

# **MOBILIZATION OF FINANCIAL RESOURCES FOR ECONOMIC DEVELOPMENT**

**By**

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## **Introduction**

1. The United Nations Millennium Declaration resolved to create an environment – at the national and global levels alike – which is conducive to development and to the elimination of poverty. Success in meeting these objectives depends, inter alia, on good governance within each country and at the international level and on transparency in the financial, monetary and trading systems, as also in removing the obstacles that developing countries and economies in transition face in mobilizing the resources needed to finance their sustained development. Economic growth, social development and poverty reduction are the first and foremost priorities in developing countries and economies in transition but few of them will be able to reduce meaningfully “abject and dehumanizing” poverty or hunger unless they sustain a higher rate of growth of at least 3% per annum per capita output to achieve many of the international development strategy’s other goals pertaining to equity, the human condition and the sustainability of the development process. In the Road Map towards the implementation of the UN Millennium Declaration, it is clearly pointed out that the mobilization of domestic resources, is the foundation for self-sustaining development. Domestic resources finance domestic investment and social programmes which are essential for economic growth and for eradicating poverty. Strategies for moving forward include, inter alia, disciplined macro-economic policies and fiscal policy, including clear goals for the mobilization of tax and non-tax revenues and responsible public spending on basic education and health, the rural sector and women. The primary responsibility for achieving growth and equitable development lies with the developing countries themselves. This responsibility includes creating the conditions that make it possible to secure the needed financial resources for investment. It is the actions of domestic policy makers that largely determine the state of governance, macroeconomic and microeconomic policies, the public finances, the condition of the financial system, and other basic elements of a country’s economic environment. A sound fiscal policy, responsible social spending and a well-functioning, competitive financial system are crucial to economic and social development. Finally, a good pension scheme is essential. To have the greatest social impact, a defined contribution scheme should be complemented by a tax-financed scheme, to provide for a minimum pension that has a progressive re-distributional impact and safeguards the poor.

## **Mobilizing resources for development**

2. Unlike many previous undertakings, the United Nations Millennium Declaration also highlighted the task of mobilizing the financial resources needed — to achieve the International Development Goals and, more generally, to finance the development process of developing countries. The International Conference on Financing for Development held in March 2002, was a key event in agreeing on a strategy for better resource mobilization. It is necessary to recommend steps that can be taken to augment the flow of resources to the developing world and to ensure that developing countries receive the financial resources they need. What policies must they adopt? What kind of help from the industrialized world will be most useful to them? Does the world have the right international institutions? And if so, how can it ensure that they play their proper role? By looking at the resources for development available from all sources we can zero in on what really matters and what really works. The approach to development must reflect today's global financial realities: forty years ago, 70% of financial flows to developing countries was foreign aid; today it is 20%. Countries that have adapted to this reality by adopting good economic policies and establishing sound institutions that enable them to take advantage of global markets have experienced far higher growth rates, increased their share of trade in their GDP, and reduced poverty. This is true even for the poorest countries. On the other hand, countries that have *not* adapted and enhanced the role of trade in their economies, on average, have seen declining growth and increased poverty. It is important for countries that have had successful development experiences to contribute to improved policy formulation in developing countries and demonstrate that it can be done. The central challenge to increasing the volume and effectiveness of development financing is to create a stable foundation to mobilize, attract and use well resources from all sources -- beginning with those available within developing countries.

**(a) Domestic Financing:** Hard-working people in developing countries produce goods and services valued at between \$6-18 trillion annually, and last year their domestic savings amounted to almost \$2 trillion. Unfortunately, domestic economic resources and capital have too often been squandered, sometimes by conflict, but also by economic and legal systems that do not give families and firms the incentive to save and invest in the future. For example, the absence of clear property titles in developing countries cuts off access to finance for poor families who want to own a home, small farmers who want to improve their land, and entrepreneurs who want to start a business. **Effective legal and financial systems** are essential to harness the power of domestic assets and to bring to life what Peruvian economist Hernando De Soto calls "dead capital," the de facto assets -- though without legal title -- of millions of developing country citizens.

**(b) Trade:** Trade is another source of financing from which developing countries have yet to reap the full benefits. Low- and middle-income countries exported close to \$2 trillion last year. Yet, full liberalization of trade could dramatically increase their exports, which is a powerful force for development and poverty alleviation for countries around the world. Following the Doha Development Round, it is necessary to offer developing countries better access to developed countries' markets. A conservative estimate of the cost to poor countries of developed country agricultural protection is \$100 billion a year. And since three-quarters of the world's poor live in rural areas, opening up agricultural markets offers the best and quickest route out of poverty. To help developing countries

take full advantage of the opportunities created by liberalization of trade in agriculture, we must facilitate investments in trade-related and rural infrastructure. Raising agricultural productivity is the key to raising living standards in rural areas and substantially reducing hunger worldwide. While we open our markets, we need at the same time to encourage developing countries to lower their own barriers dramatically since 40% of developing countries' trade is now with other developing countries.

© **Foreign Direct Investment:** Foreign direct investment (FDI) can also be a tremendous force for development. Not only does it bring capital, it brings new technology, skilled management, and knowledge of foreign markets as well. Foreign investment flows to developing countries have grown exponentially. Between 1990 and 2000, FDI flows to and among developing countries grew from \$24 billion to almost \$180 billion. And these flows will continue to increase as more countries put in place sound investment policies, with rule of law and enforceable contracts chief among them. Many of these same policies will also serve to stimulate domestic private investment and savings within developing countries.

**(d) Official Development Assistance :** Official development assistance (ODA), at \$50 billion annually, is much smaller than the financial flows associated with domestic saving, trade and foreign investment. Nevertheless, ODA can play an indispensable role, especially if it helps countries tap these larger flows of finance. Until 1993, official development assistance (ODA) was the main external source for financing development. Since then, however, its share has declined continuously. In 1996 ODA fell to \$58.2 billion. This amount is lower than the sixty billion dollars the countries of the South lose every year from agricultural subsidies and barriers to textile exports in the North. More dramatically, the ODA/GNP ratio reached an all-time low of 0.22 percent in 1997. As in previous years, only four of the 29 OECD member countries - Denmark, Norway, Sweden and the Netherlands - exceeded the UN target of 0.7 percent. That is why the United States has increased to over \$500 million annually the programs that strengthen countries' capacity to build market institutions, to attract investment, and to participate effectively in the trading system. In the light of the continued downward trend, some argue that the target is no longer helpful either as a realistic goal or as a political rallying-point. In negotiations over the replenishment of the International Development Association (IDA), the World Bank's concessional window, USA has offered to increase its assistance to the poorest nations by up to eighteen percent over three years if performance benchmarks are met. This is an important initiative that suggests a basic bargain: increase the effectiveness of development assistance, and development assistance can be increased. If other developed countries also take this approach, developing countries and development institutions will respond. The U.S. has also proposed that up to half IDA's resource flows to the poorest nations should be in the form of grants rather than loans to fully support "pre-development" activities such as education, health, and sanitation that do not generate high financial returns and that do not create an unsustainable debt burden for the poorest countries. All recognize the role of IDA repayments in making more monies available for future loans. But over-reliance on repayments for future financing really amounts to the poorest financing the poorest. In fact, the World Bank estimates that if donors continue business as usual, reflows from

IDA borrowers are projected to increase from about 45% to some 60% of replenishment funding over the next twenty years and to about 75% in 40 years. If the U.S. proposal is adopted, reflows will remain at the 45% level. The grant proposal is an urgent issue. It does not threaten the viability of the international financial institutions; on the contrary, it makes them more central to our international development efforts. USA is working hard with its donor partners to come up with an effective proposal acceptable to all. This could be considered as a significant outcome of the Financing for Development Conference.

