Thus, there has been a growing recognition of the need to ease budget constraints and allow for an increasing degree of deficit spending, especially to support social investments.[34] This not only helps quick recovery, but also minimizes social impacts of economic shocks, especially poverty. At the same time, growth helps to repair the budget as tax revenues rise and social protection expenditures (e.g. unemployment benefits) decline.

Box 6: Uzbekistan's counter-cyclical macroeconomic policies and social protection during transition

Uzbekistan responded to the external shocks following its independence in 1991 with heterodox macroeconomic and structural policies. Uzbekistan expanded its social protection measures in order to prevent declines in living standards, especially of vulnerable groups. For example, between 1991 and 1995, the government provided considerable consumer subsidies and the social transfers to all citizens, regardless of their income. Subsidies for bread, flour, rice, meat, milk, tea, free breakfasts at schools and food coupons for students accounted for 50% of all subsidies. Subsidies for heating, electricity and public services were provided to more than 50% of the population. Retiree health care & war veterans were also subsidized regardless of their income level.

As a result, public expenditure on social transfers (excluding pensions) rose in the first phase of the reform, to reach 4% of GDP in 1996 as the coverage of pre-existing transfers (e.g. allowances for children under 16 of age, birth grants and an allowance for the care of children under two years) was maintained while unemployment compensation and assistance to low income families was introduced.

On the demand side, Uzbekistan's contraction after 1992 was cushioned by rising public investment, small declines in government purchases and expanded income transfers. It was further aided by the control of luxury imports as the expanding class middle class was forced to spend on domestically produced goods. On the supply side, Uzbekistan boosted growth through industrial policy supported by cheap credit from state-controlled banks, favourable access to foreign exchange for importation of industrial raw materials and capital goods, aided by agricultural policy of state-order, guaranteed price and subsidized inputs.

An undisputable success of Uzbekistan during the transition period was that fiscal balance was achieved without squeezing pro-poor or pro-growth public expenditures which absorbed more than 22% of GDP in 1995. The composition of public outlays reflected a clear concern for alleviating the impact of the transition on the poor and for keeping the state machinery running, and represented a model of how the poor can be protected during a turbulent stabilization through social policy interventions.

[32] Nkusu (2004, p. 16)

[33] Ball, Leigh, and Loungani (2011, p. 20)

[34] See IMF (2009)

VIII. How can donors assist developing countries through coordinated policies in order to contribute to poverty eradication?[35]

Estimates suggest that for achieving health, education, food security and water-sanitation related SDGs by 2030, the annual incremental costs (in constant 2010 prices) will be about $172 billion – $70 billion for health, $40 billion for education, $40 billion for food security and $22 billion for water and sanitation.[36] Almost all of these costs will need to come out of public funds.

But aid flows reached only $135.2 billion in 2014, according to preliminary OECD estimates. As a group, developed countries continue to fall short of their commitments, with DAC donors providing 0.29% of their GNI as ODA in aggregate compared to the 0.7% commitment. ODA to LDCs at less than 0.10% of donor GNI has also been far below the target (0.15-0.2% of GNI). Preliminary 2014 data indicate a 16% fall in bilateral ODA to LDCs in real terms.[37]

Many donor countries are also diverting aid to humanitarian relief in response to the recent refugee crisis. Norway, one of the few countries to achieve 0.7% ODA target, planned to use 21% of its $4.8 billion 2016 ODA budget for supporting refugees during their first year in Norway. Although it is consistent with the OECD guideline that ODA funds may only be used for the first year of a refugee's resettlement domestically, there is no capping of how much ODA can go to such purposes. Donors can spend as much as they want, and may abuse the policy for political reasons, using the refugee offsets to rationalize a reduction in ODA. Some donor countries are not even following the OECD guidelines. For instance, Hungary does not differentiate between costs relating to the first year and those relating to subsequent years. Spain is using ODA to support and equip security forces in transit countries, essentially building walls in Ceuta and Melilla, its North African enclaves. Malta has also traditionally used almost half its aid budget to pay for migrant detention centres. Australia used AU$375 million of its 2012 aid budget for processing and supporting asylum seekers.

Furthermore, taking the advantage of a continued lack of clarity about the relationship between development finance and climate finance with no internationally agreed-upon definition and no international coordination like OECD's DAC, currently all DAC donors count their climate-related spending as ODA – which made up 17% of total bilateral ODA in 2014.[38] While climate finance should be 'new and additional aid', this practice clearly inflates ODA figures.

One can, however, argue that using aid money for refugee settlement or for climate change mitigation and adaptation measures is legitimate development finance, given a direct link between forced displacement/dislocation (refugees) and poverty as well as development impacts of climate change. The issue is the additionality of aid; the diversion of aid reduces finance for other development needs.

