Financing for development in Latin America and the Caribbean

Key messages of the Latin American and Caribbean regional consultation on Financing for Development

Esteban Pérez Caldentey
Chief
Financing for Development Unit
ECLAC
Domestic resource mobilization is at the core of financing the post-2015 development agenda but it is constrained by insufficient tax revenues, tax evasion and elusion, and illicit flows.

- Tax reforms made in the region in the past two decades, jointly with other factors, have increased the tax burden and shifted fiscal policy towards improving redistribution as well as fulfilling its role as a macroeconomic stabilizer.

- Between 1990 and 2013, the average tax burden in Latin America and the Caribbean rose from 14.3% to 21.3%, which has narrowed the gap with respect to the OECD average.

**Latin America and the Caribbean and OECD: tax burden, 1990 and 2013**

*(Percentages of GDP)*

Despite the progress made, domestic resource mobilization efforts have been curtailed by problems of tax evasion, avoidance and compliance.

- According to official data, the rate of VAT evasion is between 17.8% and 37% in Latin America and the Caribbean and between 10% and 22% in the OECD countries.
- ECLAC estimates show that the rate of income tax evasion is higher than for VAT and can even exceed 60%.

Rates of VAT evasion in Latin American (2008) and OECD (2006) countries (Percentages)
In addition the region’s governments are facing new challenges internationally including illicit flows and the practices of multinationals

- Illicit financial flows represent a huge transfer of financial resources out of developing economies, including those of Latin America and the Caribbean.
  
  ➢ In 2012 illicit flows were estimated to represent US$ 154 billion dollars for Latin America and the Caribbean.
  
  ➢ Illicit flows surpass FDI flows (US$ 129 billion) and represent twice the amount of remittances (US$ 63 billion) and fifteen times the amount of ODA (US$ 10 billion) received by the region.

- The tax practices of multinationals must also be subject to regulation
  
  ➢ This means regulating transfer pricing which a major source of tax avoidance, it also fosters pernicious fiscal competition and activities that produce negative externalities.

- As part of these efforts, tax havens and offshore financial centres must also be regulated and these should comply with international standards on commercial banking.
Within this context international cooperation in fiscal matters becomes a key issue to overcome the challenges facing domestic resource mobilization

- International and regional agreements should be the basis for common international tax rules and standards to improve tax transparency and prevent the erosion of tax bases.

  - Addressing the erosion of tax bases from a regional or multilateral perspective.
    - Preventing tax avoidance by large transnationals.
    - Preserving greater taxation rights in “source” countries where profits are made.
    - Limiting tax incentives.

- The Committee of Experts on International Cooperation in Tax Matters, a United Nations body, can therefore play a key role as a forum for agreements and consensus.

  - This can pave the way for the gradual coordination and harmonization of taxation and tax rules at the international level and in Latin America and the Caribbean.
In the Caribbean SIDS context the high levels of public debt have become a main stumbling block to the mobilization of domestic resources

- In the past three decades the public debt stock in the Caribbean has with few exceptions remained at very high levels
  - This is particularly the case of some of the smaller economies, namely the Member States of the Organization of Eastern Caribbean States (OECS).
  - In 2014, Caribbean countries public gross debt represented on average 79% of GDP.

- Highly indebted countries such as those in the Caribbean are exposed to higher risk premia, currency instability, financial fragility, and lower levels of investment and growth.

- Given the importance of the multilateral component in total debt (roughly 35% on average of the total), and the current conditions of Caribbean countries the international community must explore a debt forgiveness initiative for Caribbean countries.

- This initiative should be part of a broader framework for debt restructuring that takes into consideration the conditions of debtor countries including the need that the payment for the debt service should depend in part on contingent macroeconomic conditions.
Domestic resource mobilization should not be equated with fiscal resource mobilization and should also include the key role played by development banks in financing sustainable development

- Sub regional and national development banks have taken on a crucial role in the provision of credit to the production sector including to SMEs
  - In 2014 the share of sub regional development banks in total lending to Latin America and the Caribbean equals that of the Inter American Development Bank (IDB) (above 40% of the total) and surpasses that of the World Bank (less than 20% of the total).
  - The share of credit provided by national development banks exceed 20% of the total.