### **Policies in developing countries**

3. The primary responsibility for achieving growth and equitable development lies with the developing countries themselves. This responsibility includes creating the conditions that make it possible to secure the needed financial resources for investment. It is the actions of domestic policy makers that largely determine the state of governance, macroeconomic and microeconomic policies, the public finances, the condition of the financial system, and other basic elements of a country's economic environment. Achieving such a positive environment is not simply a matter of political will. Though beyond the purview of this subject, capacity building and institutional development are an absolutely essential complement to finance in the effort to improve living standards among the poor. Many developing countries, usually the poorest ones, still lack institutions capable of implementing the necessary actions and will need to focus major national efforts on capacity building. In this task, more and better assistance from the international community is needed; indeed, experience shows that imposing tough policy conditionality on poor countries without helping them to build their domestic capacity is a recipe for frustration and unsatisfactory results.

### **Governance**

4. First and foremost, a country needs to have good governance that commands the consent of the governed, and effective and impartial rule of law — including relentless combat of corruption, competent and socially legitimate protection of property rights, and well-designed, well-enforced regulations (appropriate to the specific country's stage of development) to protect workers' rights and the environment. One of the signs of how serious the world is about forging a new, results-oriented approach to development is the fact that the Monterrey Consensus makes clear, domestic good governance is a prerequisite for sustainable development. Developing country leaders increasingly accept the fact that they bear primary responsibility for their own development, beginning with good governance. When sustained economic growth and poverty eradication have occurred over several generations, it has generally been in situations where governments are open, democratic, inclusive, and accountable. Good governance is the key to unlocking private resources and opportunities from all financial flows that are essential for economic growth

### **Macroeconomic policy**

5. The generation of domestic resources to save and invest productively is the

essential foundation of sustained development. A very low domestic savings rate is one of the main structural weaknesses to be overcome in most developing countries; but there will not be enough domestic savings, nor enough high quality national investment, without macroeconomic discipline. Economic policy must be designed to make inflation and the current account balance consistent with sustained growth. For countries with high inflation, this implies that monetary policy should aim to reduce inflation over time, and once it has reached a low level, to hold it there. Monetary policy also needs to be consistent with the chosen exchange rate regime, which must give reasonable assurance that the country will avoid an unsustainably large current account deficit.

### **Fiscal policy and social spending**

6. Fiscal discipline, too, is required at all times, so as to keep deficit financing small enough to avoid causing inflation, avoid excessive accumulation of public debt and ensure that government borrowing does not crowd out the private sector from domestic credit markets. Almost everywhere the most potent way to empower the poor to integrate themselves into the market economy, and hence to contribute to and benefit from growth, is to make public investments in broadly accessible education, health, nutrition and other basic social programmes, and in the rural sector, where large proportions of the poor typically live. These programmes need to have the first call on government resources — they should not be treated as marginal programmes whose budgets can be slashed when times are difficult. Financing an adequate level of social public expenditure while limiting budget deficits calls for substantial tax revenues. Most countries of the developing world must undertake significant tax reforms if they are to raise the additional revenue that they need. These reforms should generally aim to broaden the tax base and encourage domestic savings. In designing tax reforms, care is needed to protect the consumption levels of the poor.

### **Financial system**

7. A diverse, well-functioning, competitive financial system is crucial both for mobilizing savings and for investing them productively. Every country needs a financial system that promotes savings and provides credit efficiently to small, medium-sized and large firms as well as to micro-enterprises, including those owned by the poor and by women. Again, in most developing countries, such a system is missing. Its development requires a modern framework that progressively incorporates accepted international standards for capitalization, accounting, auditing, regulation and supervision, as well as arrangements for corporate governance and bankruptcy that are adapted to the local culture while meeting global standards. Building financial systems that will meet these specifications is difficult. The international community needs to help developing countries in this task.

### **Pension reform**

8. A country's pension system has a dual role: as a social safety net for the elderly and as a source of savings that can be used for productive investment. How the government approaches the provision of old age security can have a significant impact on the national savings rate. The type of pension scheme with the greatest impact on savings is probably a defined-contribution scheme in which participants accumulate rights to the assets that they contribute, and thus regard their capitalized contributions as a part of their personal wealth. To have the greatest social impact, a defined-contribution scheme should be complemented by a tax-financed scheme, to provide for a minimum pension that has a progressive re-distributional impact and safeguards the poor. The feasibility of this approach is likely to vary among countries, however, depending in part on the solvency of the existing system and in part on the weight the society places on social cohesion. Economic growth, social development and poverty reduction are the first and foremost priorities in developing countries and economies in transition. They are themselves essential to meeting national and global sustainability objectives. The provision of effective means, in the form of financial resources and technology to these countries will serve their common interests.

9. In the context of the growing awareness of the international community of slow economic growth in most developing countries and economies in transition, as also the related negative global implications, it is essential to promote and initiate action oriented programmes to reduce poverty and achieve sustainable socio-economic development. Revitalizing the vision of development requires expanded capital formation through enhanced efforts to mobilize financial resources. This necessitates the attraction of more private foreign capital, improved mobilization of domestic personal and corporate savings and more effective collection of government revenue.

10. As the Secretary -General observed in "An Agenda for Development":

"Governments can no longer be assumed to be paramount economic agents. They nevertheless retain the responsibility to provide a regulatory framework for the effective operations of a competitive market system. Governments have to intervene where appropriate; to invest in infrastructure, to facilitate the development of productive sectors, to provide an enabling environment for the promotion of private enterprise, to provide that proper social safety nets are in place, to invest in human capital and to protect the environment. Governments provide the framework in which individuals can plan their long-term prospects.....

Finding the right blend of government direction of the economy and encouragement of private initiative is perhaps the most pressing challenge of economic development. This is not only a problem for developing or transitional economies. In the search for the difficult path which lies between dirigisme and *laissez faire*, all countries are involved...."<sup>1</sup>

11. The circumstances highlighted by the Secretary-General call for concerted action to help developing countries and economies in transition to marshal greater amounts of

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<sup>1</sup>Document A/48/935, paragraphs 47 to 50.

financial resources for development through enhanced resource mobilization, to rationalize government spending through improved public financial management, and to create an enabling environment for private investment leading to expanded private sector development.

### **Marshalling greater amounts of financial resources through enhanced resources mobilization**

12. Although considerable national and international efforts to reduce poverty, illiteracy and diseases and mortality rates have yielded satisfactory results, development as a common cause is being increasingly relegated to the background of international concern. Since developing countries are lagging behind and economies in transition are facing serious hardships, development is in crisis. Revitalizing the vision of development requires expanded capital formation through enhanced efforts to mobilize financial resources. Increased availability of financial resources is a pre-requisite for accelerating the rate of economic growth and effective international cooperation to that end should be a major objective of the international community.

### **External debt**

13. The lack of financial resources for development has been further exacerbated by the debt crisis which has aggravated an already difficult situation. In recent years, the developing countries and economies in transition have been obliged to transfer abroad an average of between 2 to 3 per cent of their gross domestic product (GDP). In some cases, these transfers have even amounted to 6% or more of their GDP. Some developing countries have even become net exporters of financial resources. In a number of cases, the commercial debts have been restructured and bilateral official debts forgiven. Many developing countries have confronted serious budget deficits as a result of increased debt servicing charges. Greater efforts are needed to reduce multilateral debt burden and to help those countries that have not defaulted despite their sizable debt servicing burden.