Donor countries are also increasingly using ODA for specific commercial instruments that are supposed to 'crowd-in' (induce or leverage) private financing and other public financing flows. ODA flows through commercial vehicles amounted to $1.8 billion and ODA channelled via a limited number of formally recognized public-private partnerships were valued at $669 million in 2013.[39] Generally used by development banks and development finance institutions (DFIs), such instruments include blending grants with private flows, equity investments and guarantees. But these instruments are less suitable for sectors—such as social spending—and in areas where private returns are limited, as in the poorest countries. All too often, donor prioritization of such instruments has been at the expense of country priorities.

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[35] Draws on Jomo and Chowdhury (2016)
[36] Sachs and Schmidt-Traub (2014)
[37] United Nations (2016)
[38] Steele (2015)
[39] *Ibid.*

A core appeal of these new instruments is financial additionality, where the public component of the package facilitates a private contribution that would not have otherwise been made. However, financial additionality is difficult and costly to determine. Instead of catalysing additional private resources, the public finance contribution could also subsidize private investments that would have been made anyway. Results of a review of additionality for infrastructure projects of five major DFIs were mixed, as more than a third of the projects would have gone ahead without DFI involvement. There are also concerns over the development impact of blending and other such instruments, particularly if there are trade-offs between commercial and sustainable development objectives. The same review found that DFI involvement did little to increase their direct poverty reducing impacts.[40]

The donor strategy to use aid money for partnerships with the private sector or 'blended finance' suffers from three problems.[41] First, the term 'partnership' is used to cover a wide array of arrangements. Second, there is little information available on just how specific partnerships are built and implemented. Third, there is little information on which partnerships have had substantial development impacts, why and how. Hence, critics see a hidden agenda to help MNCs gain control of global supply chains, or to substitute private finance for official aid, which has declined as a percentage of donor GNI since 2010.

IX. Concluding remark

This paper has provided a broad-brush review of changing role of public external vis-à-vis domestic sources, in particular aid and tax revenues, of development finance since the adoption of the First United Nations Decade of Poverty Eradication. It has become clear that developing countries should not expect any serious progress to the almost half-century-old commitment to transfer 0.7% of developed countries' economic output to developing countries through official channels (e.g. foreign aid). The prospect of a fair and predictable sovereign debt work-out mechanism also does not seem very bright in the near future.

Therefore, developing countries have to increasingly depend on domestic resources, in particular tax revenues and export-earnings for poverty eradication. But, with receding hope for successful conclusion of the multilateral Doha Round of trade negotiations, and continued adverse shocks to their terms of trade, developing countries must rely on tax revenue for financing sustainable development.

However, tax revenue in most low- and lower middle-income developing countries are still low, despite some progress globally. In the vast majority of countries in sub-Saharan Africa and Latin America, the tax-to-GDP ratio has actually stagnated or declined as tariffs and export duties, which accounted for the largest share of tax revenue, declined with trade liberalization. Unfortunately, other taxes have not grown to compensate for the lower trade taxes. Tax competition is also undermining revenue mobilization.

There is an urgent need to reverse this trend, with greater commitment to revenue generation in order to improve social protection, create employment and eradicate poverty. The donor countries agree that taxation is the only viable strategy for developing countries to exit foreign aid dependency in the long run. Thus, they should accede to the developing countries' desire for a full-fledged inter-governmental body for international tax cooperation under United Nations auspices for meaningful and inclusive inter-governmental discussions to enhance overall as well as national tax capacities.

Since tax revenue is closely linked to trade-related activities, there is an urgent need to harmonize trade policies to enhance the efficacy of trade's development potential. The multilateral trading system should be protected to support and sustain an enabling development environment. Easier access to developed countries' markets for developing countries'

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[40] Ryan-Collins and Spratt (2012)

[41] Callan and Davies (2013)

manufactures would reduce excessive dependence on raw material exports and related vulnerabilities – exposure to periodic fluctuating demand and prices – and hence instability of foreign exchange earnings.

Equally important is the need to co-ordinate trade and aid policies. This is essential not only to offset or avoid losses arising from price or demand fluctuations and worsening of developing countries' terms of trade, but also to limit the rising burdens of debt and debt servicing. The rapid reconstruction of war-ravaged Europe with large-scale Marshall Plan aid injections and German debt-forgiveness and debt-restructuring, linking debt-repayment to German export earnings, underscore the critical inter-linkages among trade, aid and debt in accelerating economic development.[42]

Finally, developing countries must find innovative ways to reprioritize their public expenditure for expanding universal access to basic public services such as healthcare, education and housing. They should also revisit their macroeconomic policy framework to make it consistently counter-cyclical with built-in automatic stabilizers and universal social protection measures in order to prevent the vulnerable section of the population from falling into poverty due to shocks.

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[42] At an international conference in London in 1953, West Germany secured a write-off of more than half its debt, accumulated after two world wars. Repayment of the remaining debt was made conditional on West Germany running a trade surplus, i.e. the German government would only pay back its creditors when it could afford to –not by borrowing even more. Reimbursements were also limited to 3% of export earnings. This gave Germany's creditor countries an incentive to import German goods in order to get their money back, thereby laying the foundations of the country's exports and 'economic miracle'.

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