



European  
Commission

## COMMUNICATION

FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT,  
THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL  
COMMITTEE AND THE COMMITTEE OF THE REGIONS

# Beyond 2015: towards a comprehensive and integrated approach to financing poverty eradication and sustainable development

Recommendations based on the 2013 EU Accountability Report on Financing for Development.

16.07.2013





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COM(2013)531



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## Beyond 2015: towards a comprehensive and integrated approach to financing poverty eradication and sustainable development

### *Introduction*

In the next two years, all partners should prioritise decisive action to accelerate progress towards the Millennium Development Goals. To that end, as we approach the UN special event on MDGs in September 2013, the EU and its Member States need to step up their efforts to meet current commitments, including increased and more effective financing to support developing countries, as outlined in the Commission Communication “An Agenda for Change”<sup>1</sup>. The actions of the EU and its Member States (hereafter referred to as “the EU”) are analysed in the annexed 2013 EU Accountability Report.

In parallel, the global conversation on the wider agenda beyond 2015 has started through various processes. The Commission Communication “A Decent life for all: Ending poverty and giving the world a sustainable future”<sup>2</sup>, endorsed by the Council<sup>3</sup>, focussed on the “what”, outlining a vision for post 2015 that addresses poverty reduction and sustainable development in an overarching framework. The Communication on the 2015 International Climate Change Agreement<sup>4</sup> raises a number of important issues related to climate finance beyond 2020. Following the Communication “Improving EU support to developing countries in mobilising Financing for Development”<sup>5</sup> and the subsequent Council Conclusions<sup>6</sup>, both include taking a comprehensive approach to all financing sources and an integrated approach to the various processes addressing the same sources.

The present Communication focuses on the financing part of the “how” of the post 2015 framework. It sets out to develop a common EU approach to financing issues in the international discussions – how a global approach could be structured, what resources are available and could be mobilised, which processes can lead there and what principles should guide the work. At this stage, the EU should remain open to dialogue with partners, and the Communication does not propose new actions or commitments for the EU. These could be taken later in the context of a global agreement on a spectrum of commitments that reflects the changing needs and capabilities of various international partners beyond 2015.

The Communication emphasises financing for developing countries, but the proposed approach can be considered universally applicable. The central tenet holds for all countries – the range of financing sources is the same for all policy goals and needs to be used in a way that brings best results.

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<sup>1</sup> COM(2011) 637

<sup>2</sup> COM(2013) 92

<sup>3</sup> 11559/13

<sup>4</sup> COM(2013) 167

<sup>5</sup> COM(2012) 366

<sup>6</sup> 14533/12

# 1. A CHANGING GLOBAL LANDSCAPE FOR FINANCE

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Over the last decade the world has undergone considerable changes, especially in the distribution of global wealth, countries' ability to influence global trends and in the increasing role of emerging donors, changing the understanding of development finance.

Several international processes consider financing issues. The report of the UN High Level Panel on post 2015 and the UN Open Working Group on Sustainable Development Goals include elements on financing and other means of implementation; the UN committee to come up with options for a sustainable development financing strategy is starting work and the UN General Assembly is holding consultations to possibly strengthen the Financing for Development process. In addition, the UN Framework Convention on Climate Change works on the mobilisation and effective use of climate finance for post 2020 and the Convention on Biological Diversity is operationalising its resource mobilisation strategy. These and other processes consider the same resources for achieving a range of policy goals, which may lead to overlapping commitments. Instead, investments towards such goals, based on existing and future commitments, should work seamlessly together and create synergies, both at national and international level. Therefore various processes covering financing should be coherent with the commonly agreed set of principles and be integrated with each other so as to maximize their utility for achieving multiple global policy objectives.

Current discussions present an opportunity to revamp the Monterrey Consensus to create an approach to financing which matters where most resources are used – at the national level. The 2002 Monterrey Consensus and the 2008 Doha Declaration on Financing for Development put on paper a common sense principle that still holds: the key to progress lies in the national action of each country, putting all available resources to good use. This comprehensive approach to financing should be at the centre of financing discussions and further operationalised.

Resources can come from two sources: public and private, both at the domestic and international level. Public domestic finance includes taxes and other government revenues, including from natural resources. Public international finance can take the form of grants, equity or loans. Private domestic finance includes investments by local enterprises and charities. Private international finance comprises international investments, private transfers such as remittances and donations. New and innovative sources like a Financial Transaction Tax, receipts from carbon trading or bunker fuel taxes would also fall into one of the above categories.

