**South Centre Input to an Elements Paper on Financing for Development**

15 October 2024

In response to the Co-Facilitators' Call for Inputs for an Elements Paper on Financing for Development issued on 26 July 2024, the South Centre wishes to provide the following input as a contribution to the preparation process for the Fourth International Conference on Financing for Development (FfD4)*.

## 1. Key messages

### A. Debt and debt sustainability

A.1. Interest rate hikes by systemically important countries can have extraterritorial impact leading to rising debt servicing cost, currency depreciation, capital outflow and trade as well as output loss among other negative spillover effects in developing countries. The exploding cost of borrowing and debt servicing is one of the main symptoms this time. History has shown incidents of debt and financial crisis in developing countries triggered by interest rate increases. However insufficient policy and counter-cyclical measures have been introduced leaving developing countries to suffer from the consequences.

A.2. The G20 Common Framework is welcome but the framework itself is not a manifestation of the reform of the international debt architecture. The IMF and the Paris Club are in the driving seats for debt restructuring cases under the Common Framework, following closely the traditional Paris Club debt rescheduling procedures and the case-by-case approach, naturally the processes are facing similar challenges. Reform of the international debt architecture should be urgently undertaken to make debt restructuring more effective and fairer.

### B. Domestic and international private business and finance

B.1. Creating an enabling environment for promoting foreign investment into developing countries requires adopting a number of regulatory measures for strengthening public infrastructure, skilled human capital, an established domestic market and industrial base, as well as a diversified economy. Future policy orientation must consider providing incentives for green industries and environmentally-friendly infrastructure which can sustain long-term growth, and promote climate resilience, through investments in

* For further information, please contact Ms. Yuefen Li, Senior Advisor on South-South Cooperation and Development Finance, South Centre (li@southcentre.int)

renewable energy. Providing sector-specific investment incentives and the use of investment facilitation measures can also accelerate structural transformation in developing countries.

B.2. Mobilizing private investment and lowering barriers for developing countries to access capital requires a concerted effort from various actors, including credit rating agencies and international financial institutions. In the short term, this includes improving sovereign credit ratings by addressing biases in rating methodologies that often unfairly penalize developing and least developed countries. Development finance institutions (DFIs) should be further mobilized to help catalyse private investment in developing countries by offering concessional financing, guarantees, and co-investment opportunities. Promoting digital finance solutions such as mobile banking can also help expand access to capital for both firms and people in developing countries by providing more affordable and inclusive financial services, reducing transaction costs and lowering the barriers to entry into the formal financial system.

B.3. The lack of consistency in environmental, social and governance (ESG) norms and sustainability reporting standards across jurisdictions poses challenges to both companies and regulatory bodies, and can lead to greenwashing. Many developing countries face significant challenge in this context. Increased international cooperation at the multilateral level is required to ensure interoperability and avoid fragmentation in sustainability and ESG reporting regulations.

### C. Domestic public resources

C.1. There needs to be a strong commitment to complete the negotiations on the UN Framework Convention on International Tax Cooperation (FCITC) and the protocol on cross-border services by the timeline of 2027 and to bring it into effect as soon as possible through signature and ratification by all UN Member States.

## 2. Problem statement

### A. Debt and debt sustainability

A.1. Recent increasing debt service cost and worsening debt vulnerabilities are largely symptoms of negative impact of rapid interest rate hikes by the U.S. Federal Reserve and other systemically important countries. Past rate hikes have many times led to financial crises in developing countries, for instance the Volcker disinflation of the early 1980s was associated with the Latin America financial crisis which led to a lost decade for some Latin American countries. The Asian financial crisis was triggered by Fed rate hikes in 1994, it collapsed economies of several countries for years. Interest hikes by systemically important countries can wipe out massive amount of financial resources from developing and emerging markets, especially those with weak fundamentals. The negative spillover could be like a tidal wave passing through various channels including trade, foreign exchange, consumption, investment and financial channels. This time net negative debt flows were prevalent in low income countries. The resultant mounting liquidity pressures forced a couple of countries into default and some countries to raise fund at double interest rates in the international capital market. International policy measures and mechanism should be put in place to address the negative spillover. During the 2013 "taper tantrum" episode, developing countries demanded better communication from the Fed. As research findings indicate, when policymakers are able to implement mitigating policies **in anticipation of** the interest rates rise, the negative spillover would be less severe. It is time to think seriously about policies including multilateral countercyclical injection of liquidity for frontier economies. The International Monetary Fund (IMF), World Bank and regional multilateral development banks (MDBs) must play their role and should not take negative spillover of interest rate hikes as a given and let countries suffer. Efforts should be made to reduce over-reliance on the U.S. dollar as dollar-denominated debt in the world has been increasing fast to the magnitude of 21 trillion dollars and continues to increase.

