THEMATIC REPORTS

Multilateral financial institutions: overhauling development finance

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Need for more development finance

There is a consensus on the need to drastically increase external financing for developing countries in order to achieve acceptable growth and make a dent in poverty. According to an UNCTAD[2] estimate for sub-Saharan Africa, this requires doubling the level of development finance. This estimate was confirmed subsequently by the Zedillo Commission[3] for developing countries as a whole. On various estimates meeting 2015 MDGs would require an additional amount ranging between USD 50 billion and USD 150 billion.

Where is this to come from? Private flows, multilateral lending or bilateral loans and grants? Of these, private flows are not a reliable source of finance for most developing countries. Multilateral financial institutions are increasingly marginalized as a source of development finance. Bilateral aid does not only fall short of what is required, but also its availability and allocation are driven by political considerations and its quality is dubious. There is therefore a need for a fundamental re-thinking. A genuine reform should not only be about new sources of development finance, but also for different mechanisms and modalities for their allocation. In particular aid should cease to be the central element of multilateral financing and the multilateral financial institutions need to be reformed drastically both in respect of their mandates and resources.

Private capital flows: unstable and unreliable

The postwar era has seen two boom-bust cycles in private capital flows to developing countries: the first beginning in the early 1970s and ending with the debt crisis in the 1980s, and the second beginning in the early 1990s and ending with a series of crises in Latin America, East Asia and elsewhere. The first boom was driven by the rapid expansion of international liquidity associated with oil surpluses and growing United States external deficits, and facilitated by financial deregulation in industrialized countries and rapid growth of Eurodollar markets. Excess liquidity was recycled in the form of syndicated bank credits, encouraged by the Bretton Woods Institutions fearing a collapse of global demand. However, with increased debt servicing difficulties brought about by the hike in United States interest rates and global recession, there was a sharp cutback in bank lending, forcing debtor countries to generate trade surpluses to service debt through cuts in imports and growth. The result was a debt crisis and a lost decade for many developing countries in Latin America and Africa.

The second boom came after almost ten years of suspension in private lending to developing countries. It was encouraged by the success of the Brady Plan for sovereign debt restructuring, liberalization, privatization and stabilization in developing countries, and rapid expansion of liquidity and cuts in interest rates in the United States and Japan in conditions of economic slowdown. Unlike the first boom, a large proportion of private inflows were in equity and portfolio investment, rather than international lending. In most cases these were driven by prospects of quick capital gains and short-term arbitrage opportunities. When they were reversed, many debtor countries were again faced with negative net transfers, and sharp declines in income and employment.

A third cycle started at the turn of the millennium with a swift recovery in private flows, driven by a combination of extremely favourable conditions including historically low interest rates, high levels of liquidity, strong commodity prices and buoyant international trade. Capital inflows in the current cycle have exceeded the peak observed in the previous boom of the 1990s, and most developing countries have shared in this recovery. However, the result is again increased financial fragility, as asset prices and exchange rates in many countries have been pushed beyond levels justified by economic fundamentals. Events in recent weeks suggest that with the combination of rising oil prices and interest rates, persistent and growing global trade imbalances, and increased volatility of the dollar this boom is now nearing its end. A number of emerging markets have started experiencing sharp declines in their stock markets and currencies. Once again countries dependent on external capital flows for balance of payments financing face the risk of tightened external financial conditions and collapse of growth.

Foreign direct investment (FDI) is often promoted as a more reliable source of development finance. Much of it in developing countries has been in the acquisition of existing assets rather than new (greenfield) investment to expand production capacity. Greenfield investment tends to lag rather than lead growth, often going to countries that do not have significant external financing gaps. Despite the rhetoric of the Bretton Woods Institutions that the recent upturn in FDI to poor countries reflects improving performance and better investment climate and growth prospects, evidence examined in a recent UNCTAD Report on Africa[4] shows that a chunk of this has been going for the exploitation of rich minerals and oil reserves in a handful of post-conflict countries or to countries with newly discovered oil and mineral resources.

Multilateral lending: burden or relief?

Multilateral financial institutions are increasingly becoming a burden, rather than a relief, for developing countries. In every year since 1991, net transfers (that is disbursements minus repayments minus interest payments) to developing countries from the International Bank for Reconstruction and Development (IBRD) have been negative. Since 2002 net disbursements have also become negative. In effect, taken as a whole, the IBRD is not making any contribution to development finance other than providing finance to service its outstanding claims. Much is the same for regional development banks. The problem here is that, for reasons related to conditionality and bureaucracy, countries which are eligible for IBRD loans are generally unwilling to borrow as long as they have access to private markets, even when this means paying higher rates. On the other hand, many poorer countries which need external financing are not eligible for IBRD loans.

The International Development Association (IDA) is the only source of net finance for developing countries from the World Bank. However, quite apart from the problems associated with the dependence of the Bank on a handful of donors for development financing, IDA disbursements are small, in the order of USD 4-5 billion a year, for

1 Former Director, Division on Globalization and Development Strategies, UNCTAD. Based on a presentation made in conference “New Financing Mechanisms for Africa’s Development”, IPALMO, Turin. 7 December 2005.

2 United Nations Conference on Trade and Development.

3 United Nations (2001). “Technical Report of the High-Level Panel on Financing for Development. Recommendations of the High-level Panel on Financing for Development”. Available from: <www.un.org/reports/financing/report_full.htm>.

4 UNCTAD (2005). *Economic Development in Africa. Rethinking the Role of Foreign Direct Investment.* Geneva, United Nations. Available from: <www.unctad.org/en/docs/gdsafrica20051_en.pdf>.

the entire IDA-eligible countries. Putting IDA and IBRD together, the contribution of the World Bank to the external financing of developing countries is negative by some USD 1.2 billion. Net flows to sub-Saharan Africa are also negative from IBRD. From the Bank as a whole they are positive but less than USD 2 billion, about 10% of what is needed. For a sample of poorest developing countries, financing provided by the World Bank is in the order of USD 3 billion compared to private grants of some USD 10 billion.[5]

Regarding the Fund, lending from Poverty Reduction and Growth Facility (PRGF) is a very small proportion of financing made available to developing countries. In the past several years the Fund support has focused on financial rescue operations in emerging markets, bailing out international creditors and lenders to crisis-stricken countries. At the end of 2004 outstanding PRGF credits were less than SDR 7,000 billion (USD 9,900 billion) or 10% of total outstanding IMF credits. In 2005 total PRGF lending approved was less than USD 500 million.

The IMF is also being marginalized in the provision of finance and liquidity to developing countries. All major emerging market economies, except Turkey, have now paid in and exited from IMF supervision, leaving only the poorest countries as its only regular clientele – barely a strong rationale for an institution established to secure international economic stability. This situation also poses the question of the IMF's financial viability. Poverty lending does not generate enough income to pay the staff and run the institution, and the IMF relies primarily on crisis-lending to emerging markets to generate some USD 800 million per annum to meet its administrative expenses. Ironically, financial viability of the IMF has come to depend on financial instability and crises in emerging markets.

Donor aid: problem or solution?

Donor aid made available either directly or through the multilateral financial institutions as concessional loans and grants is the only major source of official finance for development. Here the problem is not just about its adequacy. There is also a bigger political problem. Aid is primarily a post-colonial, cold-war instrument, and its availability and allocation are governed by political considerations rather than expediency, generally serving the interests of donors rather than recipients. As noted, a very large proportion of development financing provided by the Bretton Woods Institutions relies on aid rather than regular resources of these institutions. In contrast with the trading system where bilateralism is widely seen as a potential threat to the multilateral system, in finance it is taken for granted that bilateral and multilateral arrangements are complements. This approach also dominates debt initiatives such as the Heavily Indebted Poor Countries Initiative (HIPC) which combines multilateral debt with bilateral debt owed to donors in the Paris Club, enhancing the room for political influence.

The dependence of the Bretton Woods Institutions on the discretion of a small number of donors is a main source of shortcomings in their governance structures. The practice of combining IMF money with contributions from major countries in financial bailout operations in emerging markets has enhanced the room for political leverage in IMF lending decisions by its major shareholders. The establishment of IDA has played an important role in reducing the autonomy of the World Bank secretariat, increasing its dependence on donors and subverting its governance by enhancing the scope for political leverage. This dependence on donor contribution would be enhanced if IDA remains in the World Bank while an increased proportion of it is made available as grants – a step that needs to be taken since many of the IDA countries are already highly indebted and in need of a substantial debt write-off.

Reforming the reformers

Thus the first step should be to separate bilateral and multilateral arrangements for development finance and debt. Certainly, it is up to sovereign nations to enter into bilateral agreements on debt and financing, but these should be kept outside the multilateral system. This means taking the donor-driven facilities out of the Bretton Woods Institutions; that is, IDA from the World Bank and PRGF from the IMF. The amounts involved are quite small, but the impact on the governance of these institutions could be important.

The European Union has recently announced plans to create a trust fund to disburse European aid to Africa without depending on the World Bank, arguing that European aid money should be spent according to European policies but the EU does not have the influence it should in the World Bank. This demonstrates once again the predominance of political considerations in the provision of aid. It is thus a welcome initiative in so far as it helps separate bilateral from multilateral lending, but it should also accompany steps to make the World Bank an independent multilateral development finance institution.

Any serious reform of the global arrangements for provision of finance to developing countries should also include mandate, operational modalities and governance of the Bretton Woods Institutions. There is no justification for the IMF to be involved in development and poverty alleviation. The Fund should focus on the provision of short-term liquidity to countries experiencing temporary payments shortages, including poorer countries which are particularly vulnerable to trade shocks. It should revive the Compensatory Financing Facility as a concessionary facility. There should be greater automaticity in access to the Fund, and limits should be determined on the basis of need. The Fund should stay away from structural conditionality and focus on macroeconomics. It should not be allowed to be engaged in financial bail-out operations but develop orderly debt workout mechanisms and focus on crisis prevention by helping manage unsustainable capital inflows to developing countries and through effective surveillance over policies in industrial countries.

An appropriate source of funding for the provision of international liquidity by the Fund is the Special Drawing Rights (SDRs). The case for creating SDRs to provide funds for current account financing is much stronger than the case for using them to back up financial bail-out operations associated with a potential lender-of-last-resort function advocated by the Fund after the Asian crisis. Current arrangements would need to be changed to allow the SDR to replace quotas and General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB) as the source of funding for the IMF. The Fund should be allowed to issue SDR to itself up to a certain limit which should increase over time with growth in world trade. The SDR could become a universally accepted means of payments, held privately as well as by public institutions. Countries' access could be subject to predetermined limits which should also grow with world trade.

Several issues of detail would still need to be worked out, but once an agreement is reached to replace traditional sources of funding with the SDR, the IMF could in fact be translated into a technocratic institution of the kind advocated by Keynes during the Bretton Woods negotiations. Its funding would no longer be subjected to arduous and politically charged negotiations dominated by major industrial countries. Such a move would also be an

5 World Bank (2005). *Global Development Finance 2005: Mobilizing Finance and Managing Vulnerability.* Table 5.1, p. 90.

important prelude to a fundamental reform of the governance of the IMF, notably with respect to distribution of voting rights.

Many of the problems encountered in multilateral development finance and policy advice could also be addressed if the World Bank went back to its original operational modalities and concentrated on facilitating capital investment through project financing, rather than trying to fix all kinds of policy and institutional shortcomings in developing countries through structural adjustment and development policy loans. It should cease to be an aid institution and become a development bank, intermediating between international financial markets and developing countries. As originally envisaged, its financing should be provided in loans rather than grants, and made available only to countries which do not have access to private capital on reasonable terms.

While improving the functioning and governance of the Bretton Woods Institutions such arrangements would still leave the main problem unanswered: financing global public goods including concessional loans and grants to the poorest countries. Here the issue is twofold; institutional arrangements and resources. Considerations should be given to pooling and allocating aid through a development fund placed under the UN, run by a competent secretariat without day-to-day interference from its contributors, reporting to the General Assembly and audited regularly by an independent body. Such a course of action would be desirable not only because of increased involvement of the UN in development goals and social issues closely linked to world peace, but also because of its democratic nature.

Poverty reduction has been declared a global public good in several UN summits and conferences in recent years. There is thus a strong case for establishing global sources of finance. This could be achieved through agreements on international taxes, including a currency transactions tax (the so-called Tobin tax), environmental taxes and various other taxes such as those on arms trade, to be applied by all parties to the agreement on the transactions and activities concerned and pooled in the UN development fund. A common feature of these is that they are all sin taxes which would provide revenues while discouraging certain *global public bads* such as currency speculation, environmental damage or armed conflict and violence. While universal participation is highly desirable, such agreements do not always necessitate the participation of all countries. Certain sources of revenue, such as the Tobin tax, would need to be introduced globally in order to avoid arbitrage against countries adopting them, but others, including environment taxes, could be introduced on a regional or plurilateral basis.

Likewise, a fund established through international taxes could also be supplemented by voluntary contributions from governments, both in the North and the South, private foundations and wealthy individuals. Even existing IDA resources could become part of the endowment provided that the donors agree to hand them over to an independent secretariat. A relatively small endowment, reaching some USD 80 billion could generate more sources for grants to poorest countries than IDA and PRGF put together.

An advantage of such arrangements over present aid mechanisms is that once an agreement is reached, a certain degree of automaticity is introduced for the provision of development finance without going through politically charged and arduous negotiations for aid replenishments and national budgetary processes often driven by narrow interests. This is exactly what distinguishes IBRD financing which relies on once-and-for-all guarantees given by its shareholders from highly-politicised IDA.

Establishing a genuinely multilateral system of development finance is a complex issue that would require reflection, engagement and debate among all the parties concerned. In the end it is down to the political will and clout of the international community. But the first step should be to put the issue squarely on the global agenda. This has unfortunately not been the case despite proliferation of UN summits and conferences on development finance and poverty. ■

Exposing the myth and plugging the leaks

Sony Kapoor [1]

It is widely believed that rich countries are transferring substantial amounts of resources to poor ones. While many people, including the millions of people who were part of the Global Call for Action against Poverty (GCAP or White Band) mobilization last year, believe that rich countries are not doing enough, few ever question the truth of the assertion that rich countries are indeed helping poor ones. They should!

