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INPUT PAPER

Topic **Inputs for Elements Paper on Financing for Development (FfD 4)**
Authors **Dr Dhruba Purkayastha**, Director of Growth and Institutional Advancement
Dr Arunabha Ghosh, Founder-CEO
mailto:dhruba.purkayastha@ceew.in; mailto:arunabha.ghosh@ceew.in
Organisation Council on Energy, Environment and Water (CEEW), New Delhi, India | ceew.in
Date Tuesday, 15 October 2024
Contact **Shuva Raha**, Fellow and Lead – International Cooperation, CEEW
shuva.raha@ceew.in

Inputs for Elements Paper on Financing for Development (FfD4)

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1. Context

Global progress on Sustainable Development Goal (SDG) targets and 2030 Agenda for Sustainable Development is off track, with around half the 140 SDG targets deviating from required paths. The reason attributed for non-achievement of SDGs is that Financing for Development (Financing for SDGs) has been inadequate, and not aligned with the Addis Ababa Agenda Action (AAAA).

The UN Inter-Agency Task Force Report on Financing for Sustainable Development Report (FSDR 2024) states that financing for SDGs is at a crossroads and that lack of financing is at the heart of the current sustainable development crisis. Financing gaps for developing countries is of the order of $ 4 trillion per annum.

1.1 Key questions for FfD4

FfD4 presents a unique opportunity to get the world back on track to meet SDGs. The focus needs to be on investment/financing to meet SDGs from all possible finance sources. Questions include:

- *How can we close financing and investment gaps by building on the proposals in the SDG Stimulus, and mobilise and align all sources of finance?*
- *How can we close gaps in the international financial architecture, and make it fit for purpose for today's challenges?*
- *How do we close credibility gaps in financing and rebuild trust in the global partnership and multilateralism?*
- *How can we formulate and finance new development pathways to deliver the SDG?*

1.2 Components of the Inputs for Elements Paper on FfD4

The Call for Inputs on FfD4 has asked for inputs on the following seven (7) actions areas:
- Domestic public resources
- Domestic and international private business and finance
- International development cooperation
- International trade as an engine for development
- Debt and debt sustainability
- Systemic issues
- Science, technology, innovation and capacity building

This Input Paper from the Council on Energy, Environment and Water (CEEW), New Delhi India, addresses the overarching question of key financing policy reforms. It is structured on sub-elements of the suggested five (5) action areas from a financing and investment approach:

- Domestic public resources
- Domestic and international private business and finance
- International development cooperation
- International trade as an engine for development
- Science, technology, innovation and capacity building

This Input Paper prioritises the need to finance climate mitigation, adaptation, and resilience.

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2. Input | Domestic public resources

Most developing countries, and especially LDCs, are faced with increasing imbalance in public finances due to high structural deficits and unsustainable public debt. Their fiscal deficits and public debt are rising again after a period of contraction in public spending and debt levels following exceptional surges due to heightened public spending during the pandemic years.

Coupled with increasing inflationary pressures which reduce fiscal space and geopolitical tensions, developing countries are unlikely to find adequate fiscal headroom to invest toward meeting SDGs and increasing their social protection payments.

Interest payments are increasing and crowding out much needed public investment for sustainable development[1]. In many countries, interest payments are exceeding development expenditure on primary health and education. For more than a decade, tax to GDP revenues for developing countries have stagnated at ~15 per cent and for LDCs, at 10-12 per cent.

There are two high level aspects to mobilise and direct domestic resources towards SDGs:
- **Increasing public resources**, i.e. Increasing domestic tax and non-tax revenues – both tax base and rate, and focusing on non-tax revenue, and
- **improving the quality (and composition) of public expenditure** at federal and sub-sovereign levels (in applicable countries).

A deeper dive illustrates the avenues.

2.1 Increase public resources

Public revenues from domestic sources, in absolute and relative to GDP terms, could be increased via some cross-cutting reforms in taxation across developing countries. Tax reforms could, inter alia, include:

- **Goods and Services Tax:** Implementation of Value-Added Indirect Taxation as Good and Services Tax in developing countries including LDCs (which may need technical support from multilateral institutions)

- **International agreement on fair tax sharing:** This can be done from e-commerce, transnational companies, and Global Value Chains (GVCs) with minimal market distortion. GVCs shift a major share of value addition to developing countries, but since final consumption gets taxed in consumption countries, developing countries are unable to get a fair share of value-added taxation.

