

**Financing
for development
in Latin America
and the Caribbean**

A strategic analysis
from a middle-income
country perspective

Ten key messages of the Latin American and Caribbean Regional Consultation on Financing for Development

Economic Commission for Latin America
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The Regional Consultation on Financing for Development in Latin America and the Caribbean took place in Santiago on 12 and 13 March 2015, in the framework of the twentieth session of Committee of High-level Government Experts (CEGAN), established by virtue of ECLAC resolution 310(XIV) and comprising Latin American and Caribbean member countries of the Commission. The Regional Consultation was held in preparation for the Third International Conference on Financing for Development, to be held in Addis Ababa in July 2015, and gave rise to the following 10 key messages:

1. **The International Conference on Financing for Development, held in Monterrey, Mexico, and the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha, had a political background and history different from those of the United Nations Conference on Sustainable Development (Rio+20), the post-2015 development agenda and the climate change conferences.** It is important to review this history, especially in relation to principle 7 on common but differentiated environmental responsibilities of the Rio Declaration on Environment and Development adopted at the Earth Summit in 1992. Where trade and finance are concerned, the Monterrey and Doha conferences applied the concept of “levelling the playing field”.
 - **The post-2015 development agenda will integrate the different dimensions of sustainable development:** economic (including trade and finance), social, and environmental.
 - Integrating these different dimensions within an overarching framework implies that the **principle of common but differentiated responsibilities** should be applied across the board so that it includes not only climate change but also trade and finance.
 - What also has to be accepted is the need for **effective participation by middle-income countries**, including those of Latin America and the Caribbean, which have emerged as important economic, social and political players. Middle-income countries account for about 46% and 70% of the world’s GDP and population, respectively.
2. **Financing the post-2015 development agenda requires a significant mobilization of domestic resources. Domestic resource mobilization is constrained by internal and international factors.**
 - Internally, **governments need to tackle tax evasion and avoidance.** Rates of value added tax (VAT) evasion in the Latin American countries range from 17.8% to 37% of the total VAT take, compared with much lower figures of between 3% and 22% for Organisation for Economic Co-operation and Development (OECD) countries. Estimates for personal and corporate income tax evasion are even higher, ranging from 46% to 49% of total receipts for these taxes in 2006-2010.
 - Besides domestic problems of evasion and avoidance, the region’s governments are facing new challenges internationally, including the need to **combat illicit flows and capital flight**; certain practices by multinationals, including manipulation of transfer prices to avoid taxes by declaring profits in jurisdictions with lower tax rates; and the existence of so-called tax havens, which not only represent a significant source of tax evasion but foment pernicious tax competition and activities that produce negative externalities.
 - Illicit flows have been estimated at US\$ 154 billion for Latin America and the Caribbean in 2012, exceeding foreign direct investment (FDI), remittances and official development assistance (ODA) (US\$ 129 billion, US\$ 63 billion and US\$ 10 billion, respectively). Estimates for developed countries, particularly in Europe, put the annual cost of tax avoidance through transfer price manipulation by multinationals at US\$ 150 billion.
 - As part of these efforts, **tax havens and offshore financial centres** should be regulated and comply with international commercial banking standards.
 - Fostering **domestic resource mobilization must involve the “multilateralization” of international cooperation on fiscal policy**, leading to the creation of major tax agreements and fiscal rules on a global scale with the participation of developing countries. This means expanding the functions and powers of the Committee of Experts on International Cooperation in Tax Matters, a subsidiary body of the United Nations Economic and Social Council (ECOSOC). The Committee can play a vital role by providing spaces for agreements and consensuses that pave the way for a progressive coordination and harmonization of taxes and fiscal rules around the world, including the countries of Latin America and the Caribbean.
3. **Domestic resource mobilization also includes the resources mobilized by national and subregional development banks.**
 - **National and subregional development banks have taken on a crucial role** in the provision of credit to the production sector through investment finance for infrastructure, production and social development, and climate change mitigation.