Every year, hundreds of billions of dollars, far in excess of aid inflows, flow out of poor countries to the rich. This money flows out in the form of debt repayments, private sector transfers and most significantly through the channels of trade and capital flight. These outflows undermine the mobilization of domestic resources, undercut local investment, weaken growth and destabilize countries by making them more dependent on inflows of unpredictable external resources.

Moreover, the inflows, in the form of aid, new borrowing and flows of private capital come with strings attached in the form of prescriptions and restrictions on the kinds of policies that developing countries can pursue. These limits on policy space undermine the exercise of democracy, challenge the implementation of domestically owned policies and emasculate efforts to reduce poverty and achieve sustainable development.

There is an urgent need to revaluate all the channels of the resource transfers between the rich and poor countries and take immediate steps to ensure an increase in inflows to the poor countries and a reduction of outflows from them.

This will significantly increase the availability of (especially domestic) resources and free up domestic policy space to implement policies targeted at eliminating poverty and achieving sustainable development.

Aid flows are insufficient and of poor quality. This can be addressed by making aid more predictable, untying it from policy restrictions and contracts with donor country companies and leveraging the proceeds of international taxes such as the airline ticket tax and currency transaction taxes to deliver the amounts needed.

As much as a quarter of the debt owed by poor countries is odious or illegitimate in origin having knowingly been lent to dictators or other illegitimate regimes such as the apartheid regime in South Africa. Much of this money was diverted and never made it to the country in whose name it was borrowed.

For all but three of the past twenty-three years, developing countries have paid out more money in the form of interest, repayments, penalties and fines on old debt than they have received in the form of new loans. Despite the fact that almost all poor countries have repaid more than they borrowed, their debts continue to mount and divert resources away from critical health and education spending.

An immediate cancellation of all odious, illegitimate and un-payable debts accompanied by a moratorium and the establishment of a fair and transparent arbitration process for the balance of debts outstanding and the adoption of clear transparent guidelines for new borrowing would help reverse this leakage of resources through the channel of debt.

Private flows in the form of foreign direct and portfolio investments that are supposed to contribute to the transfer of technology, create jobs, stimulate the local economy and increase tax intake have mostly failed to do so. Until as recently as 13 years ago, outflows in the form of profits and unwinding of old investments exceeded the inflows in the form of new investments. This is likely to be the case again in the near future.

Investments, especially in sub-Saharan Africa, earn returns as high as 30% per annum so countries are forced to try and attract ever-higher investments in order to keep resource inflows positive. This severely restricts policy space as countries reduce tax rates, grant tax holidays and introduce policies such as financial liberalization that put the interest of foreign investors over domestic development goals, and encourage the flight of capital through both legal and illegal channels in the banking system.

The increased threat of financial instability that comes about as a result of such policies has meant that developing countries have had to accumulate as much as USD 2 trillion in foreign exchange reserves to guard against financial crisis. The accumulation of this, most of which is invested in rich country bonds at very low interest rates, comes at the cost of development related investment that has much higher social returns.

More than half of developing country trade is controlled by multinational firms who are able to manipulate the prices on trade and financial transactions with related subsidiaries in tax havens and other countries to shift hundreds of billions of dollars out of poor countries.

Taken together, these leakages cost developing countries more than USD 500 billion in untaxed outflows which completely undermine the impact of aid and other resource inflows and hold these countries back from embarking on a path of sustainable development.

In order to plug these leaks, there is an urgent need to control and reverse the liberalization of the capital account and re-impose domestic performance requirements and profit repatriation restrictions on foreign investment. Other steps such as the elimination of bank secrecy, closing down tax havens, and firm action against financial institutions, accountancy and law firms, and multinational businesses that facilitate the leakage of these resources, would also help plug the leaks.

More than half of African and Latin American wealth now resides overseas, much of it in tax havens and financial centres such as London and New York – identifying and repatriating these assets, much of which were illegally acquired or transferred, and reversing the flight of capital, will mobilize domestic resources, free up policy space and allow developing countries to develop in a sustainable way.

The backdrop

> …defying all economic logic and need, for many years now the net transfer of resources and capital has been from the poor capital-scarce developing world to the rich capital-surplus developed world. Money, instead of flowing into productive investments in developing countries with high potential returns has gone into fuelling real estate and asset prices booms in rich countries such as the United Kingdom and the United States…

Despite the unprecedented media attention, the grassroots mobilization and political profile that development issues had in 2005, little was achieved in the way of provision of the scale of resources that are needed to achieve even the modest Millennium Development Goals (MDGs) leave alone fund sustainable development. The deal on debt cancellation and promises of aid increases provide only a fraction of resources that are needed with the funding gap growing each day.

The focus on the triad of debt, aid and trade was too narrow – the development debate has

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focused only on trying to increase inflows into developing countries with little if any attention to the significantly larger and increasing outflows of money and resources *from* developing countries. Despite unprecedented mobilization by civil society groups and widespread discussion of debt, aid and trade at the highest political levels, little tangible progress was achieved in terms of net resource flows.

One of the most disturbing phenomenons of recent decades has been the persistent and increasing outward transfer of resources from poor developing countries.[2] This has taken many forms both legal and illegal, some of which are discussed below.

This has serious negative consequences for both the development and humanitarian needs of these countries where because of a net outflow of already scarce domestic resources, these countries are left with fewer resources to target towards domestic development needs and towards life saving humanitarian interventions such as the provision of basic health services.

While occasional lip service has been paid to the importance of Domestic Resource Mobilization, this has been limited to increasing the level of domestic resources through new tools but has excluded a more fundamental consideration of 'retention' of resources mobilized domestically. This means that domestic resources continue to be susceptible to "leaking out".

Inflows have stalled – outflows are increasing

At the same time as the increase of inflows has stalled, outflows from the poorest developing countries, in the form of debt servicing, the build-up of foreign exchange reserve, trade deficits, profit remittances and – most important – capital flight have been on the rise.

This has severely restricted the room for manoeuvre within several countries. The "bleeding" of government revenues because of the rise of tax competition, tax avoidance and the fall of import tariffs, has further exacerbated the situation restricting the availability of resources to invest in basic health, education and infrastructure. It has also led to an increase in aid dependence.

Focus on inflows not outflows

However, the focus of development policy thus far has been limited to increasing aid, increasing foreign direct investment, channelling remittances and so on. Discussion on trade, which is also seen as a mechanism for resource delivery focuses almost exclusively on increasing exports from developing countries. Debt cancellation, which begins to address the question of reducing resource outflows, is discussed within very limited parameters which even under the most optimistic scenarios would have little impact on the direction of net resource flows.

Overseas Development Aid

Real aid, the aid money that is actually made available for funding development in the poorest countries, is running only at about USD 30 billion a year or only about 40% of the total aid volume. Administrative costs, technical assistance, accounting for debt relief, tying aid to purchases from the donor country, and aid to geo-strategically important but less needy countries are some of the reasons that more than 60% of the current aid volume is not available as money that can be spent on real and urgent development needs such as meeting the MDGs. This exists within a broader context of insufficient aid volumes which despite promises are currently running only at about 0.3% of the Gross National Income (GNI) of donor countries.

However, the new discussion on "innovative sources of financing" such as an airline ticket levy and currency and other financial transaction taxes among others, provide a promising avenue to improve aid quality and quantity.[3]

Debt

Debt, which has great potential as a source of funds for financing development has ended up being a channel for significant amounts of resource outflows from the poorest countries. For example, low-income countries, which received grants of about USD 27 billion in 2003, paid almost USD 35 billion as debt service. Sub-Saharan Africa has seen its debt stock rise by USD 220 billion despite having paid off USD 296 billion of the USD 320 billion it borrowed since 1970.

In fact, since 1984, net transfers to developing countries through the debt channel (net of inflows as new borrowing and outflows in the form of debt service) have been negative in all but three years. So debt, instead of providing a source of funding for development, has become a major source of leakage of scarce resources from developing countries.

What makes the situation worse is that a significant proportion of the debt owed never made it into the debtor country in the first place. Money lent to dictators and corrupt regimes such as Mobutu of Congo, Abacha of Nigeria and Suharto of Indonesia was stashed away offshore to personally enrich the dictators. Another significant chunk of the debt was used to fund projects where there was a suspicion of corruption and proper due diligence was not performed.

The Bataan nuclear plant in the Philippines, which has never generated any electricity because it was constructed on an earthquake fault, is one such example. Yet the government of the Philippines is still repaying the debt contracted to construct this plant. Even poor countries such as Zambia and Niger continue to pay a quarter of their budget towards debt servicing, much more than they spend on health and education combined.

While debt cancellation has been on the agenda for a while, the amounts under consideration are tiny in comparison to the scale of the problem and are funded out of already scarce aid budgets.

However, the Norwegian government's recent lead on the issue of odious and illegitimate debt offers a promising opening to finally tackle the real issues behind the debt crisis in an open, honest and effective way. It has the potential to finally 'wipe the slate clean' for countries that have been suffering under the burden of unjust and unpayable debt and allow them to make a fresh start. For creditor countries and institutions, it offers a chance of learning lessons from the mistakes of the past.

There is also hope that the recent debt deals struck by Argentina with private creditors, Nigeria with bilateral creditors and Heavily Indebted Poor Countries (HIPC) with multilateral creditors have finally opened the path for a serious discussion on a systemic treatment of debt problems with the establishment of a Fair and Transparent Arbitration Process (FTAP) preferably under the aegis of the United Nations.

Foreign Direct Investment

The reality of Foreign Direct Investment (FDI), which has grown to become the largest source of funds flowing into developing countries in recent years, is also disturbing. Despite the fact that on paper FDI can contribute significantly to development, in reality it has done little to deserve the focus and attention it has got in recent times where it is increasingly seen as the most important link in the development process by many policy makers.

Though since 1992 FDI has been the largest source of inflows into developing countries, it has been highly concentrated with a small group of countries such as China, India, Brazil and Mexico accounting for the bulk of recent increases in FDI. Countries in sub-Saharan Africa, most in need of capital, get very little FDI. Moreover, increasing amounts of FDI are used for mergers and acquisitions (they do not directly add to productive capacity or bring about technology transfer) where a foreign firm acquires an ongoing domestic operation.

FDI inflows are accompanied by large outflows in the form of profit repatriation. For sub-Saharan Africa, for example, apart from a period of ten years from 1994 to 2003, the inflow of funds through new FDI was exceeded or matched by an outflow of funds as profit remittances on existing FDI. As the stock of FDI in a country grows, the potential for future profit repatriation will also grow. In sub-Saharan Africa, the average rate of return on FDI is between 24% and 30%, which shows that the scope for an increase in future outflows is very large. For a number of poor countries, FDI continues to be a channel for net resource outflows.

The concerns highlighted above are exacerbated because there is strong evidence to believe that both FDI stocks and profit remittances are under-reported and may be as much as two to three times the reported figures.

2 Cf. Pietrikovsky, I. "Latin America: debt, investment, capital flight" in this Report.

3 Cf. Foster, J. "Beyond consultation: innovative sources" and Wahl, P. "International taxation: the time is ripe" in this Report.

One of the key benefits of FDI that is often touted is that the profits generated will increase government tax revenues. However, with the massive growth in tax competition and an exponential growth in enclave investment (export promotion zones among others) this benefit has all but disappeared. Honduras, for instance, offers permanent tax exemptions and tax holidays of up to 20 years are becoming increasingly common. This has been accompanied by a general and accelerating downward drift in corporate tax rates and in some export promotion schemes effective tax rates have fallen below zero!

The already grave situation has been compounded by the increasing trend of tax avoidance by multinational corporations (MNCs) operating in developing countries with the extractive sector being by far the worst culprit. Some of the tools used for this are:

- using inaccurate prices to value inter-subsidiary trade transactions in such a way so as to maximize profits in a low tax jurisdiction (transfer mis-pricing),
- using intra-corporate or parent subsidiary financial transactions such as loans from parent to subsidiary at exaggerated interest rates to shift profit out of the host country,
- using exaggerated values for intangibles such as goodwill or patents and royalties to underreport profit, and
- a whole host of other such practices such as mis-invoicing the quality and or quantity of imports and exports.

The overall focus on FDI, the generous incentives offered and the profits laundering/tax avoidance strategies of MNCs undermine the domestic private sector by putting it at a competitive disadvantage to already stronger MNCs with deeper pockets. This unfair competition is detrimental for the long-term development of poor countries.

Most of all, FDI has not fulfilled the promise of significant employment generation, integration with the local economy and technology transfer. While the costs of FDI have been very real, the benefits have been elusive. There is hence a need to rethink the current focus on FDI as a central tool in development, and for both developing and developed countries to take damage control measures to minimize the harmful effects and have a more critical cost-benefit analysis for future investments in developing countries.

Trade

The linkages between trade and resource mobilization are complex. There is no doubt that trade has the capacity to have a significant positive impact on development. However, at the same time the potential of the current trade regime to generate resources for investment in development is probably exaggerated. What is relevant from the perspective of external resource generation is the excess of exports over imports for a country or the trade surplus. The larger the trade surplus, the larger the resources the trade channel generates for development.

Under pressure from the World Trade Organization (WTO), the International Financial Institutions (IFIs) and rich countries, developing countries have been forced to lower their import tariffs and liberalize trade. While this has increased imports (including those of non-essential and luxury goods), exports have not kept pace. Continued rich country subsidies and protectionism especially in the farming (and textile) sector (where developing countries have a competitive edge) have also played a significant role in depressing exports from developing countries.

Many developing countries especially in the sub-Saharan African region and in Latin America run persistent trade deficits where they are forced to borrow (or use aid money or try attract FDI to generate scarce foreign exchange) to pay for the excess of imports over exports. This means that the trade channel, rather than boosting resources available for domestic investment, has also acted as a source for leakage of scarce domestic resources. Even in developing countries running trade surpluses (except for the major oil exporters) the trade surplus has seldom amounted to more than 1-2 percentage points of GNI which while significant is not enormous and can only contribute to development in conjunction with other sources of funds.

More than 60% of international trade is now intra-firm trade between various subsidiaries of multinational enterprises. A large faction of this passes through tax havens, which are characterized by secrecy and low or zero rates of taxation for non-domestic enterprises. This means that firms have massive opportunities to transfer profits out of developing countries into these low tax jurisdictions. The easiest and most exploited way of doing this is through the practice of mis-invoicing and of transfer mis-pricing when exports are under-priced and imports over-priced by firms so that higher profits are declared in tax havens and other non-developing country jurisdictions at the cost of a serious under-reporting of earnings in developing countries. Both domestic and international firms shift between USD 200 billion to USD 350 billion out of developing countries every year through this and related mechanisms.