- **Wealth tax:** Most developing countries tax formal income as direct tax and there is tax leakage due to poor tax administration and rampant tax evasion. Increasing inequality is not only a reflection of income distribution but also of wealth, which can be done via a small tax on wealth.

- **Land and asset monetisation:** Public land and asset monetisation initiatives could be used to finance infrastructure investments – usually referred to as Land Based Infrastructure Financing. This could form an important component of MDB interventions and keep the focus on climate resilient infrastructure development.

[1] IMF Fiscal Monitor 2023.

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2.2 Improve quality of public expenditure

- **Budget for SDG-linked outcomes:** Developing countries need to align public spending towards meeting SDGs with outcomes directed to SDG indicators, thus prioritising public health, primary education, water and sanitation, reducing air pollution, and increasing allocation to social protection/safety nets.

- **Manage climate action expenditure:** While SDG 7 and 13 remain time sensitive and critical towards meeting global climate goals in line with the Paris Agreement, it is imperative for developing countries to focus selectively on climate mitigation towards meeting NDCs, and enhance focus on adaptation and resilience to address local adverse effects of climate change.

- **Adopt a Sustainable Budgeting taxonomy**: Instead of adopting a Green Taxonomy and Green Budgeting as being advocated, it may be useful to think of SDG-aligned budgeting for Public Financial Management, with public finance outcome indicators derived from SDG indicators (Sustainable Budgeting instead of Green Budgeting).

- **Leverage public finance**: Use public finance to leverage capital mobilisation from domestic private sources to increase the impact of public expenditure on development outcomes though risk sharing and guarantees, and increase Gross Fixed Capital Formation through Public Private Partnerships. Increased contingent liabilities on public exchequer need to be well-managed for better risk allocation between public and private finance.

3 Input | Domestic and international private business and finance

Domestic public finance resources are a major component of sources of finance to meet SDGs and need to be complemented by private finance – domestic and international. However, private business and finance have lagged behind in SDG investments. As per the FSDR 2024[2], *"Private sector development, a key driver of sustainable growth and development has stalled in recent years."* The Addis Agenda approach of private sector investment and innovation being an instrument to meet SDGs, since private business activity is considered an engine of inclusive growth and job creation, has not met its ambition.

It is important to understand and reflect on the misplaced onus placed on private business and finance to meet SDGs and create jobs without easing the binding constraints of government and market failures[3]. The Addis expectations from private sector were inflated, and the international development agenda did not focus on interventions which could have led to higher private sector contribution to SDGs. Instead, most development interventions focused only on broad business enabling environment, such as WB Doing Business[4], and investment climate reforms. The Addis agenda was followed by the Paris Agreement, which further burdened private business and finance with investments for climate goals[5].

Developing countries have moved away from industrial policy, mainly based on advice from multilateral development banks (MDBs). The need for industrial policy today, when the world needs to transition, is being acutely felt in the overarching market failures to counter the global effects of climate change arising from unabated greenhouse gas (GHG) emissions.

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[2] UN Inter Agency Finance for Development Report 2024
[3] Growth Diagnostics – Rodrik, Hausman, Velasco.
[4] [4] World Bank Doing Business

The need for green private sector development

For decades, governments have tried to foster industrial competitiveness and economic growth. While economic growth has widely been achieved and has extracted billions of people out of poverty, this has depleted natural resources. The rate of this depletion is unsustainable, and yet inextricably linked to economic growth and development. E**conomic activity needs to be de-linked from resource depletion.**

Increasing contribution from private business and finance in meeting SDGs

While the broader enabling environment for business has improved significantly in many developing countries, private and business has failed to deliver on SDGs. **Meeting SDGs requires massive investment of the order of USD 4.5 trillion per annum till 2030** – the commitment period for SDGs. Private sector development approaches need to go beyond Doing Business and Investment Climate and recognise that meeting many key SDGs naturally causes monopolies or classic market failures. Thus, this needs state intervention and regulatory action to shift markets towards SDGs through policy rents.