These are the categories of resources that each country can invest in all national and internationally agreed goals, albeit using different instruments for different primary purposes. They should form the basis of a financing approach. Public resources are directly at hand and can be put to use by governments. Private finance is fundamentally different in that it follows private interests and needs to be harnessed to support policy goals. Public policy makers should seek to increase the financing available and ensure that resources are effectively targeted towards the agreed goals. To this end, all the sources should be seen together as a mix of means available for delivering results.

## 2. WHERE'S THE MONEY? FOCUSING WHERE IT MATTERS FROM A DEVELOPING COUNTRY PERSPECTIVE

In developing countries, an estimated EUR 7,129 billion<sup>7</sup> of public and private finance was available in 2010, with a potential to contribute to poverty eradication and sustainable development.

Table 1: Finance available to developing countries (billion EUR, 2010)

<b>Public Domestic Finance</b>
<b>Total: 3,317</b>
<b>Tax revenue: 3,252</b>
<i>Potential of removing harmful fossil fuel subsidies: 309</i>
<b>Public External Borrowing: 65</b>
<b>Memo items</b>
Total Reserves, incl. gold: 4,074
<i>Illicit financial outflows: 649 (estimated 120 lost in tax revenues) including from corruption, criminal activities, and tax evasion &amp; avoidance.</i>
<b>Public International Finance</b>
<b>Total spent: 158</b>
<b>Official Development Assistance (ODA) Grants: 92, of which EU 39</b>
<b>Concessional Loans: 7, of which EU 3</b>
<b>Other official development finance: 54, of which EU -4</b>
<b>UN-sanctioned international security operations: 5 of which EU 2</b>
<b>Private Finance – domestic and international</b>
<b>Total: 3,652</b>
<b>Domestic Private Investment: 2,678</b>
<b>International Investments: 624</b>
Foreign Direct Investment: 443
Foreign Portfolio investment 181
<b>Private External Borrowing: 70</b>
<b>Remittances: 238</b>
Potential from reducing the transfer costs to 5%: 12 per year.
<b>Private Philanthropy: 42</b>

<sup>7</sup> All sources of the figures in this Communication are listed in the accompanying Staff Working Document.

The data confirm that domestic public resources exceed international public finance (by a factor of 20), itself only 2% of the total finance available in developing countries. Private finance is on par with public finance. At the same time, there are fundamental differences between countries in the composition of financing sources, as shown by the different situations of the Low Income Countries (LICs) and Middle Income Countries (MICs).