The discussions on GATS, for liberalizing the trade in services, have the potential to exacerbate this problem of capital flight. Services are intangible in contrast to goods, more customized as compared to goods, which are more generic, and potential misreporting in services is much harder to detect because of their transient nature. All of this makes capital flight through the mis-invoicing of services easier and hence a much bigger potential problem than the capital flight through the mis-invoicing of goods. This means that there is a need to step back from the current trend towards a liberalization of services to redo the cost-benefit analysis for developing countries including capital flight in the analyses.

Hence, while trade can significantly enhance the efficiency of an economy and bring about many advantages, its potential as a source of development finance is perhaps exaggerated and the potential costs through resource flight because of mispricing are underreported. There is an urgent need to have a balanced discussion on trade issues that accurately reflects all the benefits as well as the costs – especially for developing countries.

Capital flight

For every dollar of aid that goes into developing countries, 10 dollars comes out as capital flight. Yet this is an issue which regularly gets sidelined in discussions on development. It has been estimated that developing countries lose more than USD 500 billion every year in illegal outflows which are not reported to the authorities and on which no tax gets paid.

The largest channel for capital flight is trade, where mis-pricing of transactions, the use of fake transactions and transfer mis-pricing between related affiliates of the same company with the help of tax havens and banking secrecy means that the tax and domestic resource mobilization ability of developing country governments is completely undermined.

Wealthy individuals and other domestic elite piggyback on the institutional apparatus of secrecy, private banking and tax havens to transfer billions of dollars out of poor developing countries depriving their fellow citizens of even the most basic needs such as health care.

Western MNCs, financial institutions, accounting firms, lawyers and financial centres have all been complicit in perpetrating, facilitating and actively soliciting this flight capital. No real progress on sustainable development can be achieved unless this stops.

If we are to move forward on the path of development, it is essential to first get our facts right and start an honest debate about development finance. No such fair debate can be had, leave alone corrective policies implemented until we expose the myth of current development flows and join hands to plug the leaks in the system. ■

Decentralization and sovereignty: how policy space is eroded

Citizens' Network on Essential Services
Nancy Alexander [1]

In many countries, citizens clamor for decentralization which can vest them with greater grassroots power and autonomy. The foundation of decentralization is the "principle of subsidiarity," which assigns power and responsibility to the lowest level of government – the level closest to the people being served.

However, *market decentralization* (another term for "privatization") shifts power and responsibility from governments to firms – even in the areas of health care, education and water services. Particularly in the absence of strong regulation, citizens, especially poor citizens, have little power over firms.

The impacts of decentralization were studied by researchers at the Organization for Economic Cooperation and Development (OECD) in 19 countries, who found that "decentralization has actually led to improvements in poverty reduction in only a third of the cases" (Jutting *et al.*, 2005). Countries where there has been no impact or a negative impact include Uganda, Ethiopia, Mozambique, Vietnam and Sri Lanka.

Many factors contribute to the disappointing impacts of decentralization. This article highlights how the international financial and trade institutions derail decentralization by diminishing "fiscal space" (i.e., options and resources) and transferring the rights of governments to investors. To take back power, citizens must not only struggle to establish accountable, representative government, but also take into account the ways in which the international financial and trade organizations, e.g., the International Monetary Fund (IMF), World Bank and World Trade Organization (WTO), can undercut their efforts.

Budget bosses

During the 1990s, Shahid J. Burki and Guillermo Perry, World Bank Vice President for Latin America and Chief Economist, respectively, engineered decentralization in the region. In *Beyond the Center*, Burki *et al.* (1998) argue that in order to protect against macroeconomic instability caused by subnational (i.e., state and local) fiscal excesses, it is necessary to have a "hegemonic and internally disciplined political party with the power to suppress any defiant behavior on the part of subnational politicians" and to revise electoral rules to "discourage party fragmentation…which makes policy-making more difficult and weakens the position of the president." The authors also stress the importance of rules and legislation that strengthen the office of the presidency in relation to the legislature, including "powers to rule by decree" and "an unassailable presidential veto."

In Latin America, this is called *presidencialismo*. This suits the reformers for whom the ultimate goal of decentralization is the transfer of public responsibilities to private sector actors. Indeed, decentralization redefines the boundaries of the public and private sectors.

The International Financial Institutions – the IMF and the World Bank – centralize power through policy conditionality attached to loans negotiated with the Finance Ministers of developing countries. Some conditions require Presidents to issue "Supreme" or "Executive Decrees." In the aftermath of protests against water price hikes in Cochabamba, Bolivia, the World Bank postponed its requirement that the Executive issue a Supreme Decree further raising water prices. In 2004, a loan called for Mozambique to issue seven decrees.[2] Such measures shift power from the legislative branch to the executive branch of government and undermine the democratic character and functions of the government.

By marginalizing parliaments, Poverty Reduction Strategy Paper (PRSP) processes have also facilitated this shift. Low-income country governments must prepare PRSPs – so-called national development strategies as a requirement for financing. Parliaments need not only greater engagement, but also more power in such processes. As it is, the IMF sets budget parameters for the governments of most low-income and highly-indebted countries to heed.

Donors and creditors do not use their power responsibly when their volatile aid flows create massive budget imbalances. Some countries, such as Ghana and Ethiopia, have absorbed rather than spent aid in order to off-set volatile aid flows, avoid currency appreciation, and build up reserves.[3] In addition, donors and creditors undercut governments when they channel financing through Program Implementation Units (PIUs) which operate in parallel with public administration and budgeting efforts.

When donor priorities appear in the budgets of local governments, these budgets need to be spent on the donors' goals rather than on other local needs. In some countries, such as Mali, donors are requiring governments to devote more resources to foreign-owned projects while local priorities are neglected.[4]

Attempts by donors and creditors to build government capacity for public financial management, including budgeting, have had mixed results. World Bank support for capacity building has encountered "considerable difficulty in the area of public financial management largely because of limited country ownership of the change agenda…"[5] Indeed, such efforts in Ghana were doomed because the government had different goals than the Bank.

Increasingly, donors and creditors provide "budget support," meaning that they pool their resources in support of national and subnational budgets. In 2004, a USAID study finds that the budget support process in Tanzania prompted the disengagement of many parliamentarians (Frantz, 2004, p. 7).

When donors pool their money, it relieves a government of the competing demands of many donors, but it also creates a donor/creditor policy cartel with many "budget bosses."

Steps to shift rights from governments to investors

The World Bank's focus on reforming investment regimes constitutes a centerpiece of its corporate strategy. This emphasis permeates its operations to promote decentralization through structural adjustment, public sector reform,[6] and sector-wide reform (e.g., health care, education) programs as well as its project financing.

Donors and creditors finance privatization, budget austerity, and economic liberalization programs that accompany the decentralization process. The impacts of such policies on local governments are discussed below.

Privatization

1. *Decentralization and Privatization.* Commonly, political decentralization precedes fiscal decentralization, so that local governments inherit "unfunded mandates" – that is, mandates to deliver services without the resources required to do so. This is particularly problematic because local governments may lack access to capital markets and rely heavily upon

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2 World Bank Poverty Reduction Support Credit I (PRSC I), 2004.

3 IMF, "The Macroeconomics of Managing Increased Aid Inflows: Experiences of Low-Income Countries and Policy Implications," 8 August 2005.

4 See the IMF's First Review under Mali's 3-Year PRGF arrangement. April 2005

5 World Bank, Operations Evaluation Department (OED). "Capacity-Building in Africa," 2005, p. 29.

6 In Fiscal Year 2005 almost half of the new Bank projects had at least one component addressing governance and public sector reform.

locally-generated taxes and fees for services. Due to the lack of resources, many local governments are forced to privatize assets and services.

The World Bank sometimes cripples local governments by promoting premature decentralization, placing additional financial resources and responsibilities upon local governments before they are prepared to handle them. (See Box 1.)

Box 1.

DECENTRALIZATION AND SERVICES IN SRI LANKA

The 2003-2006 World Bank Country Assistance Strategy (CAS) for Sri Lanka stipulated that the government would gain access to higher levels of financing if it increased the share of revenues transferred to the local level. On one hand, there is a good argument to be made that decentralization needs to be accompanied by corresponding increases in fiscal resources. On the other hand, the CAS suggests that this transfer will be the principal measure of effective decentralization – a classic case of using a simple input (money) to measure a complex outcome (good local governance). Because more World Bank funds are promised if these transfers are sped up, the government has an incentive to channel significant revenue streams before mechanisms are created for ensuring transparent and accountable governance at the local level. ■

In the privatization process, local governments are often faced with demands that they provide subsidies and guarantees for private firms.

2. *Subsidies.* As privatization proceeds at the subnational level, local governments are often required to provide subsidies for corporations. Some schemes provide "performance-based" subsidies to firms when delivery of services (e.g., health care, education, water) to poor populations is verified. However, there are serious transaction costs and constraints to such schemes, especially in low-income countries and those with weak governance.

Donors and creditors promote subsidies to corporations, since cross-subsidies between sectors (telecommunications and water) or between rich and poor rate-payers violate trade rules.[7]

3. *Guarantees.* Generally, investors expect local governments to provide guarantees – particularly for infrastructure projects – which shift specific price, demand and currency risks onto taxpayers. The Articles of Agreement of the World Bank (IBRD and IDA) require that, if the institution provides a guarantee to a subnational government, it must obtain a counter-guarantee from the central government. However, the World Bank and other creditors and donors launched a new Subnational Development (SND) Facility in July 2006 that offers guarantees to local governments without backing from the central government.

When private ventures backed by a guarantee fail, the local government is likely to assume large, debt-like financial obligations without any mechanisms for restructuring or writing down the obligations. Creditors might intercept transfers from the central to local government, leaving the local government impoverished.

4. *Infrastructure spending.* At present, donors and creditors are promoting infrastructure investment. Soon, infrastructure operations will constitute 40% of the World Bank's lending portfolio. The IMF raised its inflation targets to permit higher levels of government spending for infrastructure, among other things. Local governments are being asked to provide significant infrastructure financing and guarantees relative to their fiscal resources. Indeed, the World Bank estimates that during the 1990s, governments and public utilities provided 70% of the financing for public-private partnerships (PPPs) in infrastructure compared with only 22% from aid, and 8% from the private sector.

In 2005, World Bank expert Antonio Estache (2004) released a study of PPPs in infrastructure from 1994 to 2004 which found that efficiency gains were often at the expense of poor people and poor areas. Risks to government budgets increased as governments offered investors costly guarantees and financial supports that ensure profitability, minimize capital outlays, and greatly increase the fiscal exposure of government. Corruption also increased.

In order to expand the supply of infrastructure and social services, donors and creditors are also scaling up community-driven development (CDD) and social fund (SF) operations which finance community groups, civil society organizations, and local governments. World Bank lending in support of CDD approaches increased from USD 250 million in 1996 to approximately USD 2 billion annual investments (or 10% of the Bank's portfolio) in 2004. Social funds have received World Bank financing in about 60 countries for a total of nearly USD 4 billion from all sources.[8] World Bank evaluators found that:

> The experience with community development shows that despite sophisticated targeting mechanisms, the poorest and most vulnerable generally appear to have been missed while the better off among the community have gained more of the benefits... Where social funds have accounted for a substantial share of public expenditure, such as in Bolivia, Honduras, and Nicaragua, they have distorted the efficiency of resource allocation and have negatively affected sectoral and budgetary planning. And where community development projects have been implemented by setting up parallel structures for community participation rather than by working through local governments, they have actually weakened the capacity of local governments and the decentralization process.[9]

Three out of four of the water components of CDD projects failed.[10] External evaluators participating in a World Bank evaluation of such projects suggested that the Bank cease financing CDD and SF operations until performance can be improved.[11]

Budgets that mortgage the future

1. *Cutting Local Governments Loose.* Since 2002, investment reform has taken center stage in the World Bank's corporate strategy. Decentralization can upset the macroeconomic stability prized by investors. Hence, to restrain demand, restore macroeconomic balances and build creditworthy subnational governments, donors and creditors promote policies to:

- limit fiscal transfers from central to state and local ("subnational") governments;
- allow central government transfers to local governments to be "intercepted by creditors in order to collect debt-related obligations;
- require local governments to adopt hard budget ceilings which prevent central governments from bailing them out.

For instance, prior to the 2002 election in Brazil, leaks revealed that the IMF and the Brazilian Finance Ministry agreed to terms which required, among other things, a reduction in revenue-sharing with the states and municipalities, termination of revenue earmarking, and promises by President Lula Da Silva's new administration to resist pressures to reopen the debt restructuring agreements between federal and subnational governments.[12] This deal, which by-passed democratic debate and decision-making by the Brazilian Congress and people, placed state and local governments under significant fiscal pressure. (See Box 2.)

7 In addition, "non-discriminatory" trade rules do not permit a government to favor domestic firms or disfavor foreign firms engaged in "like" activities. Such rules, where they apply, could require that, where a government subsidizes domestic health care or water companies, it must also subsidize "like" foreign companies. (See GATS Article III, Paragraph 17).

8 Draft Concept Note, International Conference on Local Development, Washington, D.C., 16-18 June 2004.

9 World Bank, Independent Evaluation Group, draft Annual Review of Development Effectiveness (ARDE), 2004.

10 World Bank, Operations Evaluation Department (OED). "Efficient, Sustainable Service for All? An OED Review of the World Bank's Assistance to Water Supply and Sanitation," Report No. 26433, 1 September 2003.

11 See comments by Robert Chambers and Norman Uphoff in Annex R of the World Bank IEG's evaluation of "The Effectiveness of World Bank Support for Community-Based and -Driven Development," October 2005.

12 IMF, Brazil – "Request for Stand-by Arrangement," 30 August 2002, p. 23; and "First Review Under the Stand-by Arrangement and Request for Modification of Performance Criterion," 4 December 2002.

Box 2.

THE CASE OF BOLIVIA

In 2002, World Bank loans required that the Government of Bolivia 1) present a legal opinion confirming the legality of the use of revenue intercepts as collateral to municipal credit operations with any lender; 2) adopt major procurement reforms; and 3) require municipalities to adopt fiscal responsibility laws, which ensure that they maintain hard budget ceilings, precluding bail-outs from the central government.[13] Such steps are intended to improve the access of municipalities to financing from the international capital markets for their local investment programs.