The following approaches could be considered for FfD4:

3.1 Public Private Partnerships in private provision of public services: Return to Public Private Partnerships as development models for SDGs to increase private sector provisioning for public services. The entire range of PPPs ranging from Design Build Operate (DBO) to Design Build Finance and Operate (DBFO) for many SDGs, such as primary health, education, water and sanitisation, and access to electricity, need to get aligned with the Universal Service Obligations (USO) of governments.

3.2 Green Industrial Policy – greening private sector development: Private business and finance have to be directed, via greening private sector development interventions primarily through Green Industrial Policy for hard-to-abate industrial sectors, to make the production function of the economy account for the marginal social cost of production.

While this may, in the near term, reduce aggregate demand in the economy, over the medium term, it will shift the economy towards green manufacturing, creating new jobs and pathways out of poverty. Quoting an extract from the Green Industrial Policy – "*Greening the economy is a goal which will require enormous investment. As markets are currently failing to provide the required incentives for environmental sustainability, governments must intervene and provide 'policy rents' for investments in sustainability while withdrawing rents from polluting investments*."

3.3 Financial inclusion for SME business – access to finance: Nearly all financial inclusion initiatives in developing countries have focused **on** retail financial inclusion and getting the unbanked to the banking system. This has yielded significant gains in financial inclusion, but progress has slowed over the last few years. While financial inclusion has helped improve distributional equity, access to credit for small business (SME) has remained a constraint to job creating private investments, especially in LDCs.

Lack of supportive financial regulation has also limited the expansion of Alternative Credit Systems such as P2P lending even as technology has reduced information asymmetry between the business and the banking system. Capital markets have remained narrow, shallow and underdeveloped in LDCs, with no contribution towards improving access to finance to develop

the private sector. International development work needs to focus on improving payments systems and credit infrastructure, and developing institutions for secured lending such as collateral registries and credit bureaus.

3.4 Domestic and international private finance

- **Mobilising international private finance:** UNDP's private finance initiative for SDGs provides the approach as (a) leveraging private finance, (b) aligning capital, and (c) strengthening policy and institutions. Attempts have been made in international development to focus private finance on sustainable development, with the primary instrument being mobilisation of commercial/private finance via ODA. While this has increased mobilisation of private finance to USD 150 billion over the last five years, it remains a fraction of what is required for the world to meet SDGs, as per the OECD report on SDG Finance Mobilisation.

  Meeting SDGs requires a significant shift in the way overall ODA works to shift private capital mobilisation from its present approach, which is "ex post" ODA interventions in developing countries, to "ex ante" mobilisation to minimise the distortionary cost of developing country sovereign and forex risks.

- **Aligning sustainable/green finance:** The last decade since Addis FfD and the Paris Agreement has seen a plethora of sustainable, responsible, and green investment and finance standards and codes getting developed, ranging from disclosures, to ESG and impact investment, to align with the SDGs. This fragmented format of standards and codes were not conducive to directing private finance towards sustainable development. Moreover, these standards were voluntary and often driven by institutional compacts between banks, asset management companies, and insurance agencies, which did not achieve their purported objectives.

  As of 2022, these standards and codes have converged to IFRS – International Sustainability Standards Board (ISSB), which are wider than climate finance. It is important to standardise, and then harmonise, finance standards, so that they can be universally applied. FfD4 could take the lead in making this agreeable for all finance.

- **Improving central banking and financial regulation:** The Network for Greening Financial System (NGFS) started operations in 2018; since then, the central banks of 140 countries have joined NGFS. While climate-related financial risks remain key to global financial stability, it is also imperative that financial sector regulation shifts the financial intermediation for domestic finance towards SDGs through various instruments.

  Banking regulations in most developing countries use the Basel three pillar approach of a) disclosure, b) oversight, and c) capital. Most developing countries have under-developed financial markets and hence it is important to shift financial intermediation towards sustainable development using directed lending and interest subvention. The IMF Article IV Assessment and joint Financial Sector Assessment Program of the World Bank need to be modified to account for new realities of climate and sustainability. A new framework is also needed to define financial stability in developing countries.