Figure 1

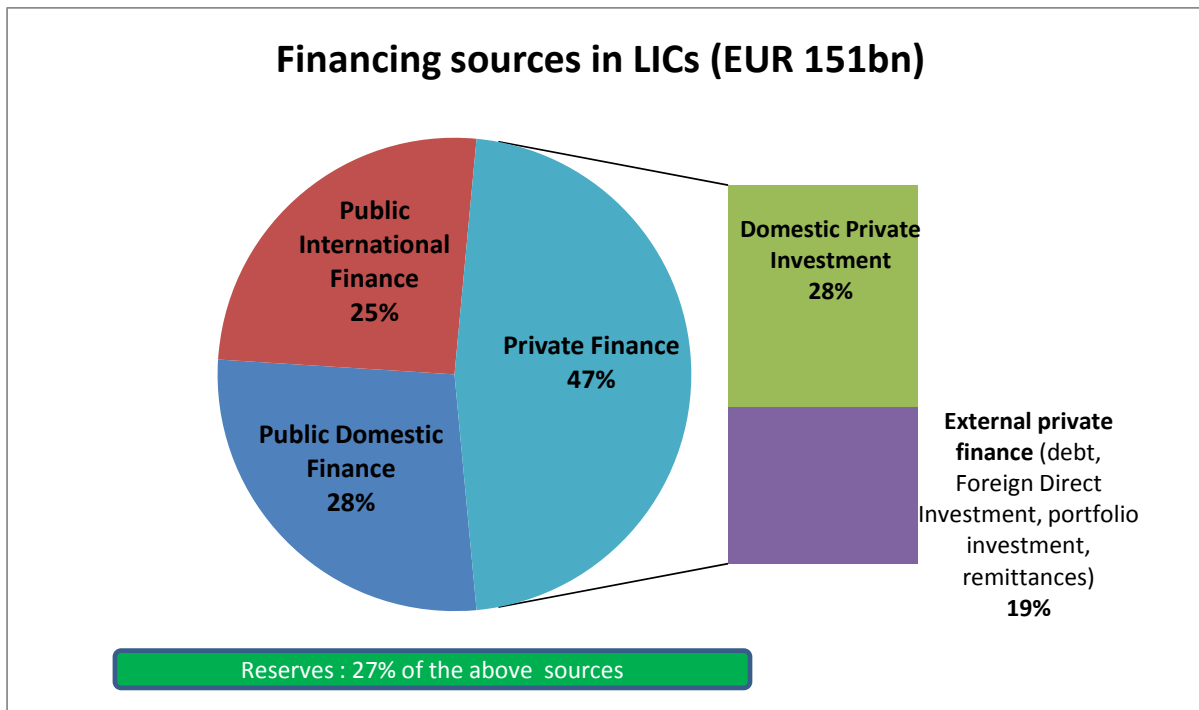
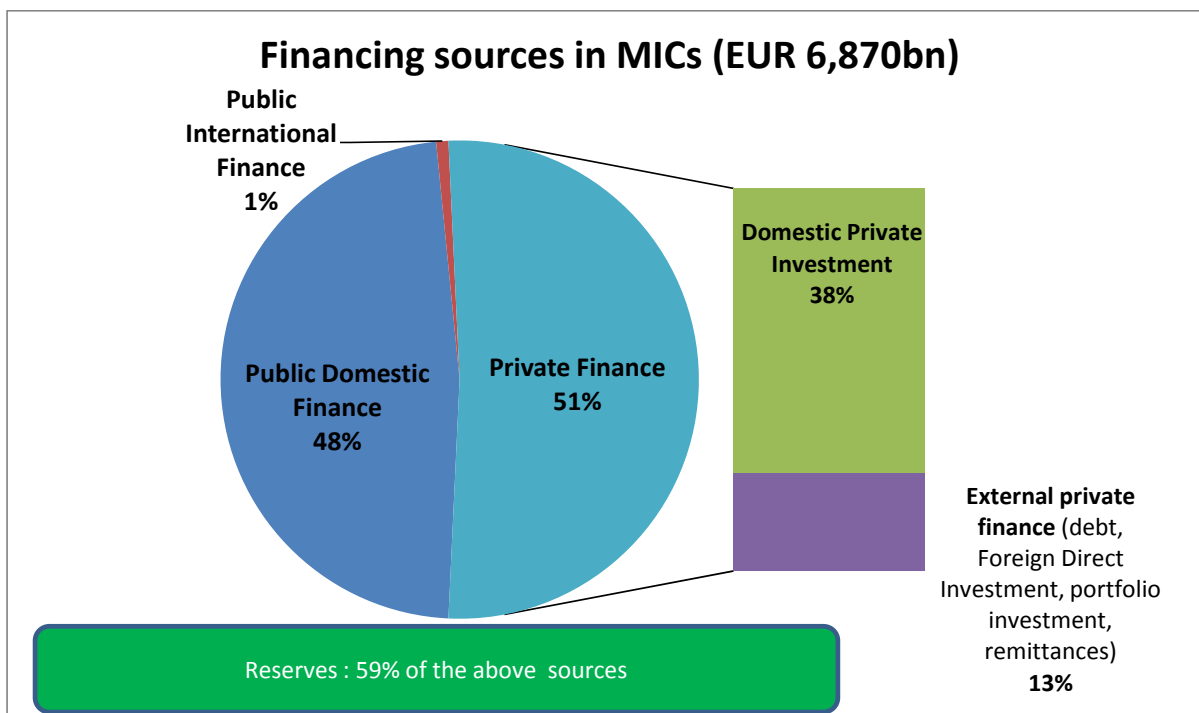


Figure 2





## 2.1 Domestic public finance – the biggest and best source for governments

Domestic public finance (EUR 3,317bn) is the main source of financing directly available to governments for spending on policy goals and is thus the most important element in a financing approach. Beyond providing the fiscal space for spending on priorities, it should also strengthen domestic accountability and contribute to a sound government-citizen relationship. Most countries could significantly increase their domestic spending on priorities, including by increased tax revenues, fighting illicit flows and removing harmful fossil fuel subsidies.