Seven municipalities adopted fiscal responsibility laws and accepted fiscal targets that were based on the IMF's assumption of 4% Gross Domestic Product (GDP) growth in 2001. The actual GDP growth rate was only 1.2% with output declining in all areas except for natural gas production. Central government revenues plunged by 26% in 2001 and general transfers from the central to municipal governments were 11% less than projected. However, the municipalities with fiscal responsibility laws were constrained from borrowing; instead, they instituted new taxes and user fees and carried out cutbacks in programs and services. ■

2. *Budgets and Government Procurement.* Donors and creditors engaged in "budget support" operations are in a position to pressure governments to liberalize government procurement at central and subnational levels. Through procurement practices, governments have always promoted national or local productive, employment, and service sectors. However, as government procurement is liberalized, local suppliers and workers must compete for government contracts with global suppliers. Liberalizing government procurement is a sure path to privatization of services.

In Ghana, a binding condition of a 2003 World Bank loan required the liberalization of government procurement.[14] The loan conditionality was so invasive that a World Bank Board member expressed concern that the World Bank's heavy pressure was forcing Ghana to liberalize well beyond WTO requirements.

In 2005, World Bank evaluators stated that IDA exerted "significant pressure" on the government of Malawi to liberalize its procurement and that the Bank did not pay attention to government concerns about proposed procurement reforms, which were finally rammed through.[15]

Trade

1. *Trade liberalization policies.* By definition, trade liberalization cuts trade taxes, hence putting tremendous fiscal pressure on central governments, which turn to local governments to shoulder greater fiscal burdens.

In sub-Saharan Africa, trade taxes accounted for between a quarter and a third of total tax revenue. Consumption taxes (e.g., the value-added tax, or VAT) seek to recoup lost revenue from trade taxes. The VAT is highly regressive, meaning that it hits low-income groups the hardest.

Low-income countries usually fail to replace lost trade tax revenues from other sources. "Using a panel of 125 countries over 20 years, Baunsgaard and Keen (2005) find that low-income countries typically recover at most 30 cents for each dollar of lost trade tax revenue, even over the longer-term."[16]

A recent United Nations Conference on Trade and Development study predicts that the losses in tariff income for developing countries under the WTO's Doha Round could range between USD 32 billion and USD 63 billion annually. This loss in government revenues – the source of developing-country health care, education, water provision, and sanitation budgets – is two to four times the mere USD 16 billion in benefits projected by the World Bank.

While many legislatures have little influence over decisions to reduce tariffs, they are generally faced with a potentially catastrophic budgetary situation after the cuts are made.

2. *Trade and Investment Agreements.* The WTO, including the General Agreement on Trade in Services (GATS), came into force in 1994. The GATS applies its rules, or disciplines, to about 160 sectors. As *central* governments make commitments under the GATS and negotiate other trade and investment agreements, they are committing *local* governments to conformity with trade rules. These trade rules are enforced on the domestic legal and regulatory activities of "*regional*, or *local* governments" and "nongovernmental bodies in the exercise of powers delegated" by any and all government jurisdictions. These rules create a loss of fiscal and policy space at the local level.

When a government's human rights norms and trade rules come into conflict, the conflict would not be resolved in a domestic court, but rather in a secret international trade tribunal, beyond the public "eye."

A UN report, "Economic, Social and Cultural Rights: Liberalization of Trade in Services and Human Rights,"[17] presented extensive evidence that, although increased foreign private investment can upgrade national infrastructure, introduce new technology, and provide employment; it can also lead to:

- the establishment of a *two-tiered service supply* with a corporate segment focused on the healthy and wealthy and an under-financed public sector focusing on the poor and sick;
- brain drain;
- an overemphasis on commercial objectives at the expense of social objectives which might be more focused on the provision of quality health, water and education services for those that cannot afford them at commercial rates; and
- an increasingly large and powerful private sector that can threaten the role of the government as the primary duty bearer for human rights by subverting regulatory systems through political pressure or the co-opting of regulators. ■

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Reclaiming development: streamline the Bretton Woods institutions

Third World Network
Celine Tan [1]

The Bretton Woods institutions – the World Bank and the International Monetary Fund (IMF) – are considered "specialised agencies" under the Charter of the United Nations (UN) in 1945 and the terms of their relationship with the UN are spelt out in respective "relationship agreements" entered into between the Bank and the IMF and the UN. Central to these agreements between these international financial institutions (IFIs) and the UN are clauses which respect the demarcation of roles between the respective organizations and the affirmation of the autonomy of IFIs in matters within their specific jurisdictions.

This decision to retain the organizational independence of the Bretton Woods institutions from the UN system, and the maintenance of their different governance structures favouring a small cartel of major industrialised countries, has had significant implications for global economic policymaking and international economic and financial cooperation, as well as on the social and economic development of developing countries. It has also largely prevented the institutions from undertaking the tasks they were originally created for – to provide for a stable and orderly international trade and financial system and to facilitate reconstruction and development.

Any reform of the multilateral governance institutions, including the current ongoing discussions on UN reform, must therefore include a reform of multilateral financial institutions to ensure the creation of truly international financial and economic governance organizations which better represent and service the interests of all member states and enable the better coordination among existing multilateral institutions to do the same. These institutions must also be subjected to the overarching universal principles which underlie all multilateral processes of decision-making which encompass not only the principle of equality among states but also a respect for human rights and the right to sustainable development.

An affront to the principle of sovereign equality and the erosion of multilateralism in global economic governance

The constitutional frameworks of the Bretton Woods institutions are an affront to the principle of equality among states and their operational practice over the years since their inception reflects a progressive erosion of the principle of multilateralism in international affairs. Although both institutions justify their autonomy from the United Nations system on the grounds that each of them is "required to function as an independent international organization",[2] neither of these institutions are truly "independent" nor "international" in character.

The governance structure of the Bretton Woods institutions is inherently asymmetrical in favour of developed countries and this asymmetry has been exacerbated over the years by both the development of the global economy and the shift in the nature of the work programmes of both organizations. The result is that those countries least affected by the decisions of the World Bank and IMF have the most influence and the most capacity to hold either institutions to account, while those who are subjected to their policies and who form the bulk of the institutions' operations have the least say in how these institutions are run.

In a paradoxical twist, changes in the financial operations of both institutions over the years have resulted in borrowing members – the developing countries who have little power in the decision-making processes – shouldering the bulk of the costs of administering the Bretton Woods institutions and their activities. While the core capital of the World Bank and the IMF relies on the financial contributions of their wealthiest shareholders – through quota subscriptions for the IMF and paid-in and "callable" capital for the World Bank – the current administrative costs of both institutions are now largely financed by borrowing member states through the charges and interest on their loan repayments and, in the case of the World Bank, their track record in servicing their International Bank for Reconstruction and Development (IBRD) debts which contributes to the Bank's ratings in the international capital markets (Mohammed, 2004).

There has also been a creeping "bilateralism" which has increased the control of specific developed countries over the policies of these supposedly multilateral institutions. As "a form of global collective action", multilateral lending is seen as a type of redistribution and instrument of international economic cooperation in which richer states pool their resources to provide external financing to poorer countries to prevent the negative externalities associated with international capital market failures and to assist in the provision of global public goods (Akyüz, 2006).

However the principle of multilateralism in the Bretton Woods institutions have been significantly weakened since the "introduction of donor-driven concessional windows" (Akyüz, 2006), such as the International Development Association (IDA) (with its three-year replenishment cycle) at the Bank and the Enhanced Structural Adjustment Facility, now the Poverty Reduction and Gross Facility (PRGF), at the IMF. These facilities require periodic replenishments from bilateral donors, providing opportunities for these countries to exercise leverage over the policies of the Bretton Woods institutions outside the usual decision-making process.

Expansion of constitutional mandates and failure in fulfilling traditional responsibilities

The administrative costs for running the World Bank and the IMF have increased substantially in recent decades as a result of policies pursued by their developed country members. After the collapse of the fixed exchange rate system in 1972 and particularly since the advent of the debt crisis in the 1980s, the World Bank and the IMF have greatly expanded the remit of their responsibilities, extending their reach into areas which were traditionally outside their jurisdiction while downgrading or abandoning other aspects of their work.

One of the most fundamental aspects of the Bretton Woods institutions 'mission creep' is the Bank and IMF's shift of focus towards social and economic development policy of developing countries, including domestic economic regulation, trade policy, poverty alleviation, social welfare and even environmental protection. This shift has been most pronounced for the IMF in terms of divergence from its constitutional objectives although the World Bank's expansion has been more extensive in scope.

The IMF no longer plays a role in ensuring international financial and monetary stability although the need for such a multilateral organisation has never been greater given the globalization of finance capital and the volatility of financial flows today. The institution no longer exercises any discipline over exchange rate policies of its member states and has no authority over the important players in the global financial system – the industrialized countries – whose domestic policies affect the stability of international financial architecture more than those of the developing countries for whom IMF regulation has been most pronounced.

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2 Articles 1(2) of the Agreement between the United Nations and the International Bank for Reconstruction and Development, 1947; and the Agreement between the United Nations and the International Monetary Fund, 1947.

The Fund's extension of short-term current account financing to countries experiencing financial crises has been seriously circumscribed both by its introduction of conditionality as well as the policy prescriptions of the adjustment programmes which accompany such financing. The IMF's financing operations for crisis countries have also been focused on servicing external debt to private creditors and maintaining capital account convertibility (Akyüz, 2005) rather than assisting countries to manage with the social and economic repercussions of financial crises. Instead, many of the policies instituted by the IMF through conditionality in these countries have worsened the social and economic dislocations of the financial crisis.

Similar impacts have resulted from the Bank's foray into development policy lending and sectoral reform programmes which have promoted liberalisation of markets, market-based land reform, the privatization of essential services such as health, education and water, and the elimination of government subsidies and protection for infant industries and agricultural sectors. This policy-based financing has provided the opposite function to the Bank's mandate of providing capital for reconstruction and development: they are "fast-disbursing" loans serving primarily to meet short-term balance of payments needs and economic restructuring purposes as opposed to long-term developmental targets.

The Bank has also deepened its social and economic policy work, including through revisions of Structural Adjustment Programmes (SAPs) and other sectoral lending instruments to include emphasis on social sectors and poverty reduction; the promotion of various financing instruments for capacity building and technical assistance in a plethora of different issue areas; and through its non-financing activities, such as its dissemination of research and policy papers and consultancy work. A report by the Bretton Woods Project estimates that "between 1997 and 2002, USD 283 million was spent on reorganizing the Bank to be a knowledge institution", with studies indicating that "the Bank's analytical approaches influence policy-making across the world even if the Bank is not involved directly" (Wilks, 2004).

Over the same period, the role of the UN economic agencies, notably the United Nations Conference on Trade and Development (UNCTAD), have been progressively weakened, with these organizations' capacity in economic research, policy formulation and international economic negotiations eroded through financial and other constraints and pressures brought to bear on these agencies and their personnel by developed countries (South Centre, 1996).

These reforms have served to establish the dominance of the Bretton Woods institutions in issues of social and economic development in the international arena and significantly increased the influence of the Bank and IMF in key economic (and lately, even social and political) policy decisions in borrowing member states. The coinciding expansion of the Bretton Woods institutions work programmes with the reduction in the UN's role in economic policy agenda setting represented a slow but sure "transfer of power" from the UN agencies to the World Bank and the IMF, thereby "eroding and weakening those organizations which were *not fully under the major powers' control*" (South Centre, 1996, emphasis added).

"Conditionality" undermines principle of national sovereignty and non-intervention

The expansion of the nature and content of conditionality has taken place in tandem with the expansion of the Bretton Woods institutions' mandate. The scope of conditionality in Bank and Fund lending now encompass conditions which are neither relevant nor critical to the purposes of the financing or are conditions in areas which "neither the IMF nor the World Bank has the expertise to give proper advice", thus creating great margins for error and negative externalities (Khor, 2001: 12). Many of these conditions erode the policy autonomy of countries and constitute interventions in sovereign states' domestic affairs, such as the current proliferation of "governance-related conditionality" (GRC), most notably at the World Bank[3].

Conditionality has also evolved to be a default regulatory instrument for disciplining developing countries, including prescribing social and political reforms. Conditionality has been used as a misguided means of ensuring compliance of World Bank and IMF borrowing countries to social and economic development priorities, ranging from poverty reduction to gender equity, as well as conformity with environmental norms. At the same time, these institutions, notably the World Bank, have failed to comply with internationally agreed standards of protection for social, political and economic rights, and environmental standards through their lending practices.

The use of conditionality in this manner is at odds with the Bank's own constitutional prohibition against political interference in borrowing member states[4]. This practice is also an affront to the principles of international economic relations as enshrined in the 1974 UN General Assembly Resolution 3281 on the Charter of Economic Rights and Duties of States, one of the fundamental norms of international law. Chapter 1 of the Charter stipulates international economic and political relations should be governed, *inter alia*, by respect for the sovereignty, territorial integrity and political independence of states and the principle of non-intervention.

Meanwhile Chapter II of the Charter affirms the "sovereign and inalienable right" of states to choose their own economic, cultural and political system without outside interference (Article 1) as well as the right to "freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities" (Article 2(1)). These represent rights of their member states that the Bretton Woods institutions should respect, as the institutions are "specialized agencies" under the Charter of the United Nations.

The Charter of Economic Rights and Duties of States also provides that in efforts to fulfil their primary responsibility to economic, social and cultural development of their peoples, "each State has the right and the responsibility to chose its means and goals of development" (Chapter 2, Article 7) while the 1986 UN General Assembly Resolution 41/128 on the Declaration on the Right to Development provides that "States have the right and the duty to formulate appropriate national development policies" and "the primary responsibility for the creation of national and international conditions favourable to the realization of the right to development" (Articles 2(3) & 3(1)).

The Bretton Woods institutions pay little credence to such international norms in the design and implementation of their conditionalities. The content of Bank and Fund conditionality, has been based on the policies of the Washington Consensus which are premised on fiscal austerity and restrictive monetary policies, the liberalization of capital flows, trade liberalisation, deregulation and privatization. These policies have generally followed a pattern of "one-size fits all" or a "boilerplate template" in which one set of policies are applied to the vast majority of countries without due regard for individual circumstances. The practice of conditionality has therefore undermined the domestic policy space of borrowing governments and curtailed the right of these countries to regulate their economies.