4 Input | International development cooperation

While Official Development Assistance (ODA) has progressively increased since 2022 FfD Monterrey, reaching a peak of over USD 200 billion in 2022, it is still far short of the UN defined target of 0.7 per cent of the Gross National Income (GNI) of Annex 1 countries. The Addis agenda recognised the key role of international public finance by way of directed ODA towards key SDGs in developing and LDCs, and also underscored the need to mobilise other public and private finance to meet SDGs.

An important indicator was added to SDG 17 in 2022 on additional financial resources mobilised by using ODA, including a set of cascading sustainable development criteria to only count flows aligned with the SDGs. It contains six sub-indicators for data on: a) official sustainable development grants; b) official concessional sustainable development loans; c) official non-concessional sustainable development loans; d) Foreign Direct Investment; e) mobilised private finance on an experimental basis; and f) private grants.

Given that FSDR 2024 underscores the issue of lack of adequate international financing flows towards meeting SDGs, it is important that overall ODA, including MDB financing, be directed and leveraged effectively to achieve SDGs. This paper recommends:

- Increasing, directing, and leveraging ODA finance to reach UN targets,
- Reforming MDBs to focus on meeting SDGs including climate Investments, and
- Restructuring International Financial Architecture.

4.1 Increase the SDG impact of ODA financing: ODA comprise bilateral and multilateral aid counted as grant equivalent and increased to about USD 220 billion in 2022 (USD 150 billion bilateral and USD 70 billion multilateral). Given the various conflicts and informal migration worldwide, a substantial share of ODA has got directed to humanitarian aid and refugee management. At the same time there is a need to focus ODA on social sector SDGs through public finance transfers to developing countries; reduce fragmentation of bilateral ODA through common regional platforms, instead of one to one bilateral aid assistance; and integrate private philanthropy into ODA where transfers are made to leverage private capital. In terms of innovative financial instruments, the ODA could provide risk mitigation and credit enhancement for LDC sovereign borrowings, and also provide forex hedging through contributions to TCX or similar structures.

4.2 Reform MDBs: Many notable MDB reform initiatives have been undertaken through various initiatives and forums over the last three years. These include:

- Boosting MDB Capacity: An independent review of MDB Capital Adequacy Frameworks, 2022 – G20 and COP
- Climate Finance Framework: Independent High Level Expert Group on Climate Finance – COP
- The Triple Agenda: Strengthening Multilateral Development Banks

These initiatives now need to focus on:

- Increasing MDB lending for SDG investments
- Increasing private capital mobilisation by MDBs
- Reducing cost of finance for developing countries

These three initiatives have been crystalised into reports and provide the overarching blueprints and analytical work for MDB reforms, but it is imperative to translate these to institutional action. **Driving this implementation through appropriate institutional actions and obtaining consensus from UN member states could be important outcomes from FfD4**.

4.3 Restructure the International Financial Architecture: High level restructuring of International Financial Architecture comprises governance reforms, sovereign debt management, and increasing finance for sustainable development with a focus on climate action[6]. Governance reforms are necessary to enhance the global legitimacy of International Financial Institutions (IFIs), and the need for restructuring starts with the IMF Quota Alignment, which does not reflect today's economic reality. IMF quota realignment would provide greater voice to the Global South countries, which would normally be followed by the redistribution of voting rights at the World Bank.

However, it is politically difficult to get consensus on reallocation of IMF quotas and change the overarching governance of IFIs. Therefore, **these inputs are limited to increasing finance for sustainable development including climate action, with a focus on the role of the IMF**.

- **Reuse IMF Special Drawing Rights (SDRs):** The last round of USD 650 billion allocation for IMF SDRs was done during the COVID-19 pandemic in 2021/22. This benefitted all countries, but a disproportionate share of the SDR allocations went to developed countries and large developing economies in G20. The G20 agreed to re-channel USD 100 billion of the SDRs to developing countries, which led to the setting up IMF's Resilience and Sustainability Trust (RST) and Poverty Reduction and Growth Trust (PRGT), but these have had limited impact.

