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The Fourth International Conference on Financing for Development: Exploring Priorities for the Latin American and Caribbean Region

ETTG Policy Brief 9/2024

This Policy Brief reflects ongoing ETTG work on FfD4 preparations in the framework of a partnership with the Agence Française de Développement (AFD).

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KEY MESSAGES

1. Many Latin American and Caribbean (LAC) countries face slow economic growth and fiscal deficits that lead to situations of development distress. In addressing the difficulties associated with mobilising more domestic revenues, it is also important for these countries to rationalise their tax expenditures and explore potential additional sources of revenue. International cooperation is needed both to support these national processes and to unlock international tax sources, by engaging with proposals on the table concerning, for instance, the Subject-to-Tax Rule and financial information exchange initiatives.

2. In order to optimise international sources of financial flows, it is key to link development finance conversations and processes with those related to climate finance, as the LAC region is particularly vulnerable to climate shocks. Beyond mitigation efforts, additional work is needed for adaptation and resilience, as well as for the mobilisation and alignment of climate-related investment, through the necessary availability of consistent data on sustainability-related risks and opportunities. Efforts should acknowledge the relevant differences within the region (including the particularities of the Caribbean situation of climate vulnerability) and engage with existing proposals.

KEY MESSAGES (CONTINUED)

3. Updating the governance models and capabilities of multilateral development banks (MDBs), with a particular emphasis on ensuring access to concessional finance, can contribute to strengthening their unique ability to mobilise private capital for development in the region. This can be done by building upon MDBs' improved coordination (as reflected in the work of the Heads of MDBs Group) and capitalising on existing dialogue spaces (such as the Finance in Common Summit).

4. All of the above implies reconsidering certain rules (such as those related to international borrowing conditions), thinking transversally about development and climate efforts and finance, and addressing the regional dimension of development challenges together with the specificities of sub-regions and countries. In order to support these processes, the EU needs to openly engage with politically delicate considerations, such as potentially conflicting interests in certain topics, or the balance between maintaining its values and standards without incurring double standards. The EU could focus its cooperation with the LAC region in the areas where it can add value through its unique convening power and an adequate use of its dedicated tools, like Global Gateway.

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INTRODUCTION

The upcoming Fourth International Conference on Financing for Development (FfD4) in Seville comes at a time of a deepening global financing gap to achieve the global development ambitions as reflected in the 2030 Agenda for Sustainable Development and the Paris Agreement on climate change. This Conference provides a unique window of opportunity to revamp and mobilise much-needed development and climate finance, and identify key accompanying policy measures. Yet it should also be acknowledged that this finance is currently provided within an international financial architecture that was designed in a different global context and is arguably no longer fit for purpose, and in a moment of ongoing geopolitical fragmentation and increasing disparities between the North and the South. The associated challenges require both technical and political solutions.

This policy brief was prepared in the context of a broader European Think Tanks Group (ETTG) project that seeks to identify common positions on the financing for development agenda within Europe, Africa, Asia and Latin America and the Caribbean. In the project, online consultations were organised with think tanks and other experts and institutions and, where relevant, to integrate these regions' priorities into the elaboration of a common European position in a way that contributes to strengthened European partnerships with the South.

This policy brief presents priorities, concerns and expectations of Latin American and Caribbean countries vis-à-vis the Conference, in order to inform a coherent, aligned and feasible European position with innovative as well as concrete proposals.

LEVERAGING DOMESTIC RESOURCES

Many Latin American and Caribbean countries are experiencing slow economic growth, characterised by fiscal deficits. This situation is partly driven by declining capital flows into their economies, limited investments due to high financing costs and interest payments, and restrained fiscal space, which is partly due to high debt servicing obligations. Domestic resource mobilisation is relatively low owing in part to narrow tax bases, significant informal economy and tax evasion. This affects productivity levels and helps explain why many LAC countries find themselves in a situation of development distress (ECLAC, 2024), whereby they have very limited resources to be invested in economic and social development. Experts consulted agreed that without systematically addressing this situation of limited fiscal space, LAC countries will not be able to finance their development agendas.

The issues associated with effective, sustainable and transparent fiscal reforms towards increased – and progressive – tax collection are well known, and include the high level of informality, administrative and capacity

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limitations, but also, and importantly, strong political opposition on the part of influential segments of society. Beyond working to untangle these political blockages to foster fundamental reforms, more targeted technical efforts could be invested in **rationalising tax expenditures** in LAC countries, by evaluating and potentially reassessing current tax incentives (such as tax exemptions or certain subsidies) in conjunction with potential new green tax incentives, as well as reconsidering uncollected taxes and their associated costs and benefits. This could capitalise on ongoing analysis efforts (Laudage et al., n.d.) and regional coordination mechanisms such as the Regional Tax Cooperation Platform for Latin America and the Caribbean, recently created as a space for dialogue and exchange of related experiences. These augmented domestic resources for development could furthermore be complemented by exploring additional sources related to the energy transition and facilitating international cooperation to support developing economies' national efforts to improve their tax administration capacities.