3 For example, public expenditure management (PEM) conditions which constituted 48% of the total share of conditionality in Bank loans in financial year 2005 (World Bank, 2005b: Figure 11).

4 Article III, Section 5(b) of the IBRD Articles of Agreement; see also Article V, Section 1(g) of the IDA Articles of Agreement.

Need for reform and revitalization

The existence of the Bretton Woods institutions with their asymmetrical governance and administrative framework existing in concert with the UN and UN agencies created specifically for social and economic development – such as the UN Conference on Trade and Development, and the United Nations Development Programme – has provided a convenient alternative forum for the discussion of issues and implementation of policies of which the more equitable decision-making framework of the UN system have proven unconducive to the interests of the major political powers.

There is therefore a need to both *reform* the Bretton Woods institutions *and reinvigorate* the economic role of the UN in order to ensure sustainable development and to achieve the objectives of the Millennium Development Goals. Four recommendations can be put forward in this regard:

- **Reforming the governance structure of the World Bank and the IMF to ensure representativeness and accountability.** There has to be a fundamental overhaul of the archaic governance framework of these institutions predicated upon an outdated post-war model which no longer reflects the developments in the global economy today and which skews decision-making control in favour of the economically powerful at the expense of the economically weak. Developing countries must be given greater voice and representation at the Bank and the Fund.
- **Streamlining the Bretton Woods institutions and scaling them down to their original mandate.** The current workload of the World Bank and the IMF is too broad and too intrusive and the administration of their many activities unwieldy and costly. Streamlining the institutions so that they return to their original mandates of facilitating a stable international trade and financial system and providing financing for development would ensure greater efficiency and effectiveness of these institutions and restore policy autonomy to borrowing countries.
- **Revitalizing the role of the United Nations economic and social development agencies.** The reduction in the scope of work of the Bretton Woods institutions should also be accompanied by the revitalizing of the work of the United Nations agencies and other UN "specialised agencies" in the area of international economic cooperation and domestic economic and social development. This would not only reduce the influence of the powerful developed countries but also the influence of the pervasive institutional ideology of the Washington Consensus prevalent at the World Bank and IMF.
- **Removing the regulatory role of the Bretton Woods institutions and subjecting them to UN scrutiny.** The application of policy conditionality as a means of achieving internationally agreed social and development objectives, but especially, global environmental norms in borrowing countries must be reviewed as this has the effect of making the Bretton Woods institutions *de facto* governance organizations in areas for which they are not sufficiently competent. Instead, the Bretton Woods institutions themselves should be subjected to internationally agreed principles, including the rules of international law governing international economic relations, environmental safeguards, protection of minorities and indigenous communities, etc. As international organisations, they should be held accountable if their lending or non-lending practices violate such internationally agreed rules and conditions in lending should only reflect the fiduciary role of the Bretton Woods institutions in this respect and nothing more.

The way forward

The Bretton Woods institutions have undergone significant changes over the 60 years since their birth in the post-war period. None of these changes have sought to change the asymmetries and inequalities which exist within the institutions which impede their role in serving as truly multilateral economic institutions. Instead, the constitutional amendments as well as shifts in operational policy and practice at the two institutions have served to reinforce such imbalances and, more worrying, to shift global economic governance away from more democratic institutions, such as the UN, to these organizations.

However as the discussion above has demonstrated, the solution lays not in increasing the authority of the World Bank and the IMF by granting these institutions more control over aspects of social and economic development but to reduce the remit of their work to their core responsibilities and revitalize the UN agencies which have been given mandate and have the requisite competence to undertake the aforementioned tasks in a more democratic manner. ■

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From Monterrey to Basel: who rules the banks?

Jan Kregel [1]

The Monterrey Consensus that emerged from the International Conference on Financing for Development held in Monterrey, Mexico, in March 2002 forged a partnership between developed and developing countries based on mutual recognition of the benefits to be gained from the implementation of policies leading to successful development outcomes. Developing countries committed to introduce sound economic and social policies, to improve governance, eliminate corruption and to create a domestic regulatory environment to support the development of the private business sector. While the Consensus was based on developing countries accepting the responsibility for their own development, developed countries pledged to take measures to provide the financial resources that might be required in addition to the mobilization of developing countries domestic resources to meet development goals. These measures included a pledge to strive to provide official development assistance equal to at least 0.7% of each developed country's gross national income, improved market access for developing country exports and completion of the development dimension of the Doha round of the World Trade Organization, the provision of debt relief to ensure that developing country debt service did not impede development efforts, the facilitation of the development impact of foreign direct investment through greater technology transfer, and improvements in the international financial architecture to predict and prevent financial crises.

The Consensus also noted that if developing countries were to have effective responsibility for the development of their own national resources, they should also have full responsibility in framing the international regulations and institutions that determine the international environment in which they participate and which have a major impact on the success of their national development strategies. This additional responsibility could only be meaningful if developing countries were given equitable representation in those institutions and processes that have been created to govern the rules, regulations and institutions that make up the international trading and financial system.

Unequal governance structure

The most obvious example of the current lack of representation of developing countries is in the governance structure of the Bretton Woods Institutions, the World Bank and the International Monetary Fund (IMF) that were created to manage the post-war international financial and trading system. Although both institutions are "specialized agencies" of the United Nations, their governance structure does not follow the traditional United Nations principle of one country, one vote. Rather, decisions are taken by a governing Board with voting power determined on the basis of a rather complicated formula representing an equal amount of basic votes, plus additional votes determined by the country's financial contribution to the institution, the size of the economy and its participation in world trade. Thus, the more powerful developed countries naturally have a large voting power than developing countries. Since the variable items have been adjusted several times to reflect changes in size of different economies, while the basic votes have remained fixed, countries that have grown most rapidly have increased their influence relatively to some of the slower growing developing countries, particularly those who came into existence and joined the IMF after its creation.

The day to day operation of the IMF and the World Bank is governed by a Board of 24 Executive Directors. There are seven countries that sit on the Board who represent only themselves: the United States, Japan, Germany, France, the United Kingdom, China, and Saudi Arabia. Thus the other 17 Executive Directors must represent the interests of the remaining 160 countries. Each of these 17 Directors is assigned a group of countries. In the current allocation, over forty countries comprising sub-Saharan Africa are represented by only two executive directors. Thus, their interests cannot be given the same hearing in the Boards decisions as the members holding single country seats.

Further, the five developed countries holding single seats account by themselves for nearly a third of the total votes. Other developed countries hold seats with another third of the votes. This ensures that any decision requiring a two-thirds majority requires the approval of the developed countries. In addition, the US holds votes that exceed 17% of the total. This is an important number since most major decisions on the structure of the IMF, such as changes in voting power, require an 85% majority. The World Bank has a similar representation and voting structure.

Thus, while developing countries are urged to take responsibility for their own development, improve their governance structures and ensure that their policies are "nationally owned", the major institutions that determine the architecture of the international financial system, and who are responsible for the majority of institutional funding for development, continue with an anomalous, and far from democratic form of governance in which developed countries have a structural majority.

Lack of representation in other rule-making bodies

It is for this reason that the Monterrey Consensus stressed the need to broaden and strengthen the participation of developing countries and countries with economies in transition in international economic decision-making and norm-setting. It sought to enhance participation of all developing countries and countries with economies in transition in the decision-making of the international financial institutions, and thereby to strengthen the international dialogue and the work of those institutions as they address the development needs and concerns of developing countries. While most of the attention to improve voice and representation has been centered on the IMF and the World Bank, there are other international rules and standards making bodies at the global level in which developing country representation is even less equitable and in some cases non-existent. It is for this reason that the Monterrey Consensus went further and urged the Bank for International Settlement's Basel Committees such as the Basel Committee on Banking Supervision, and Financial Stability Forum to continue enhancing their outreach and consultation efforts with developing countries and countries with economies in transition at the regional level, and to review their membership, as appropriate, to allow for adequate participation. It also included in this call all ad hoc groupings that make policy recommendations with global implications to continue to improve their outreach to non-member countries, and to enhance collaboration with financial standard-setting bodies such as the International Association of Insurance Supervisors, the International Accounting Standards Board, the International Organization of Securities Commissions, the International Organization for Standardization, and the International Federation of Stock Exchanges.

Attention to developing countries' representation on these other bodies is particularly important because most of them have no formal governance structure or are voluntary bodies that provide no representation to developing countries. It is also important because given the lack of any formal governance

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institutions at the global level, these bodies have taken on the responsibility for formulating rules, regulations, standards and codes for the global economy and the international financial system without even minimal formal representation of developing countries. As a result a de facto global governance system is being built up on the basis of

decisions made by developed countries, without any participation from developing countries. It is the unrepresentative nature of this growing global governance structure that has given rise to what has come to be known as a "democratic deficit" because of the absence of equitable representation of the interests of all countries.

The extent and proliferation of these global regulations, standards and codes is often underestimated. They include the core principles for affected banking supervision issued by the Basel Committee on Banking Supervision, Objectives and Principles of Securities Regulation issued by the International Organization of Securities Commissions, Insurance Core Principles issued by the International Association of Insurance Supervisors, Principles and Guidelines On Effective Insolvency and Credit Rights Systems issued by the World Bank, Principles of Corporate Governance issued by the Organization for Economic Cooperation and Development, International Accounting Standards Issued by the International Accounting Standards Board, International Standards On Auditing issued by the International Federation of Accountants, Core Principles for Systematically Important Payment Systems issued by the Committee on Payment and Settlement Systems, Recommendations for Security Settlement Systems issued by the Committee on Payment Settlement Systems and the International Organization of Securities Commissions, the 40 Recommendations and nine Special Recommendations on Terrorist Financing issued by the Financial Action Task Force on Money Laundering, the Code of Good Practices on transparency of Monetary and Financial Policies issued by the IMF, the Code of Good Practices in Fiscal Transparency issued by the IMF and a Special Data Dissemination Standard, and the General Data Dissemination System issued by the IMF.

A de facto regulatory power

The globalization of finance and the growing internationalization of financial crises in recent years have resulted in increased efforts to force countries to adopt similar regulatory arrangements. However, in difference from national financial regulation there is no formal power at the international level to set and enforce regulations worldwide. Representatives of developed country financial market regulatory and supervisory agencies have been drawing up a set of best practice standards and codes whose adoption is encouraged through peer pressure. However, in practice these global regulations are enforced by the international financial institutions such as the IMF and the World Bank, either by introducing them in the conditions that developing countries are required to meet in order to qualify for financing from these institutions, or as part of the standards used in IMF Article IV surveillance, or as standards by which their commitment to sound governance and institutions specified in the Monterrey Consensus are judged.

Mechanisms have also been put in place to encourage their introduction, govern their use and monitor compliance. The key instrument is the Report on the Observance of Standards and Codes, prepared by the IMF as a part of Article IV consultations or through Financial Sector Assessment Programmes conducted jointly by the IMF and the World Bank. They have been carried out for more than 100 countries. It is thus clear that there is in operation today a de facto international regulatory power monitoring implementation of a set of best practice standards for financial institutions operating in international markets.

Since the credit worthiness of individual countries' liabilities assigned by credit rating agencies is also increasingly judged by the quality of individual countries' regulatory and supervisory systems as measured by their adherence to these international standards, it has become crucially important for developing countries to be seen to be adhering to these standards as minimum conditions for attracting and retaining international capital flows. Thus, the ability of developing countries to attract official or private finance increasingly depends on a governance structure in which they do not participate.

"Democratic deficit"

However, the representatives that meet to propose and implement these standards are far from democratically selected. They overwhelmingly represent the Group of Seven (G-7) developed countries and hardly any provide a formal representation for developing countries. There is thus a large "democratic deficit" in the operation of this de facto global governance system in financial markets. A formal study of the operation of this de facto system is necessary to determine if its democratically inefficient mechanism of operation can be justified by delivering the promised results of increased global financial stability.

Most of the attention has been placed on the question of voice and representation in the World Bank and the IMF, and it is because developing countries have some, even if minor, representation in these institutions that they have been most actively engaged in discussion of the means to provide more equitable voice and representation of developing countries in their governance structures since Monterrey. However, nearly five years after the Conference there are still no formal proposals on how this should be done. The issue will be on the Agenda of the next Annual Meetings in Singapore, but given that there is still no formal proposal for action, prospects are not good for more rapid action on the issue.

Much less attention has been given to the other bodies that set global standards. The first of these de facto international governance institutions was the formation of the Basel Committee on Banking Regulation and Supervision, hosted by the Bank for International Settlements to deal with the risks in making international payments between large global banks from developed countries. It produced regulations known as the Basel Concordats in 1975 and 1978 that attempted to allocate the responsibility for the regulation of global banks operating across borders to each bank's home regulatory agency and to require banks to provide financial reports on a consolidated basis covering all their global operation. In essence the Concordat was a global supervisory agreement that was supposed to provide a substitute for an international lender of last resort, or an allocation of international lender of last resort responsibility, for banks operating internationally. The failure of the Concordat to provide lender of last resort support for the failure of an Italian bank owned by a Swiss-Luxembourg holding company led to a search for an alternative arrangement. This took the form of the creation of global capital adequacy standards set out in the first Basel Accord on Capital Adequacy.

The East Asian crisis of 1997 was instrumental in highlighting the importance given to globally coordinated financial regulation and to ensuring that the multiplicity of such regulations were considered by some central body. The answer was the creation of the Financial Stability Forum, established by the Finance Ministers and Central Bank Governors of the G-7 in February 1999. It was given responsibility for defining a set of standards and codes to be observed by all international banks. This was the first attempt to develop a single set of international rules and principles for domestic

policy in the financial and monetary spheres that all countries would adhere to. In addition, The Financial Stability Forum has identified 70 financial standards from which the G7 countries and the multilateral financial institutions have identified a subset of standards deemed necessary to ensure financial stability.