- Development banks are also can also foster financial inclusion through new and innovative practices and instruments, and innovations in financial processes.
  - Financial inclusion should be viewed as a policy of productive insertion as it widens the possibilities for consumption and savings and improves entrepreneurship and investment opportunities.
Financial inclusion should also guarantee equal access by gender to the formal financial system

- The evidence across different regions in the world show that men have greater access to the formal financial system than women.
  - In Latin America and the Caribbean 44% and 35% of males and females have an account at a formal financial institution.

**Account at a formal financial institution (% age 15+), 2011 (percentage)**

<table>
<thead>
<tr>
<th>Region</th>
<th>Female</th>
<th>Male</th>
<th>Female</th>
<th>Male</th>
</tr>
</thead>
<tbody>
<tr>
<td>Middle East &amp; North Africa</td>
<td>12.5</td>
<td>22.9</td>
<td>21.5</td>
<td>26.7</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>25.0</td>
<td>25.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Asia</td>
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<td>40.7</td>
<td>35.0</td>
<td>44.0</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>50.3</td>
<td>50.3</td>
<td>52.1</td>
<td>57.8</td>
</tr>
<tr>
<td>Europe &amp; Central Asia</td>
<td>52.1</td>
<td>52.1</td>
<td>57.8</td>
<td>57.8</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>88.9</td>
<td>92.3</td>
<td>57.8</td>
<td>57.8</td>
</tr>
<tr>
<td>High income: OECD</td>
<td>52.1</td>
<td>52.1</td>
<td>57.8</td>
<td>57.8</td>
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</tbody>
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Source: Own elaboration based on World Bank data
Given the growing role of private flows as a source of finance, a key challenge of a post-2015 financing for development architecture is how to enhance public-private partnerships.

- Mobilizing private resource for development effectively involves blending private and public resources, and creating public and private partnerships in order to achieve the leverage required to maximize the impact for development financing.

- Public-private partnerships (PPPs) pose potential benefits in terms of lower costs and higher quality.

  ➢ However, 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.
The new financing for development architecture must also mobilize and channel private resources towards development objectives

- This will require efficient and targeted government interventions to overcome some the issues posed by private flows as a source of development finance.

  - Private finance 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.

- The public sector is playing an increasingly important role in ensuring that social returns are included in the cost-benefit analysis.

  - It can provide public financing for sectors that generate significant social benefits but do not attract sufficient private flows.
  - Alternatively, the public sector 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.
Effective mobilization of resources not only requires greater access to tools and sources of development finance but also new models of cooperation based on equals such as South-to-South cooperation.

- South-to-South cooperation has the potential to become a key pillar of sustainable development.
  - It provides a new model of cooperation based on equals.
  - It overcomes the long-standing vertical relationship between donor and recipient typical of traditional forms of cooperation.

- While traditional forms of cooperation place great significance 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 growth in production that will enable them to avoid becoming mired in the “middle-income trap”.
National resource mobilization strategies must be placed within the broader context of an enabling external environment which addresses the asymmetries in the international financial architecture.

- The international financial architecture has to reflect the shift in global economic and political power towards developing countries and, towards middle-income countries.
  - Emerging markets’ and developing countries’ weight in global GDP equals that of 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.

- The international financial system must also deliver stability as a global public good.

- To this end the current the multilateral elite (G20, G7, etc.) governance must evolve towards a representative entity within a Global Economic Coordination Council.
  - The Global Economic Coordination Council (GECC) would meet at the heads-of-state level and would enjoy the formal support of a subset of existing UN system entities.
  - The GECC should also include regional financial institutions such as regional reserve funds. These can and must play an important role in complementing international financial institutions as they are an integral part of a wider set of financial instruments and support mechanisms.
An enabling external environment must also close trade asymmetries: including the inconsistency between the importance of developing economies and their share in world trade and opportunities for market access and knowledge acquisition.

- One of the main challenges facing middle-income countries, is the need to increase their share in world trade, commensurately with their importance in the world economy, diversify their exports and increase their technology content.

  - Emerging and developing economies produce half of the world’s GDP, they account only for 40.6% of global exports.

- To meet this challenge, multilateral trade practices and agreements need to be made more flexible to take into account the specificities of middle-income countries.

- Export diversification and trade liberalization must be applied on the basis of flexible trade rules, including on adequate financing and an appropriate time frame for implementing the necessary adjustments and domestic economy restructuring.

  - The global trade system should seek fairness in its rules and mechanisms and promote market access by all participants, especially developing countries, which as things stand often face discriminatory measures.