14. For many countries, even full use of traditional mechanisms of rescheduling and debt reduction - together with continued provision of concessional financing and pursuit of sound economic policies - may not be sufficient to attain sustainable external debt levels within a reasonable period of time and without additional external support. In September 1996, the IMF and World Bank have addressed this problem through a Heavily Indebted Poor Countries (HIPC) Initiative<sup>2</sup> designed to provide exceptional assistance to eligible countries following sound economic policies to help them reduce their external debt burden to sustainable levels, that is, to levels that will comfortably enable them to service their debt through export earnings, aid and capital inflows. This assistance will entail a reduction in the net present value (NPV) of the future claims on the indebted country. Such assistance will help to provide the incentive for investment and broaden domestic support for policy reforms. The HIPC Initiative is a

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<sup>2</sup> International Monetary Fund (2000): "Debt Initiative for the Heavily Indebted Poor Countries (HIPC), April 7, 2000.

comprehensive, integrated and coordinated approach to debt reduction that requires the participation of all creditors - bilateral, multilateral and commercial. Central to the Initiative is the country's continued effort toward macro-economic adjustment and structural and social policy reforms. In addition, the Initiative focuses on ensuring additional finance for social sector programs - primarily basic health and education.

### **Foreign Direct Investment**

15. The early 1990s witnessed a significant rise in net capital flows from industrial countries to the developing countries and economies in transition. (See Annex). These capital flows were associated with considerable interest shown by international asset-holders in the "emerging market economies" and with a noticeable trend towards the integration of financial markets. This phenomenon has the attribute of creating a more efficient worldwide allocation of savings and investment than in the past when domestic investment was usually associated with the availability of, and constrained by, domestic savings. Net capital inflows to developing countries and economies in transition (as they are now known), were low in the 1970s, both in dollar terms and as percentage of their GDPs, namely, \$16 billion annually, or 0.8% of their combined GDP. Moreover, FDI was a small proportion of the total; net FDI flows to these countries averaged only \$3.6 billion a year or 0.1% of their combined GDP. However, the data for the years 1990-96 shows that net capital inflows to these countries more than doubled from \$71 billion in 1990 to \$157 billion in 1991 and to \$200 billion in 1996. Further, net FDI flows rose sharply from \$19 billion in 1990 (0.3% of their combined GDP) to \$102 billion (1.6% of their combined GDP) in 1996, with capital inflows amounting to 3.2% of their combined GDP and FDI inflows approximately half the total. For 1990-96, the annual savings transfer to these countries averaged 3.1% of the combined GDP, more than twice the average rate for the preceding decade. Although the financial crises in certain countries in 1995 briefly spread contagion in other emerging markets, net inflows to these countries still rose by 60% in that year.

16. The significant increase in capital flows to the developing countries and economies in transition in 1990-96 and the steep rise in FDI in the aggregate can be attributed to a variety of factors. From mid 1980s, the IMF-sponsored structural adjustment facility (SAF) and the extended structural adjustment facility (ESAF) and World Bank loans enabled many developing countries and economies in transition to undertake macro-economic adjustment programmes, which resulted in yielding lower inflation and better growth performance. Similarly, in late 1980s, many transitional economies from the erstwhile Soviet bloc in Eastern and Central Europe undertook structural transformations which induced FDI inflows as their economies began to be privatized and their markets expanded. Since 1992, even certain Baltic countries, Russian Federation and other countries of erstwhile Soviet Union have initiated fundamental transformation which has yielded monetary stabilization. In most developing countries and economies in transition which undertook structural reforms accompanied by privatization of public enterprises and financial institutions, a trend tended to increase market capitalization and widen the scope of available financial instruments to domestic and foreign asset holders. The substantial increase in the financial flows to these



countries also reflects the continuing process of financial innovation in developed countries thereby encouraging greater spreading of risk exposures to emerging markets.<sup>3</sup>

17. However, it is relevant to mention that although the global flows of FDI have increased sharply, taking the developing world as a whole, FDI inflows are heavily concentrated in a few host developing countries: 18 economies accounted for over 80% of total FDI inflows into developing countries in 1997 (i.e. 37.2% of total world inflows). Of these, the share of developing countries in Africa was 1.2%, Asia and the Pacific 1.8%, Latin America and the Caribbean 14% and of the economies in transition in Central and Eastern Europe 4.6%.<sup>4</sup> Clearly, private international investment has not yet proved to be the answer for the poorer countries, although their expectations of progress with regard to poverty reduction have been greatly and legitimately raised. As reflected in paragraph 36 of “A Partnership for Growth and Development” adopted by UNCTAD IX in 1996<sup>5</sup> :

“Foreign direct investment (FDI) can play a key role in the economic growth and development process. The importance of FDI for development has dramatically increased in recent years. FDI is now considered to be an instrument through which economies are being integrated at the level of production into the globalizing world economy by bringing a package of assets, including capital, technology, managerial capacities and skills, and access to foreign markets. It also stimulates technological capacity-building for production, innovation and entrepreneurship within the larger domestic economy through catalysing backward and forward linkages.”

18. The effects of FDI on development often depend on the initial conditions prevailing in the recipient countries, on the investment strategies of multinational corporations and on host government policies. Governments, therefore, cannot afford to be passive. The contribution that FDI makes to development can be enhanced by policies that do not remain confined to the mere liberalization of FDI regimes and the granting of legal protection and guarantees to foreign investors. There does indeed exist a wide array of policies that can be used to stimulate greater learning, innovation and linkage effects as well as to promote trade and employment gains. Government action needs to aim at fostering, channelling and complementing FDI. Beyond these challenges to national policy, the growth of FDI and the emergence of integrated international production

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<sup>3</sup> Knight, Malcolm (1998): “Developing Countries and the Globalization of Financial Markets”: IMF Working Paper WP/98/105.

<sup>4</sup> United Nations Conference on Trade and Development (UNCTAD) : “Foreign Direct Investment and Development” :UNCTAD Series on Issues in International Investment Agreements, 1999: Annex Table 1.

<sup>5</sup> United Nations Conference on Trade and Development (UNCTAD) (1996a): “A Partnership for Growth and Development” (Geneva : UNCTAD), United Nations document, No. TD/378.

systems raise a number of new policy issues which, increasingly, require international attention.

19. The distribution of the benefits of development is a major challenge to stability in the world, a challenge that must be urgently addressed to ensure that social injustice does not distort or destroy economic and political advantages. Resource mobilization, therefore, lies at the core of the development process; it involves the mobilization of funds for public expenditure and infrastructure financing, the mobilization of personal and corporate savings and the attraction of foreign capital.

### **Mobilization of financial resources through Government revenues**

20. The sources of funds for budget expenditures and infrastructure financing are taxes, customs duties, excise duties, general sales tax, VAT and non-tax revenues comprising grants, borrowing fees and charges, property income, sale proceeds of public assets, fines and other government receipts. In almost all countries, taxation is the principal source of budget resources. However, in many countries, widespread tax evasion and tax avoidance at the national and international levels have created serious resource mobilization problems.

21. In their efforts to restore financial equilibrium and promote sustainable economic development, developing countries and economies in transition which are coping with unsustainable fiscal deficits, unabated debt servicing and declining development assistance may have to rely on action aimed at :

1. Overhauling the entire tax system so as to adapt tax policy and tax laws to the evolving economic and financial situation, minimize equity distortion, ensure that taxes are consistent with the privatization of state enterprises, trade liberalization, increased financial intermediation and other reform initiatives;
2. Selecting taxes that are administratively feasible and have an optimum collection level;
3. Expanding the tax base and including the informal sector therein to the greatest possible extent;
4. Making the existing taxation rules and practices more simple and efficient.