  Similar mechanisms to re-channel 'excess' SDRs directed to specific SDGs and LDCs could help in meeting SDG financing targets such as energy transition, primary healthcare, etc. In addition to scaling up RST and PRGT, more such mechanisms are required to allow for zero interest and concessional financing to LDCs as provided by PRGT.

- **Set up a Global Risk Pooling Reserve Fund:** This approach could be useful for other risks such climate-related physical risks, financial contagion, and pandemics. A Global Risk Pooling Reserve Fund[7] could be created to address the partial or entirely missing insurance safety net for underserved developing countries and vulnerable communities and bring them into a risk-resilience framework. Such a global reserve fund would have three premises: a) different countries face different kinds of climate risks; b) the fund would not require initial payments of public money and its nominal capitalisation could be based on a voluntary allocation of a share of a country's SDRs; and c) the fund would assume an initial loss but would transfer the bulk of the subscribed risk to existing market insurance mechanisms.

5 Input | International trade as an engine for development

As per the G20 official report on Developing Resilient Renewable Energy Supply Chains for Global Clean Energy Transition, co-authored by CEEW, "*the rapid adoption of renewable energy (RE) will help decarbonise the world's electricity systems, thereby helping realise the desired impacts of SDGs. However, a speedy and risk-proof transition to RE will only be possible if countries can secure access to uninterrupted and affordable supply chains of key technologies.*"

The report notes that global manufacturing capacities of clean technologies such as solar, wind, battery, and green hydrogen tech are concentrated in a few countries. For example, in the last decade, 70 per cent of solar PV and 80 per cent of wind technology exports globally have come from only 4 countries each. The production of these diverse technologies requires significant and specific manufacturing, logistical and energy infrastructure, and large quantities of minerals and

[6] The Reform of Global Financial Architecture That Delivers for Global South – Atlantic Council
[7] Multilateralism for Chronic Risks – Arunabha Ghosh

other materials. Despite a significant decrease in prices of clean technologies due to economies of scale and the steady growth in their global trade, high demand and few exporters keep increasing traded values. This puts the energy transition and SDGs of developing countries and LDCs at high risk. Recommendations to enable fair trade as an engine for development include:

5.1 Ensure comprehensive tracking of global RE manufacturing capacity and trade flows to inform expansion and diversification strategies and foster competition in trade.
- Tracking trade flow data for RE products and raw materials
- Periodic updates on manufacturing capacities
- Track projects and periodically assess technologies

5.2 Create new avenues of supply and enhanced investments across supply chains to help meet the increasing demand for clean technologies.
- Increase financing of manufacturing by MDBs
- Upskill individuals and institutions on scaling local RE value chains
- Improve local infrastructure for RE supply chain logistics
- Develop RE circular economy standards

5.3 Enable co-development of technologies to support the uptake of advanced technologies.
- Share novel technology centric public procurement models
- Formalise international collaboration between lab

5.4 Develop and harmonise globally accepted standards and certification systems for new and emerging clean technologies such as green hydrogen.
- Establish interoperability of operational and safety standards
- Harmonise global certification systems

6 Input | Science, technology, innovation and capacity building

Risk and responsibility: As the world rapidly invests in new technologies for development, FfD4 should delve into the aspects of ownership and accountability. An excerpt from Time for geoengineering governance?[8] by Dr Arunabha Ghosh underscores this point: "*Many horizon technologies for climate mitigation, such as solar radiation management (SRM) or carbon capture and storage (CCS), entail significant known and unknown risks. In such cases, technology partnerships serve two purposes: a) they could draw in a broader set of actors to independently conduct regular risk assessments as the technologies evolve; and, b) they could serve as a countervailing bulwark against risky, unilateral behaviour by rogue scientists or technologists.*

With risk assessments also come the assignment of responsibility and clear rules for liability. Technological innovation within single countries can be governed by the domestic laws. But multi-country partnerships need clarification on who bears what kind of responsibility should anything go wrong. Liability provisions have informed nuclear energy collaborations, for instance. Similarly, if a coalition of countries d implement a large CCS facility and there were some leakage, the liability of the actual deployment (not just the tech development) has to be established in advance."

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[8] Ghosh, A. (2017c, April 25). Time for geoengineering governance? Business Standard. Link.