A.2. Improving sovereign debt restructuring and making it more effective and fairer have been a longstanding international ambition. The international community wants to have a mechanism which can create a pathway toward the quick restoration of debt sustainability of insolvent sovereign states through fair burden sharing, including meaningful debt reduction. The Common Framework (CF) is a major international new initiative on debt restructuring developed under the G20 in 2020 during the COVID-19 pandemic. It is not like Heavily Indebted Poor Countries (HIPC) Initiative which has a special financing mechanism from donor money which offered deep haircuts and had a special procedure including Poverty Reduction Strategy Papers (PRSPs). The CF has its own parameters and it was clearly indicated that "In principle, debt treatments [under CF] will not be conducted in the form of debt write-off or cancellation." The CF has no special carrots nor sticks like the Brady Bond initiative. Therefore, the CF is not a reform outcome of the international debt architecture. It follows the sequential process of the Paris Club debt restructuring. The most outstanding feature of the CF is the participation of the non-Paris Club creditors like China, India and Saudi Arabia.

**B. Domestic and international private business and finance**

B.1. Attracting foreign investment is a high priority for developing countries, aiming to leverage inward foreign direct investment (FDI) for their sustainable development. Foreign investors typically consider a number of factors while assessing the viability of their potential investments, including expected returns, market size, availability of labour, regulatory stability and predictability, and sustainability of the investment. Addressing these elements is a necessary precondition for attracting and facilitating investment, and reforms are needed to ensure that foreign investments align with the countries' national development priorities and contribute to their sustainable development (See South Centre Research Paper 185).

B.2. There is a need to consider reforming international trade rules to enhance the flexibilities available for developing countries to use targeted measures, including tax incentives and public investments to foster key industries, especially those aligned with the SDGs and green industrialization. Further attention is required to build adequate capacities in developing and least developed countries to incorporate provisions in international agreements that promote trade in environmental goods and services, and facilitate the transfer of technology such as in areas like renewable energy, as well as reducing trade barriers and facilitating investments to help them participate more effectively in global value chains.

B.3. For developing countries, having a strong project pipeline can provide a number of projects available for investors that are viable for funding and implementation. This has gained even more importance in recent years as projects on climate change mitigation and adaptation, and green industrialization have become urgent priorities for developing countries, as well as for international funding partners. However, many developing and least developed countries often lack the technical expertise needed for detailed project preparation and implementation, especially in technologically advanced sectors.

B.4. Currently, reporting on ESG, corporate sustainability as well as Corporate Social Responsibility (CSR) initiatives suffers from some major weaknesses. First is that they are largely voluntary in nature. Second, the access to credit for enterprises still relies almost exclusively on their ability to be profitable and pay back loans. This results in sustainability and ESG elements generally not being considered when assessing credit-worthiness. Third, the lack of consistency in ESG and sustainability reporting standards across jurisdictions poses challenges to both companies and regulatory, and can lead to greenwashing. A lack of standardized reporting frameworks allows companies to selectively report their ESG impacts. Many developing countries do not have any guidelines for ESG reporting by companies. Even when they do, enforcement remains a significant challenge for regulators.

## C. Domestic public resources

There needs to be urgent reform to the international tax system, so developing countries are able to more effectively crackdown against Illicit Financial Flows of tax avoidance and evasion. More fundamentally, there needs to be a genuinely inclusive and effective international tax governance architecture so developing countries can be equal participants in agenda-setting and decision-making and devise equitable solutions to current and future problems of international taxation.