22. Since there is a clear correlation between tax policy formulation and implementation, the success of overall tax reform depends on a concomitant overhaul of tax administration. Since there is a direct correlation between voluntary taxpayer compliance and the public's perception of the tax administration as being fair, honest and efficient, the tax administration should be endowed with an organizational structure that will enable it to implement tax laws fully, keep pace with changes in those laws, provide better taxpayer service and achieve maximum revenue collection at the lowest possible cost. In undertaking fiscal reform, Governments may consider endowing the tax administration with the ability to formulate its own administrative policies and objectives and create its own recruitment with the aim of achieving the maximum revenue

collection. The tax administration should also be endowed with the ability to enforce the existing rules and regulations.

23. Fiscal policy is the government's important direct tool for achieving several socio-economic objectives, and for re-distributing income, both in the short and long term. The budget is the medium to offer two channels for influencing income distribution: taxation and public expenditure. It has been the experience that public expenditure offers better opportunities than the tax side to re-distribute income. The role of re-distributive tax policy has become very restrictive, particularly in the context of globalization. Therefore, tax policy should concentrate primarily on devising an efficient system of taxes which could be easily administered with broad bases and moderate and reasonable marginal rates. Although equity and efficiency considerations should be paramount in designing the tax system, there is need to design tax systems which are seen and perceived as consistent with the society's conception of a just and equitable burden of taxation. In this context, vertical and horizontal equity are important.

24. The proportion of public expenditure devoted to social expenditure depends on several factors, inter alia, the tax-to-GDP ratio, and the resources devoted to other objectives. Tax policy can indirectly contribute to equity by raising enough resources to allow a level of expenditures on public services that is adequate to promote social goals without creating any impediment on economic growth. For this purpose, developing countries and economies in transition should endeavour to attain optimum revenue realization potential through the device of "widening of the tax base" which has both legislative and administrative implications. Despite best efforts, very few countries have been able to define precisely the concept of income. As a consequence, due to the inadequate and incomprehensive concept of income, large quantities of taxable receipts do not become exigible to tax and escape tax net altogether. On the other hand, vague and ambiguous basis of charge creates situations where legislative provisions become prone to multiple interpretations leading to tax avoidance. Hence legislative amendments become necessary, time and again, to plug the loopholes and to make the legislative intent clear, by broadening the concept of income. It may also become necessary to make the legislative amendments with retrospective effect, thereby large-scale unsettling of the completed assessments to recoup the loss of revenue of several past years. In the absence of system of indexation, this may also result in collecting the taxes due many years earlier in a depreciated currency at a fraction of its true worth. Tax administration has to be constantly vigilant to unearth devious schemes of clever taxpayers to practise tax avoidance and to watch adverse judicial decisions which are prejudicial to the interests of revenue, which may require legislative amendments to clarify the legislative intent.

25. Another aspect of widening of the tax base has administrative implications. No matter how well designed tax laws may be in theory, they may still fail to achieve their objective in practice unless they are efficiently implemented or administered and taxpayers can be induced and if necessary, compelled to ensure their compliance. An efficient and effective tax administration is a pre-requisite if a tax system is to fulfil its revenue producing potential and even a best designed tax system is only as good as the administration which implements it. Tax administration is, therefore, a major tool in a

government's efforts to pursue a sound fiscal policy, achieve an optimum tax effort level and establish an appropriate tax structure. Fiscal policy which encompasses tax policy as also public expenditure interacts with tax administration in various ways and may actually help countries to move from fiscal disequilibrium to fiscal equilibrium, resulting in the promotion of sustainable economic growth. For example, higher taxes, although a convenient way of augmenting revenue, may result in a disincentive to save and invest, to engage in unproductive activities and a contraction of consumption.

26. Efficient and effective tax administration may generate more revenue without these negative side effects, thus helping to reduce budgetary deficits and curb inflation. Furthermore, the reduction of fiscal deficits may make the governments more conscious of their spending behaviour and give tax administration additional incentive to combat tax evasion. Improved tax administration may also enable higher levels of capital formation, increased domestic savings rates, and reduced public debt; and monetary and foreign exchange policies can be supplemented by tax incentive devices, leading to increased exports and foreign exchange earnings.

27. The ease and rapidity of communications, the progressive elimination of obstacles to the movement of persons and property and the expansion of international economic relations, combined with differences in national tax systems and in the tax burden from country to country as also with the growing sophistication of the techniques used by tax professionals to help their clients take advantage of legal loopholes, have enabled an increasing number of individuals and companies to resort to tax evasion or tax avoidance.

28. Tax evasion and tax avoidance at both the national and international levels have serious implications for fiscal policy. They violate the principle of fiscal equity and undermine the concept of voluntary compliance with tax laws. They can greatly diminish the value of statutory incentives and thereby affect allocative behaviour to thwart redistributive programmes, create artificial biases in macro-economic indicators and increase the tax burden when tax rates must be increased in order to offset the revenue losses incurred, thereby imposing an unfair burden on taxpayers who cannot shift their tax liabilities. The greater the extent of tax evasion and avoidance, the more difficult it is to finance government expenditure without inflation, or in other words, to increase tax revenue adequately, with the result that the excess of expenditure over taxation is positively correlated with the tax burden. Tax payment has, in fact, come to be regarded as unfair, since public expenditure has been increasingly perceived as failing to yield commensurate benefits either to taxpayers personally or to their communities.

29. Tax administrators have adopted various measures to reduce the opportunities for tax evasion and avoidance. The scope of these measures varies according to the characteristics of the country concerned, including its legal structure, its political system, its traditions and the psychology of its people. These measures have included reliance on indirect taxes, reliance on declarations and withholding of taxes by third parties, the operation of an efficient system and cross-checking of information, auditing of cases, and the unilateral determination of taxable income, the bilateral determination of taxable income (forfait system) and the use of legislative provision, administrative rulings and

judicial decisions, as well as the enactment and enforcement of penalties. International tax evasion and avoidance can be combated by the conclusion of bilateral tax treaties providing for mutual assistance and the exchange of information.

30. A country's tax effort or level of taxation, which is expressed as a percentage of GDP can be affected by a variety of factors, namely, government spending for consumption or investment, the extent and scope for public debt, the inflow of foreign direct and portfolio investment and the extent of income from public enterprises. These elements constitute a means of determining and comparing national tax burdens. The overall average tax effort level in developing countries is around 20% as against over 35% in the developed countries, although in developing countries, it varies between 10% to 30% as well. While no useful tax performance comparison can be made between developed and developing countries, this proves that in developing countries the tax efforts are low in relation to the amount of tax revenue that could be collected on the basis of voluntary taxpayer compliance. It would be seen that there is scope for an increase in the tax effort in developing countries and economies in transition. While no rational or desirable magnitude of that increase can be laid down applicable to these countries, governments in these countries should endeavour to strike a reasonable balance by setting taxation at levels high enough to generate sufficient revenues to meet the necessary public expenditure, but not so high as to discourage investment in business or industry and personal savings and to encourage attempts at tax evasion and avoidance.

31. The tax structure of each country is unique and undergoes changes during the course of the process of economic growth. Countries with low per capita income collect more revenue from taxes easy to administer, while developed countries can resort to more sophisticated taxes, such as, sales tax, or service taxes whose administration is linked to proper maintenance of accounts. In most developing countries, reliance on taxes easy to administer leads to considerably flawed tax structure, based mainly on foreign trade taxes, namely, customs duty or export taxes. In fact, administrative constraints tend to determine a country's actual tax structure. Tax administration's capacity should be strengthened through intensive training and to modern methods of administration. This will enable the government to introduce new broad based income and consumption taxes, thereby reducing the absolute dependence on foreign trade taxes.