While there is clear inequitable representation in the multilateral financial institutions, they do nonetheless have a clear governance structure. On the other hand, the ad hoc voluntary bodies such as the Basel Committees do not have either democratic mandates or transparent governance structures and lack any formal of representation of developing countries. It is here that the most important democratic deficits are to be found. And it is here that there is the least information on how these institutions functions.[2]

The Basel Committee on Banking Supervision has formulated a Revised International Capital Framework, usually known as "Basel II". Informal mechanisms were used to provide developing country participation, but its rules of operation are not transparent. For example, the methods used to select countries to participate in the Basel committees are not made public. Nor is there any information on how these countries participate in the deliberation of these bodies. While the implementation of standards and codes is supposed to be voluntary, and implementation is supposed to be adjusted to meet diverse circumstances of different countries and firms, it is unclear whether these differences across countries are taken into consideration at the stage of formulation of the standards, or whether the differential application is considered as only an unavoidable exception to their full application at some later date.

Further, it is unclear how the developing country representatives are themselves chosen, and to whom they are responsible. Neither is there information on how these primarily developing country representatives prepare for their participation in these bodies and whether they consult with other countries that are not invited or try to represent positions other than their own.

Finally, there is the question of how these voluntary standards are implemented in countries that do not participate in their formulation. Are national governments responsible as part of their domestic policies, and thus subject to parliamentary approval and oversight? Are the decisions taken democratically by national representative governing bodies, or by technical agencies? How important is the suasion by the multilateral financial institutions? Is there influence from private market participants?

The Revised Basel II Framework should provide increased global financial stability. This financial stability goal may not be compatible with the essential function of international capital markets of providing financing for the investment process that allows countries to fully use their domestic resources and to undertake decisions in a way that provides for national ownership of these policies.

For example, it has been argued that the introduction of the Revised Framework will make international capital flows to developing countries more pro-cyclical. This would clearly make the international financial system less stable, and more asymmetric. Others have noted that although its application is supposed to respond to national conditions it has only been developed countries, rather than developing countries, that have introduced changes to meet national conditions and objectives. The majority of developing countries have announced their intention to make full implementation on schedule.

The Revised Framework is intended for private financial institutions operating internationally, but in its initial Basel I version it was applied much more generally to all banks, including government owned banks and national development banks in a number of countries. It is unclear whether the capital of such banks, and in particular national development banks, can be considered on the same level as international private banks and whether such a framework is consistent with their national objectives. This is a particularly important issue as a number of countries are again seeking to give a greater role to their development banking system, or to recreate one if they have previously abandoned it. ■

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2 IBASE, with the support of the Ford Foundation, has launched a major research project headed by Jan Kregel and Fernando J. Cardim de Carvalho, to investigate the issue of the role of these institutions in the governance of the global financial system. For more information write to: lcerqueira@ibase.br

Forever in your debt?

European Network on Debt and Development (EURODAD)
Alex Wilks[1]
Francesco Oddone

UK Chancellor Gordon Brown hailed the G8 debt deal of 2005 as a "historic breakthrough", using the language of 100% debt cancellation. Is it true that after the Gleneagles G8 Summit the debt issue has been taken care of? No. There are still many countries – and therefore many millions of people – who are left outside the official debt initiatives and are forced to pay their creditors at the expense of making social investments in their countries.

The Multilateral Debt Relief Initiative (MDRI) launched at Gleneagles so far covers 19 countries. They will have between 21% and 79% of their debt stocks cancelled. These countries will still, however, have debts in their books. And many countries will receive nothing at all from the initiative. Worthwhile as it was, the Gleneagles deal will leave many developing countries with crippling debts. Indeed, the oft-cited figure of USD 40 billion debt cancellation pales into relative insignificance when compared with the debt stocks of all developing countries of USD 2.6 trillion or the debts of low-income countries of USD 424 billion.

How the deal works

Under the MDRI, eligible countries will obtain cancellation of debts owed to the World Bank, International Monetary Fund (IMF) and African Development Fund.

Eighteen countries can expect to benefit from the International Development Association (IDA) debt cancellation as of 1 July 2006 with a further 25 countries becoming eligible over the next five years. In total, IDA debt cancellation is expected to amount to around USD 37 billion over 40 years. This cancellation will be provided up-front with beneficiary countries receiving a letter from the Bank announcing that they no longer have to meet their IDA debt service payments on loans contracted before the cut-off date of end-2003.

The IMF has approved the debt cancellation for 17 out of the 18 countries that had been promised cancellation at the G8 Summit in Gleneagles in July 2005. Two further countries will also benefit from IMF debt cancellation: Cambodia and Tajikistan. Some USD 3.3 billion of IMF debt has hence been wiped-off the books of 19 countries since January 2006. The adopted cut-off date is end-2004, a full year better than IDA's choice.

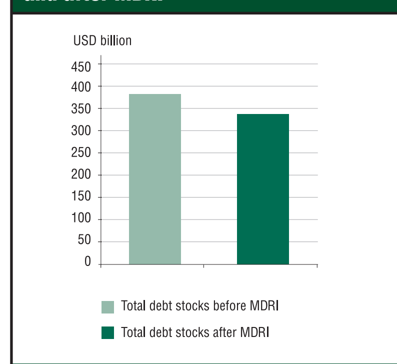
Limitations of the deal

Thus, the G8 debt deal in no way represents 100% debt cancellation: it neither covers 100% of countries in need nor 100% of debts. Debt cancellation has not been extended to all those countries that need it to achieve the Millennium Development Goals (MDGs) by 2015. This agreement covers only 17 impoverished countries' debts to the International Monetary Fund, World Bank, and African Development Fund. Debts to the Inter-American Development Bank (IADB) are excluded, for example. This matters to countries such as Honduras and Bolivia, which owe 40% and 32% of their debts to the IADB respectively.

The deal also remains firmly wedded to the flawed Heavily Indebted Poor Country (HIPC) process – whose list has merely been expanded by a very limited number of potentially eligible countries, i.e., Eritrea, Haiti, the Kyrgyzstan and Nepal – with all of its deeply unpopular economic conditionalities. It is a puzzle how many more extensions and expansions we will see of this initiative before creditors realise that the Initiative as it stands does not offer the solution to unsustainable debts or the global debt crisis. Indeed, what does the MDRI explicitly stand for if not for the acknowledgement that the HIPC Initiative was – is – by far insufficient in order to allow countries to place themselves on a path to achieve the MDGs? And, also, to do away implicitly with all sustainability calculations and methodologies?

Following the MDRI, beneficiary countries will see their overall, aggregated debt burden – in Net Present Value (NPV) terms – decrease from USD 26.5 billion to USD 11.3 billion, and their debt-to-export ratio (also in NPV terms) fall from 139% to 59%. This varies of course from country to country, and even more depending on the region under consideration. The debt-to-export ratio for Uganda is set to decrease by 79%, while for Guyana it will fall just 21%. For the African countries that are included we see a decrease of the debt burden from USD 19 billion to USD 6 billion (with the debt-to-export ratio falling from 144% to 43,9%), while for the Latin American countries (Bolivia, Guyana, Honduras and Nicaragua) the debt burden is reduced from USD 7 billion to USD 5 billion and the debt-to-export ratio goes from 127% to 92%.

CHART 1. Low income countries. Long term debt stock before and after MDRI



In Africa, the picture is mixed: in percentage terms, Uganda will have the largest proportion of its debt cancelled at 79%. This is followed by Ghana at 76%, and Tanzania and Zambia (both at 74%). The two sub-Saharan African countries which will see the least reduction in percentage terms are Mali with a 56% reduction and Mozambique with a 48% reduction, principally because these two countries owe money to creditors other than the IMF, World Bank and African Development Bank. In Latin America, the picture is even gloomier. On average, the four Latin American HIPCs will see less than one-third of their debts written-off thanks to the exclusion of the Inter-American Development Bank, one of Latin America's most important creditors. Guyana languishes at the bottom. It will see its debt reduced by only 21%, Nicaragua by only 23%, Honduras by 28% and Bolivia by 31%. In addition, the net financial gain from the MDRI for individual countries will depend on the quality of the country's policies and institutions as judged by the international financial institutions (IFIs).

Excluded countries

What about those non-HIPCs that urgently need debt cancellation and which are squarely left out of this deal? Again, this deal covers only a very limited number of countries that need debt cancellation urgently if they are to meet internationally agreed development targets. Take Indonesia, a Lower Middle Income Country where more than 50% of its 220 million population live below the UDS 2 poverty threshold, and who owes a staggering USD 130 billion, 60 billion of which to official creditors. Or Ecuador, with a USD 17 billion debt outstanding, with more than USD 6 billion owed to bilateral and multilateral creditors.

When questioned, the World Bank replies consistently that currently no discussions were currently

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underway about debt cancellation for countries beyond the HIPC Initiative (including the four mentioned above). However given that we have already seen four extensions to the HIPC Initiative and two sets of country expansions, one suspects that it may only be a matter of time before the IFIs and the international community more broadly come to realize that impoverished countries such as Kenya and many more also need comprehensive debt cancellations. Sadly however, time is costing lives and wasted opportunities for too many people.

From debt repayability to a rights-based approach

A necessary step toward this is a radical change in the concept of debt sustainability. As it is now, it simply reflects the capacity of a certain debtor to repay its debts, whatever the consequences on its social and economic development. This principle, enshrined in the IFIs' recent Debt Sustainability Framework, simply does not consider the urgent needs many countries face toward the achievement of the MDGs. It also completely ignores the illegitimate origins of many of the debts – contracted for dubious purposes by undemocratic regimes with the full knowledge of the Northern creditors.

Take Nigeria, a young yet poor democracy that has been consistently left out of the HIPC initiative. As a result of intense pressure both from the inside – parliament, government and civil society – and with the support of the UK government , then G8 President, Nigeria got a Paris Club debt deal in 2005. This amounted to a cancellation of 60% of its bilateral debts (USD 18 billion out of USD 31 billion). Yet to obtain this the government was asked to pay - upfront and in cash a massive USD 12.5 billion over just six months. This represents more than what the MDRI is going to deliver for the rest of Africa in the next 10 years! And these are resources flowing from South to North, rather than in the opposite direction, which are badly needed to fight poverty and tackle the many grave problems faced by the largest African country. They are needed in Abuja and Lagos to finance the government's strategy to achieve the MDGs (it exists, it is called the National Economic Empowerment and Development Strategy (NEEDS) which has even been approved by the IMF through the Policy Support Instrument, not in the coffers of Northern export credit agencies, who may well use them to cause further damage in the South.

Looking to the future

The debt stock cancellations that some countries have obtained in recent months go some way to alleviating the problem that Northern creditor institutions provide with one hand and take away with the other. Net transfers on debt were minus USD 240 million during 2004 for sub-Saharan Africa, in other words interest payments were higher than incoming net flows on debt. Total sub-Saharan Africa debt service paid during the same year was a staggering USD 15.2 billion. It is acknowledged by the IFIs that "MDRI countries would still require substantial grant resources to preserve debt sustainability if aid were scaled up substantially to help them meet the MDGs". Governments such as that of Zambia and Uganda greeted the Gleneagles deal by starting to announce extra spending plans – for example on HIV/AIDS treatment. But they had not read the small print of the deal. G8 finance ministers said that countries which obtained debt cancellation should have their World Bank future financing reduced, leaving them with little net gain. Dao Dounantié, Secretary General of the Coalition des Alternatives Dette et Développement (Coalition for African Alternatives Debt and Development), a Malian campaign coalition, told Eurodad this month that "nobody in Mali can yet say what have been the savings from this initiative. Because of this and because the international financial institutions have previously never respected their commitments, we are being cautious. We recognize, however, that – if implemented – this will be a small step forward, particularly because it involves debt stock cancellation".

Added to this the richest countries are simply not providing the concessional finance that is needed in order to try to attain the MDGs. The fact that donors are falsely inflating their reported Official Development Assistance by inserting all debt cancellations – even those resulting from export credit subsidies of Northern companies operating in Iraq and Nigeria during completely undemocratic periods – is a blatant attempt to delude the public. Eurodad and many other groups are campaigning for a clean-up of aid reporting, and demanding the provision of additional funding.

While certainly worthwhile, and having set an important precedent of debt cancellation, the G8 deal of last year is not sufficiently comprehensive in the debts it covers, or the countries it covers. The problem of clearing the overhang of past debts is by no means over, and campaigners will continue to highlight the deep injustices of governments having to favour creditors rather than their own people. We will also point out the major problems with the international financial system, which is structurally biased toward the rich and strong, and consistently geared against developing countries' ability to reach the MDGs. ■

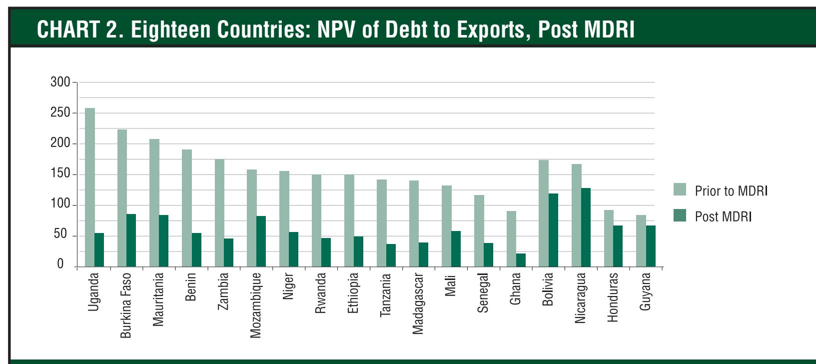

CHART 2. Eighteen Countries: NPV of Debt to Exports, Post MDRI

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LATIN AMERICA: DEBT, INVESTMENT, CAPITAL FLIGHT

Iara Pietricovsky [1]

The Latin American gross domestic product (GDP) was on the decline until 2002 in concert with the performance of the world economy. From that year forward, signals of a recovery of growth have begun to emerge. This trend is leading to a reduction in the debt/GDP ratio thanks to GDP growth, although other factors must be considered to explain the behaviour of the debt.

The public debt in Latin America was on the rise since 1997, reaching its peak in 2002. In 2003 the tendency toward growth of debt was reversed.

Currently the world economy finds itself in a cycle of expansion, which is to say, it shows high growth rates, which explains in part the behaviour of the debt/GDP ratio in the countries of Latin America. Nevertheless, the region's growth did not match growth in the rest of the world.

With the exception of Chile, the region's countries show a high level of debt, at both the internal and external level. In the case of Brazil, the most worrying part is the internal debt – that owed by the states and large cities to the federal government – because it is among the highest in Latin America.