The issue of taxing cross-border digital services is particularly urgent. Big Tech firms like Amazon, Google, etc. continue to derive enormous revenues from developing countries while paying minimal taxes. Negotiations on the OECD solution for taxing the digital economy, known as Amount A, have been continuing for more than 12 years, with no end in sight. Further, the revenue estimates are minimal. In June 2024, the South Centre, in partnership with the West African Tax Administration Forum (WATAF) and the African Tax Administration Forum (ATAF) released country-level revenue estimates for the 55 Member States of the South Centre, and 54 Members of the African Union, which are a combined total of 85 developing countries. The results show that the 85 combined Members of the South Centre and the AU can expect between EUR 20-34 billion from a 5% Digital Services Tax (DST, a commonly used national measure) compared to EUR 7-10 billion in revenues from the OECD solution of Amount A. Thus, developing countries can on average obtain more than three times the revenues from Digital Services Taxes compared to the OECD's solution.

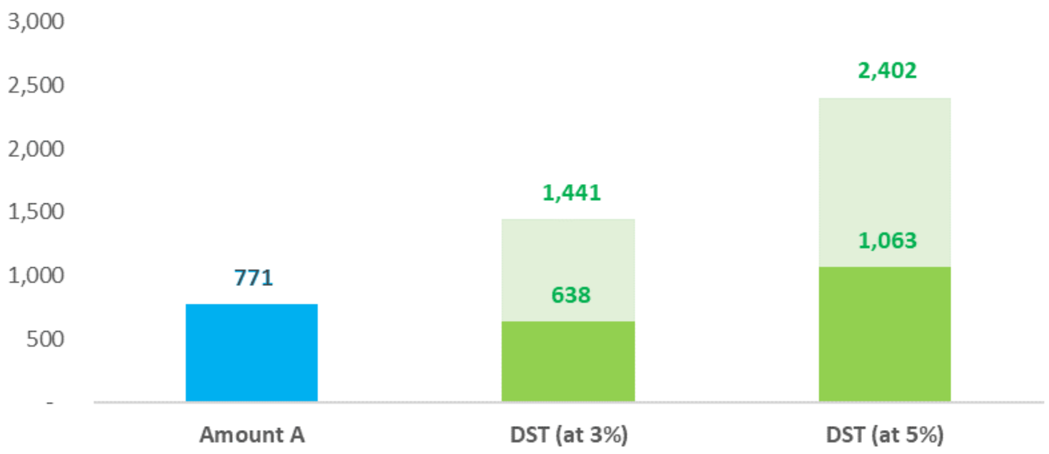


*Figure 1: 2022 Tax Revenue Estimation under Amount A vs. DST Regimes for African Union Members (EUR Millions)*

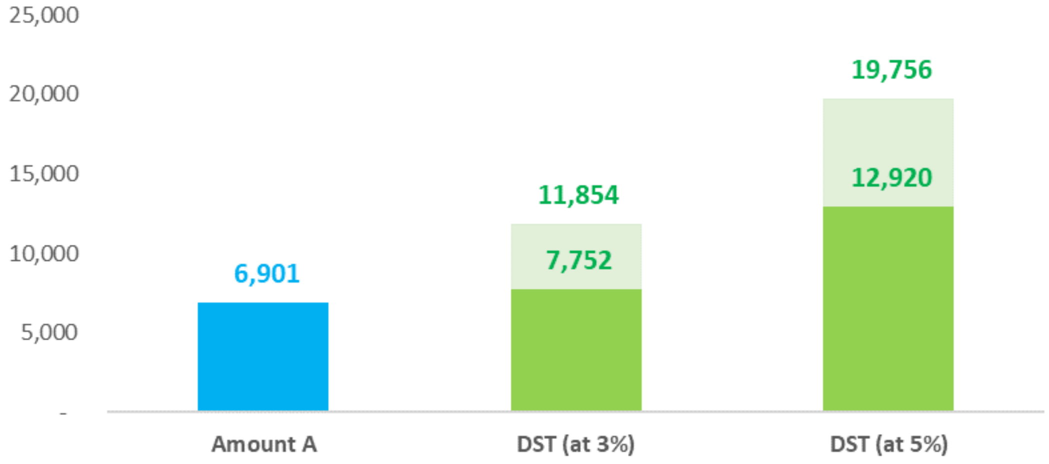


*Figure 2: 2022 Tax Revenue Estimation under Amount A vs. DST Regimes for South Centre Members*