32. While considering the tax policies in developing countries and economies in transition, the following points need careful consideration, namely :

1. Governments should explore the possibility of increasing the percentage of collection of direct taxes, such as, by the medium of withholding taxes on wages, salaries, interest on securities, including bonds and debentures, insurance and other commissions, interest on bank deposits and term deposits, dividends, payments to contractors and sub-contractors. In addition, there should be system of advance payment of tax in the income-earning year on business and professional incomes.

2. There is need to emphasise the greater revenue potential of indirect taxes, such as, Value-added-tax (VAT), levied on goods and services, and is largely self-enforcing, although this type of tax requires minimum administrative set-up but involves large number of exemptions and many rates giving rise to administrative difficulties.

### **Strengthening public finances : enhancing revenues**

33. Increasing public revenues are key in achieving non-inflationary growth and ensuring enough resources to finance essential public expenditures, including poverty-eradication programmes. Within the constraints imposed by the structure of the economy, the domestic tax system and non-tax revenues should be designed to raise enough revenue to finance public expenditures resulting in sustainable fiscal balances and reduce the need to rely on increasing public borrowing or money creation.

34. On-going transformations and evolving national development strategies in the context of globalization of the international economy suggest that many developing countries and economies in transition may have to adapt their tax policy, administration and legislation, including the international dimension of national tax systems to the changing domestic and external economic, fiscal and financial environment. Globalization, liberalization, international trade agreements and efforts to attract foreign capital have persuaded countries to lower rates and tariffs, often privileging the mobile factor - financial capital - at the expense of labour and underlining the need to establish or strengthen a progressive tax system.

35. Past experiences also point to the need to strengthen or put in place a tax system that is fair and equitable, that minimizes disincentives for economic efficiency, that is simple (easy to understand and administer) that eliminates evasion and avoidance, that is flexible enough so as to secure equitable tax revenue from income attributable to the new and innovative financial instruments, that allows for gradually widening the tax base and integration of the informal sector in the mainstream of the economy. The selection of taxes and duties need to ensure that they are administratively feasible and result in realistic collection of revenue. The system should protect national revenues from tax havens and other shelters, and prevent unhealthy and harmful tax competition from becoming a race to the bottom.

36. A transparent budget process and linking revenues to delivery enhance accountability and legitimise revenue collection. Successful outcomes of public programmes in education and health are a point in case. An efficient and transparent tax administration system, free of corruption, can expand revenue collection.

37. While mobilization of domestic resources is in the long-run a *sine qua non* for sustained development, for a large number of developing countries and economies in transition, in particular least developed countries and other countries that have difficulties attracting financial resources, there will be a need for substantial external resources in order to make major strides in poverty eradication.

38. A country's **tax effort** or level of taxation, which is expressed as a percentage of GDP can be affected by a variety of factors, namely, government spending for consumption or investment, the extent and scope for public debt, the inflow of foreign direct and portfolio investment and the extent of income from public enterprises. These elements constitute a means of determining and comparing national tax burdens. For the period 1985-87, the average total tax level in the developing countries was about 17.5% of GDP, and for 1995-97, it was 18.2% while the average tax level in the OECD countries in 1985-87 was more than twice as high at 36.6% of GDP and in 1995-97 at 37.7%. While no useful tax performance comparison can be made between developed and developing countries, this proves that in developing countries the tax efforts are low in relation to the amount of tax revenue that could be collected on the basis of voluntary taxpayer compliance. The non-tax revenues include social security contributions, grants from foreign governments and international organizations, property income, interest, dividends from state enterprises, rents from government property, fines, penalties and forfeits and sale of goods and services.

### **Public debt**

39. If public debt is properly utilized, it can contribute to economic growth and poverty reduction and smooth out consumption in response to shocks. However, if inefficiently allocated, the cost of borrowed external resources can contribute to macro-economic management problems in the form of high and unsustainable levels of external debt servicing obligations. The external debt burden of many low income developing countries increased substantially since the 1970s, due to (1) exogenous factors, such as, adverse terms of trade, shocks and weather (2) a lack of sustained macro-economic adjustment and structural reforms (3) non-concessional lending and refinancing policies of creditors (4) inadequate debt management (5) political factors, such as, civil wars and social strife. Future policies should limit the need for external financing and create an environment conducive to diversifying export growth, managing debt more prudently, and basing economic projections on more cautious assumptions.

40. It is considered that the following measures will be relevant:

#### **1. Mobilization of domestic resources can be enhanced by:**

- Fostering fair and honest government to promote a culture of tax compliance;
- Using public sector specialized banks to mobilize savings and provide investment in neglected areas and in a counter-cyclical fashion;
- Reducing over-dependence on banks by developing bond and equity markets institutional investment institutions such as mutual funds or pension systems.
- ❖ **Supporting finance for small and medium-sized enterprises** through venture capital funds and commercial credit reference agencies;
- ❖ Using **provident funds, unit trust and postal savings systems** to mobilize savings and finance investment, particularly for social development.

#### **2. Mobilization and management of external private flows can be enhanced by:**

- Opening capital markets to external investors in a slow and phased manner;
- ❖ **Changing the maturity structure of foreign capital** through indirect restrictive measures, such as, taxation and reserve requirements, and using capital controls only in emergency situations;
- ❖ Regular monitoring of borrowers, lenders and maturities against a target portfolio of capital inflows;
- Liberalizing capital accounts when effective regulatory and supervisory regimes for the financial sector are in place and macroeconomic policies are consistent and appropriate;
- Encouraging the development of a global supervisory mechanism for outflows of private capital, highly leveraged funds and offshore financial centres.

### **3. International financial architecture can be improved by:**

- Enhancing the participation of developing countries in the decision-making processes of international financial institutions;
- ❖ **Adopting transparency and disclosure initiatives** for financial markets and their member institutions, such as, banks and highly leveraged funds;
- Strengthening International Monetary Fund surveillance of the macroeconomic and financial policies of major industrial countries which impact on developing countries;

### **4. Regional cooperation and collaboration on money and finance can be enhanced by:**

- A phased approach, beginning with measures that are the easiest to implement;
- ❖ Strengthening regional cooperation in line with the **Chiang Mai Initiative of ASEAN+3**, including inter-bank swap arrangements;
- ❖ Establishing an **Asian Monetary Fund** for preventing or managing the effects of financial crises;

### **5. Innovative sources of finance can be enhanced by:**

- Increasing support for and effectiveness of micro-finance schemes by utilizing economies of scale and integrating with the formal financial system;
- ❖ Expanding the **use of information technologies in capital markets**;
- Setting aside a small percentage of interest payments on loans from international financial institutions to provide finance to small and medium-sized enterprises;
- A currency transaction tax to raise funds for development.