The LAC countries also face significant capital leakages in the form of illicit financial flows (IFFs), which are facilitated by issues related to bank secrecy and lack of transparency at a global level (BRICS Policy Center and Chinese Academy of Social Sciences, 2024). Additionally, the current international taxation system fails to tackle issues such as cross-border profit shifting, tax competition and capital flight in response to domestic wealth tax attempts. New measures aimed at penalising fiscal incentives, such as higher taxes to multinational corporations, carry their own risks, such as the possible disincentivising effects for foreign investment (Garcimartín, 2024).

The continuation of **global tax conversations** – that is, those related to international tax sources, beyond national tax collection – is still identified as key to mitigating countries' reliance on debt and promoting income distribution. A key point of discussion in this context is the global wealth tax debate. It is important to engage with the different proposals on the table and focus on identifying their merits and potential areas for agreement as starting points. For instance, the UN proposal for a **Subject-to-Tax-Rule** with a wider application scope than that of the OECD is backed by a large share of Global South countries, including Brazil which currently holds the G20 Presidency. The UN proposal includes a pollution contribution component in its tax measurements, and it does not require agreeing on a whole new governance structure but rather allows for incorporation into countries' bilateral treaties. While it might prove difficult for all countries to agree on a comprehensive set of international fiscal measures over the next few months, joint work could already focus, for instance, on improving the exchange of financial information to generate more accurate data on assets and their environmental impact, and to avoid the proliferation of tax havens.

In terms of addressing debt issues, it is urgent to focus on debt prevention measures, such as ensuring countries' access to concessional finance and to local currency borrowing (more on this below). Importantly, debt-related actions need to be forward-looking in order to avoid temporary responses that compromise future debt sustainability. **Debt sustainability models ought to include climate-related factors** to help build resilience through productive investment, since otherwise climate-vulnerable countries will keep further indebting themselves in response to every new climate shock.

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OPTIMISING EXTERNAL FINANCIAL FLOWS

Experts identified climate finance among the most urgent issues that should mobilise most political and technical capital in the context of FfD4. These are vital years for LAC countries' climate finance needs, in light of the upcoming COP16 on biodiversity to be held in Colombia in October/ November 2024, Brazil's G20 Presidency and Brazil's hosting of the COP30 on climate change in 2025. New funds and multilateral initiatives to close the climate financing gap will be discussed in these spaces, and the FfD4 process needs to refer to, and support these endeavours. **Development and climate finance are still debated separately in spite of being systemically linked**, both in terms of problems (climate shocks are projected to continue compromising GDP growth levels in the region exponentially) and need for solutions (one cannot be addressed without the other). Additionally, the LAC region would benefit from closer regional cooperation, both to jointly finance regional public goods and to present their (converging and diverging) needs and realities through a more coordinated voice in multilateral fora.

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The significant natural resources of the LAC region could be leveraged to foster a green and just economic transition. Yet, LAC countries' climate-related spending remains insufficient (under 1% of GDP in most countries) in spite of their high climate vulnerability (OECD, 2024), while the capital costs related to renewable energy sources for the green transition and on biodiversity conservation act as a key barrier. Policies are needed to **incentivise these investments** in a way that serves LAC countries' sustainable development agendas, by emphasising the global benefits – financial and otherwise – of doing so, and by going beyond mitigation measures by including support to building **adaptation and resilience**. This requires addressing the lack of consistency, interoperability and comprehensiveness across fragmented climate expenditure and alignment measurement methodologies (ECLAC, 2024). **Transparent and consistent data related to sustainability-related risks and opportunities** needs to be available to both financial and non-financial actors, through a revision of data governance based on common principles and strategies (G20, 2023).

The differences within the LAC region also matter. Small Caribbean islands are particularly affected by climate shocks that impact their entire economies, and are usually insufficiently prepared to face them. This exacerbates the need to **study and capitalise on existing concrete proposals for climate-resilient financing**, such as those reflected in the Bridgetown Initiative, which in turn relates to the reform of the international financial architecture (more on this below) and to the avoidance of perpetuating patterns of borrowing and indebtedness. Other proposals are also on the table concerning liquidity provision mechanisms for the increased resilience of emerging and developing economies against shocks (CLAAF, 2023).

In this context, experts agreed on the still critical role to be played by **MDBs** in addressing the financing gap for development and climate efforts, due to i) their **unique ability to mobilise private capital especially in emerging and developing economies** – many of which are in LAC – due to their different **risk appetite** that can contribute to de-risking private investment including private climate financing, and ii) the types of products they can offer (**bundled operations** such as the combination of financing with technical assistance and capacity building), among other factors (Artecona et al., 2019).