Source: South Centre, West African Tax Administration Forum et al (2024)

## 3. Policy solutions

### A. Debt and debt sustainability

A.1. Systemic issues relating to debt and debt sustainability should be addressed and examined vigorously in the FfD4 process. Strengthening global financial safety net becomes even more important in the face of net negative financial flows from developing countries, when insurance against crises and short-term liquidity finance are needed most. As many low income and vulnerable countries have very low foreign exchange reserves and have little or no swap arrangements, the IMF, which is mandated to be the centre of the global financial safety net, should inject counter cyclical financing prior to and during such instances to countries expected to face such external shocks and cushion the below to the financial system of these countries. This time multilateral lending seemed to have suffered from a time lag of one year or so. Additional concessional and affordable financing from multilateral lenders should be offered. Financial instruments such as debt swaps or credit enhancements to enable the rollover of commercial debt, as well as regional and plurilateral financial contingency arrangements.

A.2. Reform the international debt architecture in earnest. The CF needs to be equipped with carrots and sticks to undertake faster debt restructuring with deeper haircuts. Meanwhile, in parallel, it is necessary to improve the CF and make if more effective through redefining the CF's terms of reference; clarifying its processes, timelines, definitions and scope of creditors. In addition, calls to expand country coverage beyond low-income countries should not be ignored.

### B. Domestic and international private business and finance

B.1. As digital transformation accelerates globally, increasing internet connectivity and digital infrastructure is also becoming essential to attract technology-driven investments. Human capital development, which contributes to an educated and highly skilled labour force, can also help attract foreign investments in some developing countries, particularly in higher-value industries. Governments should focus on improving quality of education and aligning skills training with industry needs. This must be accompanied with providing workers with access to healthcare and social safety nets, which can create a more stable labour market and increase worker productivity. Developing countries can also foster their domestic private sector by providing support for startups, and small and medium enterprises, through facilitating access to credit, technology transfer, and market opportunities. Encouraging diversification in exports through targeted incentives can also help developing economies to reduce their dependence on a narrow range of products (such as raw materials) and make them more resilient to market fluctuations and global crises.

B.2. Providing capacity building and technical assistance to developing countries for reducing trade barriers and facilitating investments can also help them participate more effectively in global value chains. International organizations should enhance their efforts in this regard, especially for green industrialization and the energy transition. This can also include providing [training for using intellectual property (IP) flexibilities](), in areas like renewable energy, climate adaptation, and public health, so that developing countries have the capacities necessary to utilize such technologies for their sustainable development. Furthermore, regional trade agreements like the African Continental Free Trade Agreement (AfCFTA) can also be harnessed by countries to enable coordination of regional industrial policy and sustainable development, particularly for industries like renewable energy, water management, and agriculture. Deepening the localization of value chains can also help global South countries to capture more of the value added within their regions.

B.3. Addressing the gap in project pipelines requires the international community to collaborate towards ensuring that the requisite skills, financing and technologies are made available to emerging economies building project pipelines. International organizations should provide technical assistance, training and capacity-building programs to enhance the skills of government officials and local institutions for conducting, among others, feasibility studies, cost-benefit analysis, and environmental impact assessments. Specific training can also be provided on topics like project management, procurement, and incorporating disaster resilience and risk reduction into project design. These efforts could be further enhanced by providing platforms for knowledge sharing, and conducting peer exchanges for sharing best practices in developing countries. The establishment of national and regional project preparation facilities (PPFs) can help developing countries access technical and financial support for preparing projects which can attract investment and contribute to sustainable development. Similarly, DFIs should increase their assistance to developing countries in de-risking projects through providing more risk guarantees, political risk insurance, or first-loss provisions. Having access to grants and concessional financing for early-stage project development, such as during the feasibility studies or design process is important for ensuring projects are viable and sustainable, even before they reach the funding stage. Developing countries should also increase their collaboration with international organizations to identify potential cross-border projects, such as regional energy grids or transport corridors. In this context, regional bodies can play key roles in coordinating and facilitating project pipelines for regional infrastructure projects. Finally, it is useful to establish Monitoring and Evaluation (M&E) systems for project pipelines, which can be used to track project pipeline development from inception to completion. Effective M&E systems can improve project design, assess impact, and increase accountability, helping boost investor confidence in future projects. In addition, analysing the lessons learned from past projects will allow countries to refine and enhance their approach to future project preparation.