### **6. The effectiveness of the external sector can be enhanced by:**

- Implementing commitments to developing countries made under the Uruguay Round;
- ❖ **Focusing official development assistance** on the social sector and human resources;
- Reducing administrative burdens and multiple conditionalities facing aid-recipient countries;
- Structuring debt relief to complement other forms of development assistance.
- ❖ options considered most forward looking

41. In a statement made by Mr. Mohammad Ali Zarie Zare, on behalf of the Group of 77, at the Third Session of the preparatory Committee for the International Conference on



Financing for Development: Mobilization of Domestic Resources in New York, on 3 May 2001, he observed as under:

“The Group of 77 and China believes that countries have the primary responsibility for their economic development. The domestic resources are the primary sources to finance the development activities in any country and are the foundation for self-sustaining development. Countries should make every effort to create an enabling environment to expand the domestic resource base, establish and strengthen mechanisms and institutions to increase and preserve those resources and to make the best and the most efficient use of them. Many developing countries have made serious attempts to pursue sound macro-economic policies, develop their human resources and to promote good governance and cooperate with civil society. They are also cognizant of the fact that, among others, sound national macro-economic policies that enhance saving and productive investment; development of institutional structure for planning and implementation of macro-economic policies; efficient tax system and encouragement of tax culture; effective financial systems; regulatory mechanism, including prudential regulations, are necessary for mobilizing and the best utilization of domestic resources. Nonetheless, we would also like to emphasize the strong need for supportive and conducive international environment, including:

- More stable and non-discriminatory fiscal, monetary and trading regimes;
- Enhanced and meaningful participation of developing countries in the international decision making and norm-setting processes;
- Regulatory mechanism for reducing volatility in capital flows;
- Transparency in the development of criteria for credit ratings;
- Mechanisms for sustainable management of external debt;
- And due consideration by developed countries on the impact of changes of their interest rates and exchange policies on the developing world which can contribute to an optimized mobilization and utilization of domestic financial resources in the developing countries.

- Domestic resources mobilization should be undertaken with policies and instrumentalities of national governments and country ownership in designing and implementation of national economic policies should be preserved. The international donor community should be fully responsive to the national policies and priorities of developing countries and necessary capacities should be created with the support of the international community, so as to equip countries to implement those international standards and codes, which have been endorsed by national governments.

- Enhancing international macro-economic stability through open, rule-based, fair, non-discriminatory and predictable financial and trading regimes; promoting FDI flows to long-term developmental projects through incentives; Regulatory mechanisms for capital flows particularly short-term capital flow to reduce their volatility; addressing external debt problems of developing countries; fulfilling the agreed target of 0.7% of GNP of developed countries for ODA; Good corporate governance rules and mechanisms for TNCs.

- To enhance international cooperation to fight corruption, eliminate money laundering and illegal transactions and repatriate illegally transferred funds. United Nations has the legitimacy to work on these issues through elaboration of effective ways and means. Putting in place, under the auspices of the United Nations, international instruments for combating corruption and the elimination of money laundering and illegal transactions in the international financial service sector as well as the repatriation of illegally transferred funds to the countries of origin could contribute tremendously to the cause of fighting corruption.

- strengthening and efficient use of public finances for better mobilization of domestic resources for development has been a major component of policy discussion in developing countries. Multilateral and bilateral development agencies can help in this regard, inter-alia , through capacity building including facilitating transfer of technology, financial and technical assistance for establishing institutional structure and sharing information regarding the expectations about financial and monetary and commercial developments at the global level to assist the developing countries to formulate their medium-term fiscal framework more predictable and accurately. These endeavors could also be done in creation of an efficient tax system.

- Creating and further development of national financial and capital markets which are transparent, efficient and stable, is one of the most important objectives of developing countries. They are also willing to promote access to long- and short-term credit, provide crop insurance and other services to farmers, fishermen and small rural producers and strengthen their social safety nets as an integral part of their national development policies. But most of them simply do not have the necessary and sufficient resources for such actions and programs. The international community can play an important role in this area, including through assisting capacity building in developing countries, dissemination of best practices and experiences and exchange of information as well as promotion of south-south cooperation through triangular cooperation. Such actions could assist the governments in developing countries in partnership with the private sector and civil society to address the challenges of assisting the poor segments of society including through innovative sources of finance.”

42. Public development funds will continue to be a major source of financing in the fight against poverty and environmental degradation and to compensate for the negative effects of globalization. As the pace of globalization picks up, we face increasing problems in safeguarding the global commons, preventing global currency crisis, fostering sustainable patterns of consumption and production and preventing intra-state and international conflicts. Challenges of this magnitude require concerted intergovernmental efforts and substantial financial resources. Blind confidence in market forces has led to failure. For sustainable development to succeed, public finance is necessary to sustain social security, public health, education, environmental protection, infrastructure, cultural diversity, economic stability and employment.

43. The mobilization of domestic resources for development requires more than a renewed commitment on the parts of governments, donors, international institutions and the UN, to the development process. Financial mechanisms for the implementation of established goals must acknowledge the social content and impacts of finance. The processes by which relevant information on the alternative uses of funds are gathered, the types of costs and benefits included in decision making, and the manner in which projects are screened and selected embody social and gender norms and have important social and economic outcomes. For instance, despite evidence of increased female employment in industry and services in Europe; the preponderance of women in farming and small scale and micro-enterprises in Africa, Latin America, the Caribbean, Europe, and the Asia Pacific regions; and the substantial contributions of the unpaid labor of women (which can amount to 2.5 to 12 times the amount performed by men), the gender norm that women are supplementary income earners persists and significantly affects women's access to financial and non-financial resources. It is important to consider the gender dimensions of access to these resources, including savings and credit, land, and services, in the context of mobilizing domestic resources for development.

44. Governments play a crucial role in steering the development of the financial sector towards serving their countries international development goals and in enhancing the welfare of all individuals - women, children and men. This involves promoting reliable and convenient financial activities that serve the credit and savings needs of women, especially from poor households. Governments also have a critical role in the provision of essential public goods and social services which markets do not adequately supply, such as, education, health and basic infrastructure. Budget cuts in these public expenditures have been detrimental to household survival and women's well-being in terms of increase in women's unpaid work. The special needs of women including domestic violence counseling and support for care of dependents (children and the sick including those with HIV/AIDS) also need to be met by budget allocations. In order for budgets to meet the needs of men and women equally, the processes must be made participatory and transparent (UN 2001 A/AC.257/12 para.35), and must give particular consideration to women's participation and gender analysis. One important tool for ensuring government accountability to international commitments with regards to gender equality and poverty alleviation is through the adoption and implementation of gender analysis and budgets.

45. Governments can also do more to mobilize domestic resources. National budgets contain huge potentials for savings and redistribution. Governments can make additional resources available for sustainable development by reforming their tax systems as well as by eliminating harmful subsidies and unproductive expenditures. This is true for all countries in North and South. The countries of the North could set a good example by tackling tax reforms with environmental and social results in mind. These have been long overdue.

46. Governments can also improve their development assistance qualitatively. This can be done, for example, by shifting resources from prestigious but wasteful infrastructure projects like dams to programs for basic social services (in line with

the 20:20 compact of the Copenhagen World Summit for Social Development). But improved quality cannot substitute for more quantity of assistance. The size of global policy challenges requires both more quality and more quantity.

47. However, it should be noted that the capacity of a country to raise tax revenue depends not only on tangible economic factors but also on a variety of non-economic factors, such as political will, administrative efficiency, and a culture of tax compliance, and as such it is almost impossible to prescribe a priori what proportion of GDP should be raised as taxes in any particular country. Most tax reforms concern the simplification of tax regimes, changing the types of taxes levied towards indirect taxes and widening the taxpayer base. Other fiscal reforms include reducing fiscal deficits, privatizing some state enterprises, particularly in the countries with relatively large public sectors, making state enterprises more efficient and self-financing, and generally reducing the role of the government in the economy.

48. This analysis leads to four core questions regarding the future of financing for sustainable development:

1. What measures are needed on the global level to promote public resources of the magnitude required for national development programs in the South and the funding of international institutions?
2. What is the potential of fiscal policy to mobilize or redistribute domestic resources for sustainable development?
3. What kinds of multilateral regulation and standard setting are necessary to assure that private investment is conducive to the goals of sustainable development?
4. How can the political obstacles to alternative forms of international financing for development be overcome?