### 2.1.1 Domestic resource mobilisation

The tax take of developing countries varies, accounting on average for 13% of GDP in LICs and 22% of GDP in MICs. UNDP has suggested that an MDG-consistent government revenue share may be over 20% of GDP, showing that most MICs should be able to reach these goals solely using domestic public resources. Furthermore, according to the IMF, raising government revenues by about 3% of GDP would be feasible relatively quickly, even without considering the potential of increased natural resource revenues and new green taxes. This shows that ending dependency on aid is, in a longer-term perspective, also possible in LICs.

Estimated at €649bn, illicit flows like proceeds of crime, tax evasion and corruption, are an important drain on public finances for many countries. Loss of tax revenue is only one part of the negative impact of such flows, as they also discourage legitimate investments and undermine the wider social contract. Countries should curb illicit flows by regulatory and enforcement measures.

### 2.1.2 Sustainable borrowing and lending

Borrowing allows countries to frontload investments and maintain stable public expenditure in face of revenue volatility. The overall indebtedness of developing countries has come down over the years, but many are still at risk or lack access to financial markets and rely on official lending. Private lenders and non-Paris Club official lenders have become more prominent creditors to developing countries. This underlines the need for all actors to apply responsible lending and borrowing principles to ensure debt sustainability.

Most of the EUR 4,074bn of developing countries' international reserves are held by a few MICs, while the buffers of poorer countries are generally low. Precautionary reserves are a part of a country's defence against shocks and could be complemented by insurance-based instruments, while a sound macroeconomic and prudential policy framework is key in limiting vulnerabilities.

### 2.1.3 Spending the available domestic public finance well

Using the available money right is at least as important as increasing the resources. Countries should follow good public finance management rules and ensure maximum value-added of available money. Investments that matter most for reaching set goals should be prioritised and spending on one policy goal should also support progress on other goals.

### 2.1.4 Key actions to increase the domestic resources invested towards globally agreed policy goals

Each country should at national level:

- Reform tax systems, strengthen tax administrations and implement legislation that reduces corruption. This includes increasing transparency, accountability and sustainability in the management of natural resources and tackling tax evasion and avoidance.

- Implement policies that ensure the money is well spent, including innovative partnerships, leveraging private funds and eliminating harmful fossil fuel subsidies.
- Follow responsible sovereign borrowing and lending principles and build resilience.

To support national efforts all countries and international actors together should:

- Require transparency of the financial sector and multinational enterprises in key sectors, including the Extractive Industries Transparency Initiative and other initiatives supporting the sustainable use of natural resources, through rules on illicit flows, country-by-country reporting, increased fiscal transparency and exchange of information. The EU is leading the global action on these issues, but progress depends also on other actors signing up to these principles.
- Implement anti-corruption rules like the UN Convention against Corruption.
- Strengthen the international financial architecture for debt sustainability and absorbing shocks.

## 2.2 International public finance – still important for some

ODA remains a major source of finance for the 36 LICs which are also more affected by global challenges; it accounts for 12% of their GDP, already below LICs' domestic revenues. At the same time public international finance (158bn) is of marginal importance for developing countries as a whole (0.7% of GDP). In the 108 MICs, ODA represents on average only 0.2% of GDP, confirming that aid should be focussed on the countries that need it most.

### *Increasing finance and monitoring what matters*

External public finance for developing countries is a result of domestic budgetary decisions of each donor. The EU collectively provides more aid than all other developed countries combined, has fulfilled its Aid for Trade commitments since 2008, has delivered on the Fast Start Climate Finance commitments and is increasing biodiversity finance in line with the Nagoya and Hyderabad decisions. While the EU collective ODA slightly decreased in 2012, the EU Heads of State and Government reconfirmed their commitment to reach 0.7% of GNI by 2015 despite the difficult economic situation. Emerging economies and countries that have reached upper MIC status should provide their fair share of international public finance, in line with the financial resources they command.

The ODA concept is increasingly criticised for being too broad or for neither covering all development cooperation providers nor all relevant actions. Reforming ODA and better monitoring of the funding for different policy objectives are needed, including improved policy indicators (e.g. Rio-markers) showing the ODA volumes that support specific policy objectives. A solid basis for capturing all finance that benefits developing countries should be elaborated, so that all actors could be held to account using the same measuring stick. The DAC work on reforming ODA is an important contribution to this end. Monitoring of international finance should be part of a comprehensive monitoring mechanism that also covers domestic and private finance.