However, current inefficiencies, a sometimes insufficient or inadequate capitalisation and the accentuated global questioning of multilateralism require **updating MDBs' capacities, models and governance**. Financing needs to be i) available, for which MDBs need to be recapitalised, ii) more accessible and responsive to crises, for which bureaucratic barriers to borrowing ought to be tackled, including for SMEs' access to finance, and iii) affordable – i.e., with more **concessionality** and lower interest rates, including to middle-income countries that have technically 'graduated' from receiving development assistance (and complement this with innovative financial instruments for when financing cannot be concessional, such as debt swaps).

Improved coordination among MDBs at the global, regional and national levels (and with other actors such as the IMF) is considered necessary to realise their joint financing for development potential. **Global South financial institutions** are exchanging in more spaces than before, such as the Finance in Common Summit of Public Development Banks, and bringing in new perspectives that were not necessarily present during the last FfD conference in Addis Ababa in 2015, or at least not in such an articulated manner. The viewpoint note (IDB, 2024) produced by the Heads of MDBs group under the leadership of the IDB earlier this year includes 16 **actionable items** for MDBs to work as a system, that already result from a consensus among all its members (from all regions) which is to a great extent also reflected in the G20 dedicated roadmap (G20, 2023). Several of these actions are already underway – like the creation of country platforms – and can provide valuable lessons learnt in the lead-up to FfD4. The success of related conversations during FfD4 partly relies on the ability to **establish dialogue and complementarities** between these visions and those of more traditional development actors, like the **OECD-DAC**.

All of this relates to the overall reform of MDBs (and their shareholding structures and governance to make them more representative of countries' needs and climate emergency contributions), and more broadly to the reform of an international financial architecture that was conceived in an entirely different world context (Wainaina, 2024; BRICS Policy Center and Chinese Academy of Social Sciences, 2024). Although the realisation of this will likely sit well beyond Spain 2025, experts shared that Global South countries expect to **engage in at least some aspects of this reform conversation** now to show political will. A **frank and realistic account of the different goals** of different countries/country groups, including the initial founders of MDBs whose nature and priorities have changed substantially since, could help push these conversations.

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CONCLUSION: OPPORTUNITIES FOR EU-LAC COOPERATION

THE LAC REGION'S FINANCING NEEDS DISCUSSED ABOVE CAN ONLY BE EFFECTIVELY ADDRESSED THROUGH A MULTI-FACETED RESPONSE. Such a response requires readdressing certain prevailing rules, such as those related to international borrowing conditions. It also means engaging with different proposals on the table (even if provocative), considering the regional dimension of many development and vulnerability challenges while accounting for differences among sub-regions and countries, and thinking in transversal terms about development and climate finance jointly.

IN CONSIDERING ITS RESPONSE AND COOPERATION AGENDA WITH THE LAC REGION, THE EU FACES CERTAIN POLITICALLY DELICATE CONSIDERATIONS, such as the balance between being coherent with its green standards and values in its international action, and defending a fair transition that avoids imposing those standards at the expense of Southern countries. The EU-LAC bi-regional dialogue ought to frankly and constructively deal with sometimes diverging or conflicting interests in certain topics of the financing for development agenda, as well as to more effectively coordinate and optimise efforts on complementary processes and exchange spaces, such as FfD4, the COPs, G20 and the Pact for the Future conversations.

THE EU'S COOPERATION EFFORTS COULD FOCUS ON SUPPORTING THE PROCESSES WHERE IT CAN ADD VALUE TO LAC COUNTRIES' EFFORTS AND PROPOSALS. This requires a realistic account of i) possible contributions by an internally diverse and increasingly polarised EU, ii) strengthened coordination in areas of synergy between LAC and the broader Global South, outside the traditional Northern-led spaces, and iii) the fact that many topics on the FfD4 agenda fall under national jurisdiction, which sometimes constrains the scope for concrete proposals (this applies for both LAC partners and EU countries themselves). Using its convening power, the EU can contribute to FfD4 constituting a significant political and technical push for conversations that are covered by the FfD4 process but have to be concretised and decided in other fora (such as those related to the G20 MDB reform agenda or international tax cooperation).

THE EU CAN MAKE AN EFFECTIVE AND TRANSPARENT USE OF ITS TOOLS TO MOBILISE FINANCING FOR DEVELOPMENT IN THE LAC REGION WHILE STRENGTHENING A CREDIBLE BI-REGIONAL PARTNERSHIP. This includes constructively and jointly addressing the recent plans to reduce EU ODA to the LAC region in light of the decision to reallocate funding to Ukraine and migration-related programmes, as ODA remains a very relevant source of financing for many LAC countries due to its concessional nature. Secondly, the EU and LAC can promote joint ownership for a functional EU LAC Global Gateway Investment Agenda, where the space to innovate and attract investments is greater than in other regions from the Global South, given the LAC market's maturity. Formulating and realising this shared agenda necessitates further strengthening of innovative financing instruments and incentivising the alignment of commercial financing approaches with sustainable development goals.

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