49. The dwindling importance of ODA has also given rise to a more fundamental rethinking of the concept of aid. The notion of "development aid" or "development assistance" was always a misleading euphemism which reduced the cooperation between sovereign states to paternalistic relations between donors and recipients. Northern Governments' gradual loss of influence due to the decline of their financial transfer to the South could lead to a more balanced relationship between North and South on the intergovernmental level. (The fact that at the same time the southern countries' dependence on the international financial markets, banks, pension funds and transnational corporations of the North is growing steadily has to be dealt with separately).

50. To overcome the old donor-recipient dependence, forms of contractual relations between all countries should be established under the auspices of the international agencies. Required is a new "contract social" between North and South which lays down rights and obligations of the states and guarantees a reliable and sufficient resource flow to the South. Some interesting considerations

in this direction are contained in a study of Keith Griffin and Terry McKinley. They call for a new global safety net - a progressive income tax on the GNP of rich countries, the proceeds of which would be allocated to the poorer countries. Models for this type of compensation or equalizing adjustment already exist on the national and regional level. In Germany, for example, there is the concept of financial adjustment among the German Laender and in the European Union there is a compensatory structural policy. Moreover, the contractual relationship between the EU and the ACP countries under the Lomé Convention can serve - in spite of its deficiencies - as an indication of the way development cooperation could move in the future. The international organizations could undertake further analyses of the feasibility of such North-South contracts.

**51. Crisis of the Multilateral Aid and Financial Agencies:** As governments have cut their official development assistance, they have also reduced their support for multilateral funding agencies like the United Nations Development Programme (UNDP), and even international financial institutions like the Bretton Woods Institutions. In particular, UNDP was seriously affected by the ODA decrease in recent years. Quite a few governments have cut their voluntary contributions to this agency, including (by 1998) the United States, Germany, France and Japan. In sum, the voluntary contributions fell from 1178 million dollars in 1992 to about 750 million dollars in 1998. "UNDP's current core funding situation has become extremely critical", warned Administrator James Gustave Speth at the Executive Board meeting on June 18, 1998 .

52. Voluntary funds have also been cut in the case of other UN and regional development agencies, including UNICEF and UNIDO, while budgets based on assessments have been cut back as well in such agencies as the World Health Organization and the International Labour Organization. Remaining funds in the multilateral sphere are more tightly controlled by funding governments, reducing the multilateral nature of the funding process. Many international agencies' core budget has also suffered severe cuts in recent years, with negative consequences for multilateral development planning and coordination. Under these circumstances, the pledge of US billionaire Ted Turner of 1 billion dollar over ten years in support of UN development and humanitarian programs, announced in October 1997, was warmly welcomed by the Secretary General and other officials as a new source of revenue. And Turner offered to find more rich individuals to help with the funding crisis. But the Turner millions are actually only a very small percentage of the total budget of the UN system (100 million dollars vs. 7-8 billion dollars or about 1.5 percent). Further, they move towards a model of private philanthropy, placing reliance on wealthy individuals for what should properly be a public function and responsibility.

**53. Foreign debt as obstacle to development :** The consequences of decreasing bi- and multilateral ODA in the 1990s are of minor importance compared with the dramatic debt situation of many developing countries. Their foreign indebtedness seriously affects their ability to pursue sustainable

development. In theory, foreign loans could be used to finance environmental and social activities in the South. For example, debt might be used to import cutting-edge environmental technology or to finance industries producing solar energy panels or similar environmentally-friendly products. But in practice, the debt process seriously damages sustainable development. Huge debt-financed projects often lead directly to environmental degradation (roads, dams, petroleum prospecting, etc.) and enormous sums (sometimes half or more of a project cost) are siphoned away as corruption into the pockets of politicians and their private sector allies.

54. Projects aimed at providing public goods such as environmental protection or basic social services like education, public health, clean water and sanitation do not directly produce a surplus for repaying debts and interests. As a consequence, Governments have been often forced to raise new loans just to meet their current obligations. This vicious circle has driven them ever deeper into debt. The situation often has gotten worse as a result of decreased raw material prices, currency devaluation, costs of environmental and social damage, bad management and corruption. The result has been a deepening debt crisis during the past two decades, which has driven more than half the world's countries to the brink of bankruptcy and forced on them ever-more-draconian austerity policies.

55. In 1997 the total debt-service flow from the developing countries to northern Governments, commercial banks and international institutions amounted to 269.2 billion dollars, more than four times as much as the whole ODA flow to these countries. If these enormous repayments were backed by productive assets, they would pose no problem. But the combination of gross investment errors, waste and corruption has resulted in assets which fall far short of sustaining the debt service. If these were companies, they would long ago have sunk into bankruptcy and the lenders would have lost their capital. But instead, the military and financial might of lender governments protects the dubious original loans, shielding the lenders from risk. So the borrowers must pay, however gruesome the social consequences.

56. If public debt is properly utilized, it can contribute to economic growth and poverty reduction and smooth out consumption in response to shocks. However, if inefficiently allocated, the cost of borrowed external resources can contribute to macro-economic management problems in the form of high and unsustainable levels of external debt servicing obligations. External debt management has close links with the management of fiscal budget, foreign exchange reserves and the overall balance of payments. The external debt burden of many low income developing countries increased substantially since the 1970s, due to, firstly, exogenous factors, such as, adverse terms of trade, shocks and weather; secondly, a lack of sustained macro-economic adjustment and structural reforms; thirdly, non-concessional lending and refinancing policies of creditors; fourthly, inadequate debt management; and lastly, political factors, such as, civil wars and social strife. The institutional arrangements for debt management

necessarily differ from country to country but their activities should revolve around: formulation of debt management policies and strategies; providing macro-economic projections and analysis to support policy making; and undertaking operations to implement terms of loan agreements and maintaining loan records (i.e. monitoring and maintaining information on disbursements and debt service payments).

57. To restore the solvency of the highly indebted countries, the World Bank and IMF imposed Structural Adjustment Programs (SAPs) on most of them which further reduced their capacity to finance social and environmental programs. The Bank and the Fund required neo-liberal policy shifts including radical cuts in national budgets that may have had adverse effects on sustainable development and social justice. But despite the immense adjustment burden which led to environmental degradation and growing social disparities, most countries' debt problems have not been overcome.

58. Many have proposed forgiveness of these debts as an essential step towards sound development, making available urgently needed financial resources to the poorest countries. But debt forgiveness alone runs the risk of throwing more money into a fatally-flawed process. Would not most of the newly available funds, released from debt service, find their way into the pockets of corrupt officials and their wealthy cronies? How much of the money would be transferred to secret bank accounts in tax haven jurisdictions?

59. So debt remission is necessary but not enough. There must, at the same time, be a major increase in the accountability of public officials, joined to a judicial process for recovery of stolen or corruptly-obtained funds. Some experts believe that if all these funds were recovered, there would no longer be a debt problem and possibly few debts at all. A former official in Algeria announced in the early 1990's that according to information at his disposal, Algeria's total foreign debt was matched by stolen funds in foreign accounts. Indonesia, the Philippines, Congo (Kinshasa) and Haiti would appear to be just a few of the many similar cases.