The countries of Latin America, and especially Brazil, are placing themselves in greater debt insofar as they present only minimal economic growth. There are a great number of macroeconomic goals that they must meet, including maintaining a primary budget surplus and avoiding errors in exchange rate policy. Argentina, following the crisis, presents the highest levels of debt in all of Latin America.

Rates of foreign direct investment in Latin America registered a rise in 2004 for the first time since 1999, brought on especially by Argentina, Chile, Colombia and Mexico, which were the targets of an increase in foreign investment. In any case, the rates of foreign investment in 2004 are significantly lower than those observed in the mid-1990s.

This tendency toward a reduction in foreign investment at the beginning of the present decade can be observed across all of Latin America. In countries that recently suffered economic crises, such as Argentina and Brazil, between 1999 and 2003 foreign investment fell more than 70%.

TABLE 1. Debt/GDP ratio

PERCENT OF GDP	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina									
Public debt of the national government	35.7	34.5	37.6	43.0	45.0	53.7	145.9	138.2	126.5
Internal	8.9	9.6	10.4	13.9	16.4	22.3	52.1	58.2	54.5
External	26.8	24.9	27.1	29.1	28.6	31.5	93.7	80	72.1
Interest payment of the non-financial public sector (percentage of income)	8.8	10.2	11.5	14.4	16.5	21.8	11.3	8.9	...
Primary balance	**-1.2**	**0.8**	**0.2**	**-1.1**	**0.8**	**-2**	**1.8**	**4**	**3.3**
Bolivia									
Debt of the non-financial public sector	67	61.7	61.2	65	66.3	74.9	79.3	93.3	85
Internal	14.1	13.6	13.8	16.7	19.4	26.4	29.1	31.6	31.5
External	52.9	48.1	47.4	48.3	46.9	48.5	50.2	61.7	53.5
Interest payment (percentage of current income)	7.9	5.7	4.7	5.1	5.7	7.5	8.2	10.1	10.6
Primary balance	**0.3**	**-1.7**	**-3.2**	**-1.9**	**-1.9**	**-4.8**	**-6.8**	**-5.4**	**-2.9**
Brazil									
Debt of the central government	16.5	19.3	25.3	32.5	32.1	34.4	41.7	37.2	34
Internal	14.9	17.3	21.1	23.9	24.3	25.7	27	26.9	26.9
External	1.6	2	4.2	8.5	7.8	8.6	14.7	10.3	7.1
Primary balance	**0.4**	**-0.2**	**0.6**	**2.3**	**1.9**	**1.8**	**2.4**	**2.5**	**3**
Chile									
Overall balance	2.2	2.1	0.4	-2.1	-0.6	-0.5	-1.2	-0.4	2.2
Public debt	15.1	13.2	12.5	13.8	13.7	15	15.7	13.1	10.9
Internal	10.9	10	9.3	9.8	10	10.4	10	7.6	6
External	4.2	3.2	3.2	4	3.6	4.5	5.7	5.6	4.8
Interest payment (percentage of income)	6.4	5.7	5.7	6.2	5.6	5.4	5.5	5.5	4.4
Primary balance	**3.6**	**3.3**	**1.6**	**-0.9**	**0.6**	**0.7**	**-0.1**	**0.7**	**3.1**
Venezuela									
Debt of the non-financial public sector	46.8	31.7	29.1	29	26.7	30	41.9	45.8	39
Internal	7.8	5.1	4.6	5.9	8.8	12.1	14.8	17.7	14.3
External	39	26.6	24.5	23	17.9	17.9	27.1	28.1	24.6
Interest payment (percentage of total income)	14.5	9.9	12.8	12.3	9.4	12.5	17.7	16.1	...
Primary balance	**12**	**6.7**	**-1.4**	**4**	**7.5**	**-1.2**	**4.2**	**5.4**	**...**
Uruguay									
Public debt	22	22.6	24	26.2	31.9	41.9	98.7	94.3	74.7
Interest payment (percentage of total income)	7	7.4	6.8	8.4	10.2	12	19.1	26.3	22.9
Primary balance	**-0.6**	**-0.2**	**0.2**	**-2.1**	**-1.5**	**-2**	**-0.8**	**1.1**	**2.4**

Source: INESC with data taken from Economic Commission for Latin America and the Caribbean (ECLAC). *Economic Survey of Latin America and the Caribbean, 2004-2005.*

Latin America's attraction of foreign investments is falling continuously, revealing the limitations of the region's capacity to compete for investments at the global level with regions such as Asia and Eastern Europe. The capacity to attract investment varied according to the strategies of the multinational corporations, such as the search for natural resources, new technologies and local markets or the conquest of the markets of third countries.

In Brazil, the peak of foreign investment entrance into the economy coincided with the period of privatizations of state enterprises, when investors were more attracted to our market. Today, even after adopting an economic policy attractive to external investors, foreign investment in Brazil continues to decline gradually, reaching in 2004 the lowest volume since 1995, and thereby demonstrating the inefficiency of this policy.

Since 2000, financial resources are tending to leave Latin America. After the boom in investment attraction in the 1990s, brought on by privatizations and policies to attract foreign capital, the time has come wen the large international investors are reaping their profits from those operations. The scarce new investments in private companies are not sufficient to cover the flight of profit and interest abroad.

Brazil and Venezuela show the greatest drop-offs in financial transfers. Argentina, after its crisis, presents growth in the balance of liquid transfers. In Argentina's position, already "in a deep hole", any entrance of resources represents progress. One must note the case of Chile, which after the period of privatizations up to the 1990s, has found itself since 2000 in a situation of constant resource flight. ■

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Migrant worker remittances: a way out of poverty?

Carlos Heredia [1]

The problem: migration and social exclusion

Emigration from Latin America and the Caribbean has sped up drastically since 1980. Some factors that have led to the expulsion of the migrant population are the inability to create jobs with decent wages, armed conflicts, devastation caused by natural disasters, the development gap between the Northern and Southern hemispheres, and the huge wage disparities with respect to the United States.

The Economic Commission for Latin America and the Caribbean (ECLAC, 2006) informs that Mexico, the Caribbean Community and Colombia have the largest number of emigrants. Countries with the largest percentage of population abroad include Cuba (8.7%), Dominican Republic (9.3%), El Salvador (14.5%), Mexico (9.4%), Nicaragua (9.6%), and Uruguay (8.3%). Half of the region's international migrants are women, who often travel alone in search of labour opportunities and find jobs in domestic service. The qualified migration of doctors, nurses and teachers jeopardizes the critical mass of knowledge.

The United States continues to be the favourite destination point; in 2004 it concentrated 18 million immigrants from the region, which together with their offspring born there make up the country's first ethnic minority. In 2006 there were 11.5 million people born in Mexico living in the United States. The current economic model in Mexico has largely favoured emigration. Far from dropping, it has grown during the 12 years since the North America Free Trade Agreement (NAFTA) with the United States and Canada came into effect. Today, United States-bound emigration affects all of the Mexican states and covers income strata that were not included before. As Armando Bartra (2005) says:

> The poor who saved for the trip or found a smuggler that would wait for his pay are leaving, but so are the wealthy; peasants take to the road, while urban dwellers buy a ticket; Indians get out of here and mestizos migrate; PRI, PRD, PAN and Zapatista followers go shoulder to shoulder; Catholics and Protestants desert at the same time; children say goodbye, like the young and the old; men and women; illiterates and doctors. The entire homeland demographically bleeds to death at the gringo rate of half a million deserters a year, more than 40,000 a month, one every minute.

Emigration is often final, since it goes beyond a temporary or seasonal situation of labour mobility. In the states of Michoacan and Zacatecas, for example, there are dozens of communities marked by the permanent absence of economically active people. A significant percentage of that population regularly sends remittances to their families in their countries of origin. Remittances have become one of the main sources of foreign financing for the region. Their use, measurement, transfer costs, and productive potential are issues to research. According to a recent ECLAC study, their impact on the poverty situation is hardly significant, although for the homes that receive them they are a strategic source of income.

Impact of migration and remittances on poverty

In this section we will try to explain in what measure remittances are a mechanism for the poor population to finance their way out of poverty. The issue in question is the access of the poor to financing and public resources, and how they contribute to the elimination of poverty.

First of all, remittances are not public resources. They should not be accounted as development aid, since they are wages earned by emigrants. It is their money: they are private resources that governments are not entitled to allotting as they please. Only as long as the migrants themselves label their money in order to invest it in works that benefit the community may the resources be accounted as development funds. In Latin America, remittances more than double the volume of development aid. In Mexico, they are the second source of foreign currency income nation-wide, after hydrocarbons and thus displacing foreign direct investment and tourism revenues.

The "addiction" Mexico has developed for remittances sent by migrants has become indispensable for 21% of households. These money flows went from USD 1,043 million in 1982 to some USD 22 billion in 2006. Although migrants earn 10 times more in the United States, the amount of money that actually reaches Mexico almost equals what they would earn here.

"When a worker is in the United States, 80% or 90% of his earnings will remain there, that is lost. What reaches Mexico is that little surplus the worker can save… without taking into account the travel costs to the United States… this questions that migration may be a way out for the country's poor families", said Agustín Escobar, from CIESAS.[2]

Monetary dispatches do not always translate into a higher quality of life for the receiving family. Family remittances seek to support relatives that remain in the country of origin of the expatriate worker. They are to pay for their daily livelihood expenses. According to Dr. Jorge Santibáñez Romellón (2005), Chairman of the Colegio de la Frontera Norte in Tijuana, Baja California, the money transfers of Mexicans living in the United States that come to visit Mexico are used as follows:

Food, rent, clothing and health	69%
Buying, repairing or improving their home	22%
Productive use	5%
Other	4%

In addition, a 2003 study by the Pew Hispanic Centre reveals the following percentage patterns in the use of remittances:

Consumer expenses	78%
Education	7%
Savings	8%
Investment	1%
Other	5%

There may be various ways of classifying the final use given to remittances, but in every case the top priority is for expendables, made up mostly by: food, beverages and tobacco; clothing and shoes; housing, home appliances; health; transportation and communication; education; and entertainment. The "Other" category may include – though not exclusively – investments made by migrants, but it never exceeds 5%.

Even more complicated is estimating how remittances are a mechanism to alleviate poverty. Remittances are constant flows whose purpose is mainly subsistence. They are not aimed at capital formation or at the creation of new riches. It is income meant fundamentally for immediate expenses, and not for the stable or permanent creation of new income. Only a small percentage is used for savings or investments. The continuity in the flow of remittances has become for the Mexican government a matter of national security, which is imperative to "shield" so it becomes permanent, at least in the short term.

1 Economist, member of the NGO Equipo Pueblo, AC, Mexico. This article collects the thoughts of scholars and specialists from civil society on the subject. It does not present original research, rather it summarizes the "state of the art" on migration, remittances, poverty and development in Latin America and the Caribbean, stressing the case of Mexico.

2 Centre for Research and Higher Studies in Social Anthropology, Mexico DF, 21 February 2006.

TABLE 1

Types of remittances, uses and areas of priority interest				
TYPES OF REMITTANCES	**REMITTENT**	**RECEIVER**	**USES**	**INTEREST AREAS**
Family	Individual migrants	Relatives in hometowns or cities.	Expenses in family's basic needs.	Bank transfer costs (from and to receivers).
	Individual migrants	Relatives, partners or the migrant himself/herself.	Investment in business and small companies.	Individual service, technical assistance, information.
Collective or community	Migrants' clubs	Organizations, leaders or authorities in hometowns.	Social expenses: small scale infrastructure.	Knowing local demands. Harmonize local demands with support programmes or funds.
	Migrants' clubs	Partners and investors.	Productive investment in small & mid-sized companies.	Evaluation of investment conditions. Technical assistance and information.

Source: Rodolfo Tuirán (2006).

Solutions for development

We face the challenge of finding mechanisms to minimize costs and capitalize positive impacts of international migration in the different countries, in terms of remittances, savings, markets and new migrant skills.

"For too long, Mexico has boasted about immigrants leaving, calling them national heroes, instead of describing them as actors in a national tragedy. And it has boasted about the growth in remittances as an indicator of success, when it is really an indicator of failure", said Jorge Santibáñez, quoted by Ginger Thompson in The New York Times (2006).

Our governments and societies should question themselves about the huge drain that our migrant exodus entails for the country's productive capacity and the gash in the social tissue caused by the forced separation of families that remain divided. Mexico lacks a nationwide strategy that enables economic opportunities to reach the regions where migrants come from, and the efforts to strengthen those communities have not been addressed. In their absence, the alternative use of remittances has been promoted through savings or investment mechanisms, or their channelling toward financing development projects.

Family remittances: roots and banking of migrants

The Inter-American Development Bank's (IDB) Multilateral Investment Fund (MIF) supports development projects through migrant resources in the United States and their integration to the formal financial sector. Donald F. Terry, MIF manager since 2006, recommends that:

- Remittances firms: improve transparency, promote fair competition, apply appropriate technologies, expand financial services;
- Government authorities: do not interfere, improve information, promote basic financial knowledge, avoid migrant abuse;
- Civil society: support the social and financial inclusion of bi-national families in their communities; promote training, attack obstacles for the impact of remittances in development.

Another crucial task is job promotion for minors under 15, who emigrate from their communities searching for opportunities and usually do not return.

Collective remittances: 3 x 1 co-financing programme

An example of community project funding in Mexico is the Iniciativa Ciudadana "3 por 1" (3 x 1 Citizen's Initiative), a co-financing mechanism whereby each dollar contributed by migrant clubs is matched by another dollar from each one of the three levels of government (federal, state and municipal) with that joint goal. Starting to take part in this mechanism are multilateral development banks and even companies involved in the remittances-transfer business, which would turn the fund into 4 x 1 or even 5 x 1.

Community programmes create a sense of belonging and identity between the migrants and their original communities. Collective remittances are sent to basic infrastructure and social benefit works, such as urban development, drinking water, sanitation, community development centres, road pavement, productive projects, education, health and sports infrastructure, and others such as town fairs or religious ceremonies. The aim is for the projects to include training and evaluation; to be profitable and self-sustaining; to be supported by professional, responsible management with transparency in public resources related to remittances; and to form part of a regional development perspective.