### 2.2.1 Spending the available external finance well

As with domestic resources, using the money well means both *doing the right things* and *doing things right*: money should be focussed where it is most needed, and used in innovative and effective ways to ensure that it serves several policy goals simultaneously, e.g. by mainstreaming specific policy objectives.

Innovative modalities of delivering finance can increase effectiveness and should be scaled up. Blending of grants with loans and equity, as well as guarantee and risk-sharing mechanisms can catalyse private and public investments, and the EU is actively pursuing this. More widely, as developed by the Leading Group on Innovative Financing for Development, innovative financing can have significant revenue generation

potential and ensure more stable and predictable financing. Some innovative financing mechanisms like the Clean Development Mechanism are designed to focus on delivering on a specific policy goal, but such investments should also take into account the broader context and contribute to other goals.

For *doing things right*, the international community has taken clear commitments through the Busan Partnership for Effective Development Cooperation to make actions more effective, based on democratic ownership by developing countries and a shared understanding of the need to provide global public goods. This can be undermined by multilateral processes that seek to earmark funding for specific policy areas while developing countries need to direct it to where it can *do the right things* to achieve national targets related to global goals.

### 2.2.2 Key actions to increase international public resources invested in global goals

Each country should take ownership and demand that all external finance follows their national development plans which integrate agreed goals, in line with the Busan principles.

All countries and international actors should agree to:

- Follow the principles and commitments of the Busan Partnership in providing international public finance.
- Contribute their fair share to the global effort based on a dynamic spectrum of commitments. The richest countries should contribute more than upper MICs and emerging economies, while the external support should focus on LICs. Cooperation with MICs, to benefit in particular lower MICs, should be focused on key catalytic actions.
- Reform ODA and monitor external public finance in the context of a comprehensive mutual accountability mechanism.
- Use financing modalities that fit country needs, respecting long-term financial sustainability. Innovative mechanisms that leverage additional resources should be scaled up, as well as stronger capacity development and technical assistance.

## 2.3 Private finance –key driver of growth

Private finance is fundamentally different from public finance. It follows private interests and does not *per se* pursue public policy goals. At the same time, private investments (EUR 3,652bn) are the key drivers of growth and can contribute to such goals. Even a small shift in private investment priorities and modalities could bring about significant benefits to public policy goals. Such shift can be achieved primarily through domestic and international policy incentives, e.g. public-private partnerships.

The domestic and international private sectors are well integrated, react to the same incentives and are therefore considered together. Separation is only relevant for monitoring commitments.

### 2.3.1 Investment and trade; science, technology and innovation

Domestic investment dwarfs foreign investment and is the mainstay of economic development. Foreign direct investment, and to a lesser extent private external borrowing, complement this, also by bringing in know-how and technology. Investments with positive impact on public goals should be supported by a conducive policy environment and innovative mechanisms such as performance-based payments for ecosystem services, carbon credits or biodiversity offsets.

Trade is a major means to increase activity and productivity. To reap these benefits, countries should create an enabling environment that facilitates trade at international, regional and national level. Richer countries should provide preferential access and support to the poorest. The EU already provides generous

access to EU markets, including full tariff and quota free access for LDCs. Most developing country trade is already with other developing countries, and the potential of South-South trade liberalisation should be realised. At international level, the ability of LDCs to benefit from trade requires specific attention.

New technologies should be harnessed towards global goals through greater global integration. The feedback loop between technology adapted to developing country contexts and innovation can be further supported by encouraging greater investment in research, including through innovative mechanisms like advance market commitments.

### 2.3.2 Remittances

Remittances are a significant private flow and account for a large share of GDP in several developing countries. A reduction in the cost of transferring remittances to 5% in line with the G20 pledge<sup>8</sup> would bring significant benefits, including in the case of the more expensive South-South transfers. Both sending and receiving countries should adopt policies that create competitive and transparent market conditions, provide access to better financial services and encourage a more informed and productive use of remittances.