B.4. Governments can increase alignment of the private sector with climate goals and SDGs by adopting green finance taxonomies (sometime also referred to as sustainable/climate finance taxonomies). These taxonomies provide guidelines on what constitutes “sustainable investments” in the country, and can reduce the risk of greenwashing by companies. In addition, financial regulatory bodies can issue detailed guidance with clear criteria for businesses to meet before labelling products or services as “green” or “sustainable”. A number of developing countries have already adopted green finance taxonomies, with efforts also underway at the regional level in ASEAN and in Latin America and the Caribbean. However, as the risk of fragmentation and incompatible standards across countries also exists, greater international cooperation is required to ensure that green taxonomies being developed are both legally binding and interoperable across jurisdictions. Once the necessary legal and policy frameworks are put in place, countries should also consider having penalties for companies engaging in greenwashing. This can include fines, legal actions, and public naming and shaming, among others. Such enforcement could deter companies from making misleading claims regarding the sustainability and climate impacts of their products. At the same time, regulatory bodies must be empowered to investigate and act upon misleading sustainability claims by companies. Finally, for avoiding fragmentation in sustainability ESG reporting regulations, it is essential to engage in multilateral discussions on the issue. Strengthening international collaboration through the United Nations could promote the alignment of sustainability-related legislation across countries. International organizations can also provide technical assistance, training and knowledge sharing to help developing countries build capacity for enabling and enforcing ESG reporting by national and multinational firms (See South Centre Policy Brief 126).

**C. Domestic public resources**

C.1. Commitment to complete the UN Framework Convention on International Tax Cooperation (FCITC) and the protocol on cross-border services by the timeline of 2027 and to bring it into effect as soon as possible through signature and ratification by all UN Member States. The UN FCITC can provide a fair, effective and inclusive governance architecture for the international tax system. The protocol on cross-border services, which includes digital services, can finally provide the world with a viable solution for the taxation of the digital economy.

C.2. Commitment to translate the UN Tax Committee’s Fast Track Instrument (FTI) into a treaty, either stand-alone or as part of the UN FCITC. The FTI is a legal instrument that can incorporate the international tax standards of the UN Model Tax Convention into multiple bilateral tax treaties simultaneously, and enable bloc tax treaty negotiation between groups of countries. This can greatly promote the international tax standards of the UN, which can help developing countries raise more revenues. It can also reduce the asymmetry in power in tax treaty negotiation between developed and developing countries. However, it needs to be converted into a treaty in order to be implementable.

The FTI will be presented to ECOSOC in 2025 for consideration, and support is needed from countries for its uptake and conversion into a treaty.

C.3. Promote international cooperation for the effective taxation of High Net-worth Individuals (HNIs), including through promoting the guidance contained in the UN Handbook on Wealth and Solidarity Taxes and the upcoming UN Template Law on Wealth Taxes. Part of the revenues collected through these taxes should be redistributed to the Global South.

C.4. Public country by country reporting of how much tax multinational enterprises pay in the jurisdictions where they operate. A similar form of reporting can be considered for High Net Worth Individuals, especially billionaires.

C.5. Inter-governmentally agreed understanding that tax avoidance is a part of Illicit Financial Flows. This can put an end to the argument that tax avoidance is permissible because it is “legal”.

C.6. Making transfer pricing comparables data a global public good accessible by developing countries for free. Transfer pricing rules are a major tool in the fight against tax avoidance by multinational enterprises. However, effectively applying them requires access to databases which are controlled by an oligopoly and are prohibitively expensive. The relevant data can be transformed into a global public good, produced by the United Nations, and made available to developing countries for free.