- In 2014, subregional development banks' share of total lending to Latin America and the Caribbean equalled that of the Inter-American Development Bank (IDB) (with more than 40% of the total between them) and surpassed that of the World Bank (less than 20% of the total). The share of credit provided by national development banks exceeded 20% of the total.
 - Development banks have traditionally focused on **channelling long-term savings towards investment in strategic production sectors** and especially infrastructure, and more recently towards the development of financial markets and financial institutions. This greatly facilitates the mobilization of savings, as well as financial inclusion.
 - Finally, development banks also perform an important **countercyclical function, mitigating fluctuations in the business cycle**. Public development banks were the most important of the instruments used by Latin American governments to partly offset the contraction of credit during the global financial crisis (2007-2009).
4. **The most pressing issues relating to sovereign debt are the creation of a sovereign debt restructuring framework and consideration of the possibility of condoning the multilateral debt of Caribbean countries.**
- The creation of a **debt restructuring framework** must take conditions in debtor countries into consideration, including the need for debt service payments to depend in part on contingent macroeconomic conditions. The framework must also include provision for resolving conflicts of interest that arise out of sovereign defaults, as the most recent case involving Argentina's debt restructuring illustrates.
 - Sovereign debt crises and litigation are a matter of particular concern for middle-income countries, as these account for the majority of debt litigation cases. Latin America and the Caribbean accounted for 65.8% of all sovereign debt litigation cases between 1970 and 2000.
 - Alongside the creation of a debt restructuring framework, the international community must explore the possibility of **debt forgiveness for Caribbean countries**. In the case of Caribbean small island developing States (SIDS), high debt burdens are a major obstacle to growth and to economic and social development. In 2014, Caribbean countries' gross public debt stood at 79% of GDP, with a minimum and maximum of 29% and 141% of GDP in Suriname and Jamaica, respectively. All English-speaking Caribbean countries' debt to GDP ratios exceed 50%.
5. **South-South and triangular cooperation provides a new model of cooperation between equals.**
- South-South cooperation leaves behind the long-standing vertical relationship between donor and recipient typical of traditional forms of cooperation, focusing instead on collaboration between equals. Similarly, while traditional forms of cooperation place great stress on poverty reduction as a main objective, **South-South cooperation emphasizes growth based on infrastructure development, technical cooperation and knowledge-sharing**. South-South cooperation can thus significantly boost development, particularly for middle-income countries seeking strategies for sustained production growth that will enable them to avoid becoming mired in the "middle-income trap".
6. **The development finance architecture must address the asymmetries in the governance mechanisms of the international financial architecture, including its failure to give proper weight and recognition to developing economies.**
- The executive committees and decision-making bodies of the international financial architecture need to reflect the **shift in global economic and political power towards developing and middle-income countries**.
 - As things stand, emerging markets' and developing countries' share of global GDP equals that of the developed countries. However, the former hold 38.8% of International Monetary Fund (IMF) quotas and 40.8% of the World Bank's voting rights, whereas the latter hold 61.2% and 59.2%, respectively. Middle-income countries account for 46.1% of the world's production of goods and services, but hold just 29% of IMF quotas and World Bank voting rights.
 - **Global governance must be universal, inclusive and reflective of the interests, needs and objectives of the international community as a whole**. To this end, the multilateral elite (G20, G7, etc.) needs to evolve into a representative entity within a global economic coordination council that would meet at the heads of State level (like the current G20) and enjoy the formal support of a subset of existing United Nations entities.
7. **The development finance architecture must also reduce trade asymmetries, including the inconsistency between the size of developing economies and their world trade share and market access opportunities, and their limited scope for reaping the benefits of technology transfer and knowledge acquisition.**
- One of the main challenges facing developing countries, and in particular middle-income countries, is the need to increase their share of world trade commensurately with their importance in the world economy, **diversify their exports and increase their technology content** in order to strengthen the connection between trade and the creation of decent jobs, thereby fostering inclusive and sustained economic growth.

- Although emerging and developing economies produce half of the world's GDP, they account for only 40.6% of global exports. Middle-income countries show a particularly clear asymmetry between their contribution to world production and their share of world exports (46.1% and 29%, respectively).
 - To meet this challenge, **multilateral trade practices and agreements need to be made more flexible** to take the specificities of middle-income countries into account. This would help level the playing field so that all countries could benefit equitably from international trade.
 - At the same time, **export diversification and trade liberalization** must take place on the basis of flexible trade rules, including provision for adequate financing and an appropriate time frame for implementing the necessary adjustments and domestic economic restructuring. Here, the global trade system should pursue fairness in its rules and mechanisms and promote market access by all participants, especially developing countries, which often face discriminatory measures as things stand.
8. **Given the growing role of private flows as a source of finance, a key challenge of a post-2015 development financing architecture is to enhance public-private partnerships and to mobilize private resources and channel them towards development objectives.**
- **Public-private partnerships offer potential benefits** in terms of lower costs and higher quality, since they draw on private-sector expertise and create competition. However, the Latin American experience (mainly with costly contract renegotiations) shows that their success requires rigorous planning and design, a clear legal framework, and suitable and well-equipped institutions in charge of their supervision.
 - **Effectively mobilizing private resources for development involves blending private and public resources** and creating public-private partnerships to achieve the leverage required for maximum development financing impact.
 - It also means **addressing the issues raised by private finance**, including the fact that it is mainly profit-driven, which can lead to underinvestment in areas that are crucial for sustainable development (such as efforts to reduce poverty or address climate change) if the expected return, on a risk-adjusted basis, underperforms other investment opportunities.
 - **Harnessing private capital flows and markets to achieve the post-2015 development agenda goals** will require efficient and targeted government interventions. The public sector can play an increasingly important role by including social returns in cost-benefit analyses. It can provide public financing for sectors that generate significant social gains but do not attract sufficient private flows. Alternatively, it can establish an enabling environment and proper incentives, thereby supporting a risk-return profile capable of attracting private capital and directing it towards development objectives. Incentives for private financing need to go hand in hand with proper regulatory frameworks.
9. **The issues surrounding remittances also need to be rethought**, since remittances are treated as a development financing mechanism, yet there is an ethical and political contradiction, as migration is not being included in the post-2015 development agenda. Indeed, remittances are transfers from migrants who are not welcomed in developed countries yet are charged high transaction costs for their transfers.
- **Remittance flows to Latin America and the Caribbean have risen significantly in recent decades.** These flows represent around 34% of total financial flows and 1.1% of the region's GDP. Remittances represent a particularly important source of finance and balance-of-payments liquidity for smaller economies, including those of Central America and Caribbean SIDS, amounting in some cases to over 10% of GDP.
 - Since remittances are such a major component of national income for some countries, the main challenge in these cases is to channel these resources into production activity, although when used for consumption purposes they do serve to improve living standards in the recipient population. **Effectively mobilizing remittance resources for development** also means reducing the average costs of transferring funds, for which greater information, transparency, competition and cooperation efforts are needed.
 - **Other challenges include ensuring gender equality in relation to financing**, which means being alert to the effects of women's financial inclusion in terms of credit, assets and financing in general.
10. **Participation: these intergovernmental processes will be greatly enriched by the involvement of civil society, which should be invited to participate at the national, regional and global levels. The participation of developing countries should be guaranteed so that the views of the South are represented.**