60. International financial institutions and bi-lateral lenders could easily establish rules of accountability insuring honest use of their loan funds. The time has come to insist on accountability as a primary condition for new lending and (especially) for debt remission. The World Bank and IMF launched a more traditional debt-forgiveness initiative for the heavily indebted poor countries (HIPC) in fall 1996. This so-called HIPC Initiative aims to remove the "debt overhang" of these countries and to ensure that their debt is reduced to "sustainable levels". Sustainable debt levels are defined by the World Bank within the range of 200 to 250 percent for the debt-to-export-ratio (on a present value basis) and 20 to 25 percent for the ratio for debt service to exports. Currently 41 countries are on the HIPC list but until 1998 only six (Bolivia, Burkina Faso, Uganda, Guyana, Côte d'Ivoire and Mozambique) had been

declared eligible for debt relief - after years of severe economic and social reforms. These countries expect to benefit from the HIPC Initiative. As the Ugandan Minister of Planning and Economic Development Richard Kaijuka stated in April 1997: "This debt relief will help us to put more resources into our national Poverty Eradication Plan, especially President Museveni's recent initiative of universal primary education, the provision of basic health care and improved nutrition to our people, and the overall enhancement of rural development."

## Conclusion

61. Most of the international declarations and programs of action of recent years emphasize the need to mobilize domestic resources for social and environmental purposes. But when faced with calls to increase funding for sustainable development, the governments usually reply that they lack financial resources. A serious analysis of national budgets shows, however, that sufficient money would be available if existing public and private resources were reallocated. The world economy is more productive and prosperous than ever and should easily be able to afford the needed new spending. Both the expenditure and revenue side of government budgets offer many possibilities for reallocation. Controls on corruption also offer huge possibilities for savings.

62. Looking at the expenditure side, governments could cut very substantially their **enormous military budgets**. Reflecting the end of the cold war, worldwide military expenditures declined by one third between 1985 and 1995. But huge waste remains. Every year hundreds of billions of dollars are spent on small arms, land mines, weapons of mass destruction, fighter-bombers, tanks, artillery and a world army of more than 23 million soldiers (1995). So there is a big potential for savings and an urgent need for further reallocation of military budgets towards social needs.

63. Similarly, government budgets now contain a large number of **harmful subsidies** which offer substantial opportunities for redistribution. Governments continue to encourage environmentally harmful and socially inequitable production and consumption patterns by granting concealed and open subsidies. These subsidies include export subsidies for agricultural surpluses, state guaranteed export credits (e.g., for the construction of dams or the export of armaments), long-term contracts to purchase products from the armaments industry, and waivers on petroleum tax for certain industries. These types of subsidies not only harm the environment, they also absorb billions of dollars in financial resources which are urgently needed in the social and development fields. According to a study undertaken by the Institute for Research on Public Expenditure, 700 to 900 billion dollars are spent every year worldwide on subsidies in just four economic sectors (water, agriculture, energy and road



transportation) - often with a very detrimental environmental impact. The study mentions these cases, among others: "Rice growers in Southeast Asia over-irrigate their fields, because subsidies cover most of the cost. Drivers in southern California continue to funnel onto congested thruways, because subsidies take care of more than half the cost of their daily commute. Uneconomical and highly polluting coal is still mined in Germany as back-door welfare support for the miners." Even if these subsidies were to be only partly dismantled, there still remain hundreds of billions of dollars that can be shifted to sustainable development.

64. On the revenue side, **new resources could be obtained by implementing an ecology-based and more socially responsible and egalitarian tax policy.** Such a policy would raise taxes on corporate profits, assets, inheritance and high incomes and eliminate tax loopholes and other forms of tax avoidance. The current tax system in many countries discriminates against "labor" as a production factor while favoring the exploitation of natural resources. Consequently, the tax system must be reorganized on an ecological basis so that the consumption and use of resources are subject to higher taxes. In doing so, care must be taken to ensure that such a reform does not lead to inequitable redistribution. Concrete blueprints for a comprehensive ecological tax reform were drawn up years ago but have yet to be put into effect. These plans involve an energy/CO<sub>2</sub> tax and a tax on non-renewable resources. While harmonized taxes on the global level would be the best solution, there remains the possibility of initiatives on a regional and even national level. Countries like Denmark and the Netherlands demonstrate this very clearly and their leadership may inspire wider reforms.

65. **Alternative Financial Instruments:** Global instruments for revenue-raising, including various taxes and fees, offer a major new potential source for development finance. Most proposals of this type involve very small taxes or fees on very large global transactions, yielding a large revenue while imposing a relatively light burden on any individual. One of the best-known proposals has been advanced by James Tobin of Yale University, who first proposed in 1972 a tax on currency exchange transactions. Tobin made his proposal in order to reduce speculation in the exchange markets, a goal which is even more important today than when Tobin first proposed it. The revenue-raising potential of the idea is enormous. With an estimated 1.5 trillion dollars in foreign exchange trades every business day in 1998, yearly trading volume is well over 350 trillion dollars. A tax of just one percent would yield 3.5 trillion dollars per year, more than fifty times the total of ODA. Even assuming a major reduction in market volume caused by the tax, the potential yield would remain very substantial. The Tobin tax has several major advantages in implementation, since the overwhelming majority of foreign exchange transactions are carried out by a small number of money center financial institutions. If their computers could be programmed to deduct the new tax and forward it to a collecting agency, the cost of collection would be virtually zero. And the process of oversight would be fairly

simple: a team of a dozen experts, endowed with the proper authority, probably could do the job.

66. Another major proposal calls for a global environmental tax, such as a tax on carbon emissions or the carbon content of fuels. This tax would be more complicated to administer, since it would have to be levied on tens of thousands of fuel producers. But there is a very compelling case for such a tax as an environmental policy instrument, quite apart from its revenue-raising potential. As a revenue device, like the Tobin tax, it could generate very large sums with a relatively small percentage tax, given the very large volume of carbon-based fuels involved. A higher tax, that would substantially reduce the use of carbon-based fuels, might raise an even larger revenue stream, at least in the short run.

67. Many other proposals have been made for global revenue-raising, including fees for various uses of the "global commons" - use of the oceans and the atmosphere, parking of satellites in earth orbit, and commercial use of the airwaves. Taxes on international air and sea travel and on internet traffic, fines for environmental pollution like dumping in the oceans, and even an international lottery have been proposed as further approaches to global revenue-raising.

68. Political leaders, eminent personalities and economic experts have shown considerable enthusiasm for these ideas. Former President Mitterand of France even supported the proposal for a foreign exchange tax of the Tobin type at the UN Social Summit in March, 1995. There have been many major conferences and intergovernmental consultations on the subject. And there are even new grassroots groups in the United States and France lobbying for such policies. But there remain many barriers, including strong opposition from affected business interests (banks are firmly opposed to the Tobin tax, for example, and oil companies to the carbon tax). There is also hesitation on the part of governments to turn even a limited taxing authority over to a multilateral agency, thus ceding an important element of national sovereignty. But the hesitation on the part of governments is short-sighted. They would lose relatively little sovereignty, since state tax authorities would remain in control of the process, as in the EU. Also, the states might retain a substantial proportion of the revenues, easing their own revenue pressures.

69. Global tax advocates must overcome serious public suspicion that such taxes would be imposed and spent unaccountably. There is a need to insure democratic oversight and control over the tax mechanism and how the resulting revenues will be spent. Some reformers have a technocratic conception of the tax and would prefer a more-or-less automatic flow of funds. But if the tax idea is to succeed, it must have the confidence and support of ordinary citizens. For this, there must be more democratic and more responsible decision-making bodies at the global level.

70. The first global taxes will probably not be as ambitious as the Tobin or carbon tax proposals, with their billions of dollars of income, for they are vulnerable to opposition from exceptionally powerful vested interests. Instead, more modest proposals are likely to set the early precedents. The EU is moving forward with an air fuels tax, an idea that might possibly be extended to global application. But planning must go forward for the larger taxes and political backing for them must now be assembled. No solution to the crisis of development finance is more promising than this one.

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