### 2.3.3 Private philanthropy

Private philanthropy shares many attributes of official assistance. It has been estimated at EUR 42bn in 2010 and may make an important contribution in specific communities and on specific issues. Due to its nature, private giving cannot mostly be taken into account in national development plans, yet its transparency, predictability and effectiveness should be increased.

### 2.3.4 Key actions to increase private resources invested in policy priorities

Each country should at national level:

- Create a business climate that supports policy goals in line with international commitments on decent work, fosters innovation and the development of domestic financial systems.
- Use public resources to invest in areas that leverage private investments towards policy priorities.

In addition, all countries and international actors together should agree to:

- Create an international policy environment of transparent and equitable rules, including on trade and financial markets.
- Use public finance to leverage private investments and support innovation, including through technologies.

Also, the private sector should agree to:

- Follow the principles of good corporate social and environmental responsibility, thereby contributing to moving to an inclusive green economy, including assessing the impact of investments on policy goals, following the arm's length principle in transfer pricing, providing transparency on their activities, and adhering to international CSR and investor guidelines.
- Private philanthropy to apply the Busan principles in providing assistance.

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<sup>8</sup> 5 December 2011 G20 Summit declaration point 77

## 3. TOWARDS A COMPREHENSIVE AND INTEGRATED APPROACH TO FINANCING

### 3.1 Principles

A global agenda with shared goals for post 2015 should motivate all actors to put their resources to good use. It should be complemented by a solid approach to financing that is universal in application, reflects the global developments and considers all resources at the disposal of different actors. Revamping and broadening the international Financing for Development agenda to fit tomorrow's world would serve this purpose best. While the process towards elaborating global goals has only started, key principles should guide the financing discussions:

- Financing should be seen in the context of policies. Good policies are the central pillar of implementation, because changing policies is more effective than spending money for compensating bad policies.
- All available resources should be considered comprehensively together, as they are parts of the same total. The three categories of financing – public domestic, public international and private – provide a structure to identify key actions at national and international level.
- A global approach to financing should leave resource prioritisation first and foremost to the country level. This is where decisions on the appropriate trade-offs between policy goals can be made most effectively, within a framework of internationally agreed commitments, goals and targets. The country level should be the focus for assessing the mix of policies, financing and instruments needed for reaching agreed goals, as this is where implementation takes place. All countries should commit to make best use of the resources available towards agreed policy goals.
- The same way as different policy goals need to be mutually reinforcing, the means for reaching these goals should work at country level as one package of linked sources and instruments, allowing to reach several policy objectives with the same money. Finance needs to support synergies between various universal goals. While respecting existing commitments, the principle should be mainstreaming of goals into national policies rather than setting aside finance at global level for a specific purpose, which creates fragmentation.
- External public finance should be rebalanced towards the countries most in need, while emerging economies and countries that have reached upper MIC status should contribute their fair share to that purpose.
- All finance should be monitored together in a harmonised manner to ensure transparency and mutual accountability both at national and global level, aiming to make its use towards multiple global and national sustainable development goals more effective. Tracking of all financial flows should be improved, including their contribution to national and global goals and related finance targets, where such targets exist. National-level data availability and quality will be crucial for this, and statistical capabilities should be strengthened.

### 3.2 An overarching setting for international processes

Building on the Doha Declaration promise to take concerted global action on different challenges, the international financing discussions should be linked within an overarching setting. Therefore, the UN

expert committee mandated by the Rio+20 conference to propose options for a sustainable development financing strategy should be fully coherent with the financing for development process. Merging these strands, an international conference should be organised to develop a comprehensive and integrated approach to financing, building on the outcome of the Expert Committee and the processes preparing a post 2015 framework. As also suggested in the report by the UN High Level Panel on post 2015, this strengthened global process should set the overarching approach to financing, in particular for the post 2015 agenda. The principles set out above should also ensure coherence and coordination of specific financing streams and on-going negotiation processes (e.g. in the context of the 2015 Agreement on climate change). This will ensure that each country can target resources where they contribute best towards agreed common goals.

### 3.3 Next steps for the EU

This Communication aims at an EU common approach to the financing discussions in the post 2015 agenda, the Open Working Group on SDGs, the UN expert committee for proposing options for a sustainable development financing strategy and the review of the financing for development process. In addition, it should also frame the common EU positions on financing in the climate, biodiversity, chemicals and other international processes.

The approach outlined above is a contribution to the international discussions and the EU should use this for outreach to engage in discussions with partners.