In short: remittances are private resources that may alleviate poverty temporarily, but should be understood as a complement to and not a substitute of state policies to encourage production, employment and growth; to combat exclusion, reduce inequity and lead to social and economic cohesion in our countries. And we should not assume that they will continue to grow in the future. "They are financial flows with high financial benefits, but at a very high human cost. There remains a lot to do to offer the necessary incentives and skills that will enable people to invest their money in a way that better serves them, their families and their futures." (Terry, 2005).

Finally, in the words of Rodolfo García Zamora (2005), for the efforts and initiatives of migrants and their organizations to have a significant impact in their communities of origin and in the country it is necessary to have a comprehensive and long term State policy, that includes them and makes them a part of development. ■

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International taxation: the time is ripe

Peter Wahl [1]

International taxes are a completely new paradigm. Their realisation is an innovation of historical significance because up until now, taxes have been firmly linked to the nation state. However prerequisites for international taxation have appeared because of globalization. The time is ripe for the establishment of international taxes.

In 1996 a number of UN Development Programme staff members published a book (Ul Haq et al. 1996) in which they proposed an international tax on currency transactions (the so-called Tobin tax). The publication may be said to have opened the discussion on international taxes. Since then the debate has grown in intensity. This is not at all surprising. After all, taxes are not simply one economic variable among others.

Taxes - more than one economic variable among others

With their dual function – generating financial resources and serving as a means to achieve regulatory effects – taxes are a key instrument involved in giving shape to social processes. Alongside the monopoly on the use of force, taxation may be said to constitute the second pillar of modern statehood.

For the economic model dominant at present, though, taxes are above all a "negative externality." And for this reason the core points of neoliberal tax policy are:

- tax cuts, above all for business enterprises and the wealthy;
- shift of the brunt of the tax burden to excise taxes and mass taxes;
- imposition of government austerity policies geared to the ideal of the "lean state"; and
- promotion of international tax competition as a means to compel the non-like-minded to bow to the dominant neoliberal tax doctrine.

The outcome is a relentless process of redistribution from the top to the bottom, exacerbation of social polarization, increasing pressure to privatize public infrastructure, government and state sectors with dwindling capacities to act and solve pressing problems. In the end, realization of the neoliberal tax ideology is leading inexorably to social disintegration with unforeseeable political consequences.

This is why, when we discuss tax policy in general and international taxes in particular, we are talking not only about money but also about the possibility of (re)gaining policy space and political options. In a situation in which the scope and reach of national policy instruments is declining under the conditions imposed by globalization, international taxes must be seen as having a major potential for use in regulating globalization. International taxation is an important approach to developing alternatives to the neoliberal paradigm and at the same time an indispensable component of a post-neoliberal world order.

The legitimacy problem bound up with international taxes

In the democratic nation-state the legitimacy of taxes is based on democratic parliamentary procedures. The 1789 French Declaration of the Rights of Man and Citizen established the norm that is still valid today: "All citizens have the right to ascertain, by themselves or through their representatives, the necessity of the public tax, to consent to it freely, to supervise its use, and to determine its quota, assessment, payment, and duration." (Article 14). Or, put in a nutshell: "No taxation without representation."

Since, at least at present, there is no parliamentary representation beyond the nation-state, i.e. no international or global parliament, to say nothing of a world state,[2] there is, in the sense of the principle of parliamentary representation, no democratic legitimation for international taxes and, accordingly, no basis for them in public or international law. This is a fact that must be taken seriously, one which any case for international taxation will have to address. After all, if we attributed absolute validity to the principle of "No taxation without representation," there would, of course, be no need for any further discussion.

It is, in other words, correct to start out by saying that international taxes can in fact not be imposed on the basis of the legal tradition normally used to legitimize taxes. But we should also bear in mind here that globalization was not part of the rationale of historical democracy theories. The territorial nation-state was - and continues to be - identical with social space of parliamentary democracy. Now, the fact that that globalization has at least relativized the principle of territoriality by transnationalizing economy and communication has substantial implications for the functioning of parliamentary democracy in general and for taxation in particular. It is for this reason recommendable to start out by taking a look at the impacts of globalization on national taxes.

Globalization and taxation

The systems of taxation that developed in the course of the 19th and 20th centuries were conceived for the comparatively closed economy of the nation-state. Capital and labor were territorially bound to roughly the same degree. It was relatively easy for national tax legislation to establish the national tax base. Globalization has given rise to a new situation. The latter's economic core may be seen in the fact that national boundaries are increasingly vanishing for movements of capital, goods, and services. And in this connection no other factor of production has proven to be as mobile as capital.

New possibilities to dodge and evade taxes

Globalization has thus opened up new approaches for global players to dodge national tax obligations. And this in turn is serving to erode the nation-state's tax base. Various mechanisms are used in this connection:

- Financial market liberalization has subverted most of the controls on capital movements in place at the national level. And more and more possibilities have also emerged to transfer funds in ways that circumvent national taxes.
- At the same time, most nation-states are actively engaged in cutting taxes on corporate profits, capital gains, and large assets. As a means of attracting capital into their own economies, many governments have seen fit to boost their "locational attractiveness" by cutting taxes for investors. Globalization-related locational competition is fueling a race to cut taxes that is taking on increasingly perverse forms of tax dumping.
- Transnational corporations (TNCs) have ways to distribute their profits and losses across locations most favorable to them in terms of taxes.
- Using procedures like transfer pricing, these corporations are also able to generate artificial profits or losses. One approach used here is for a parent corporation to charge subsidiary excessively high or low prices for intermediate products, services, patents, and the like.
- Offshore banking centers and/or tax havens provide additional incentives to dodge or evade taxes.

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2 Whether or not this would be desirable in the first place is an entirely different question.

The outcome is that revenues from corporate and asset taxes have started to crumble. This is one of the main reasons for the structural crisis of national finances.

New ways to earn profits

In parallel to the new tax problems besetting the nation-state, globalization has also opened up new sources of corporate profits (Wahl, 2005b). Some of these new profits can of course still easily be taxed in the national framework. But the character of a good part of these new high-yield activities is by nature well suited to dodging national tax obligations.

Now, if anyone profits in this way from globalization, it is actually only logical that these earnings should be taxed globally, with the revenues being used to fund the environment, development, and other global public goods. The Landau Report for this reason sees international taxation of TNCs as "a normal counterpart to the benefits [TNCs] derive from globalization." (Landau, 2004, p. 16).

Globalization as a legitimation for international taxes

The globalization-related erosion of the nation-state's tax base is not only an economic problem. This development at the same time strikes at the heart of modern statehood and democracy. A good measure of democratic sovereignty is being lost because the sovereign is gradually being deprived of the material means it needs to shape and sustain the community. If the chronic crisis of public finances leads to further deterioration of community social and physical infrastructure, the erosion of democratic policy spaces and options will also be a consequence.

Hence, international taxes may be seen as democratically legitimate because they restore to the democratic sovereign – the citizenry – some of the scopes it needs to give positive shape to life in the community. While this can certainly not be seen as the one-and-all solution to the globalization-related problems with which democracy has to contend, it is nevertheless a key moment of democratization. If the argument "No taxation without representation" is not to relinquish its democratic substance – the power of the sovereign to formulate and implement public policy – the new interrelationships between globalization and taxation will have to be taken into account.

Taxes as a regulatory instrument

Another noteworthy advantage of taxes is their regulatory function. They can be used to set incentives to pursue certain economic or socio-political goals. Viewed in economic terms, taxes can serve to eliminate or compensate for negative externalities and/or to generate positive externalities.

We must, to be sure, bear in mind here that a successful regulatory effect may also lead to a decline in, indeed in tendency even to a complete loss of, tax revenues. If this is not intended, or if the ultimate outcome could be new negative externalities, it is essential to strike a proper balance between regulatory effect and tax revenues. International taxes can also be used to achieve such regulatory effects – e.g. a currency transaction tax designed to drain a macroeconomically harmful level of excess liquidity from the market, or an air-transportation tax designed to lower kerosene consumption or reduce emissions.

Earmarking as a key factor for legitimacy

And last but not least, earmarking revenues from international taxes for purposes that enjoy a high level of moral authority may serve to boost the acceptance of such taxes. This is the reason why advocates of international taxes are in favor of starting out by using these revenues to finance the MDGs (United Nations, 2004).

The issue of earmarking is as a rule not relevant for national taxation. One of the fundamental principles of national tax policy is precisely that tax revenues are not earmarked for specific purposes. All the same, at present more and more exceptions to this principle can be observed in national taxes. For example, the revenues from the German ecotax are used to fund social expenditures. Also, the contributions paid by the European Union (EU) member countries to fund community institutions are financed from a given, earmarked share of their national value added tax (VAT) revenues. And the church tax officially levied in Denmark, Germany, and Switzerland also has some very clear-cut features of earmarking.

The most important proposals on international taxes

The most popular of the proposals on international taxes is the one advanced by the Nobel laureate in economics James Tobin. It calls for a tax on currency transactions. The underlying idea goes back to Keynes. The concept, as well as a number of variants, has been elaborated in great and differentiated detail. Some recent studies have worked out the legal and technical aspects to the point where the currency transactio tax (CTT), in a modified, two-tier variant of the Tobin proposal, is virtually ready for implementation (Jetin/Denys, 2005). The issues remaining to be resolved boil down to little more than a matter of the political will needed to take the first step.

Despite massive resistance, the number of advocates of the tax continues to rise. Both the French and the Canadian parliaments have come out in favor of the tax. In 2004 the Belgian parliament even passed a relevant bill, although it is set to come into force only if other EU countries follow suit. The advocates of a CTT also include Nobel laureate Joseph Stiglitz, the German Bundestag's fact-finding commission on globalization (Deutscher Bundestag, 2002), billionaire financier and philantropist George Soros, French president Jacques Chirac, and Austrian Prime Minister Wolfgang Schüssel. At the Davos World Economic Forum 2005 former German chancellor Gerhard Schröder likewise came out in favor of the tax. As early as 2002 the German Ministry for Economic Cooperation and Development (BMZ) commissioned a study that came to the conclusion that a two-tier variant of the Tobin tax would not only be feasible but also desirable in terms of development policy (Spahn, 2002).

The most recent success of the advocates of a CTT is a resolution adopted by the Austrian parliament on April 27, 2006, calling on the government to examine, "in the framework of the European institutions, the feasibility of an EU-wide tax – e.g. a currency transaction tax, a tax in the area of air transportation, shipping, natural resources, etc. – and at the same time to work for uniform steps toward the implementation of such a tax - without placing the Lisbon goals in jeopardy."

Even though other taxes have also found their way on to the agenda, it would be absolutely essential not to abandon the CTT or to play off one tax or tax type against others. The thrust of the CTT is aimed at the core of a globalization dominated by the financial markets. Without political control of the financial markets, alternatives to the dominant neoliberal paradigm are doomed to precariousness.

Certainly, the CTT is not the only instrument suited to regulating the international financial markets; but implementing the CTT would create a precedent. This – and not the tax's alleged weaknesses – is also the reason why the CTT has run up against such vehement resistance. Indeed, what institutions ranging from the Deutsche Bank to the European Central Bank have put forward in the garb of expert arguments has as a rule not been addressed adequately even in the literature of the proponents (ECB, 2004; for a critical assessment see Wahl, 2005a).

Environmental taxes

If we take a close look at environmental taxes, we cannot help but find that the logic of international taxation is quite cogent:

- Many environmental problems are international or global by nature and can therefore not be addressed only in the national framework. And for this reason international financing mechanism also appear called for.
- Viewed in economic terms, environmental damage is a negative externality. That is, such damage causes costs that are not covered by those responsible for them. A tax or levy would serve to internalize these costs by requiring those responsible to pay at least part of these costs.
- Many environmental goods are what is referred to as global public goods, or global commons. And they should therefore be financed publicly, i.e. through taxes.

The air-ticket tax

Since July 1, 2006, France is levying a tax on air tickets; the revenues from the tax are set to flow into a fund set up to combat Aids, malaria, and tuberculosis in the developing world. France sees this as a contribution to reaching the Millennium Development Goals (MDGs). The Chilean government has also decided in favor of an air-ticket tax and has already initiated the appropriate legislative procedures. Brazil likewise plans to introduce a tax on air tickets in the course of 2006. Norway and Republic of Korea as well as some other countries have joined the initiative.[3]

The UK has announced to put a certain amount from the revenues of its already existing ticket levy into the fund against AIDS, malaria and tuberculosis. This is part of a French-British deal. France supports in return the British pilot project for an International Finance Facility which is also destinated to the financing of the MDGs.

The French air-ticket tax levies a rate of one Euro on every ticket sold for economy-class domestic and European flights. The rate for business and first class is EUR 10. The respective rates for intercontinental flights are four and EUR 40 per ticket.

The rationale for the higher rates on business and first-class tickets is not distributional policy. With 60% of the revenues of air carriers stemming from these classes, the tax revenues collected are accordingly high. On the whole, the French government anticipates revenues from the tax amounting to up to EUR 200 million.

Estimates for the Brazilian ticket tax foresee an income of USD 12 million and in the Chilean case it would be between USD 5 million and USD 6 million. These are rather small amounts. However, politically it underlines the character of the project as a North-South partnership beyond the traditional donor-receiver relationship.

However, viewed in environmental terms, tax rates as low as these generate virtually no regulatory effects. Even those used to flying at discount rates will have no trouble paying an additional one or four euros for a flight, and the rates for business- and first-class tickets are certain not to induce passengers to switch other means of transportation, or not to travel at all. Any attempt to drastically increase the tax rate with the aim of reducing the volume of air transportation would be bound to run up against virtually insurmountable political problems. At least in the industrialized countries, the ticket tax is a mass tax. The air-ticket tax is unsuited as a means of regulating globalization, at least viewed in terms of the criteria outlined above. An air-ticket tax is acceptable only in view of its function as a first international tax, as a means of gaining a toehold for the new paradigm.

In deciding what use these tax revenues should be put to, France has opted in favor of a dedicated fund, the so-called International Drug Purchase Facility (IDPF). And here we may bear witness, once again, to the truth of the adage: The devil is in the details. Brazil e.g. has already indicated that it intends to pay only part of its revenues from the tax into the IDPF, reserving a certain share for national expenditures. Bearing in mind that Brazil now has a pharmaceutical industry of its own that produces, among other drugs, generics for use against AIDS, we cannot help but conclude that one of the government's aims here

3 Congo, Cyprus, Guatemala, Guinea, Ivory Coast, Jordan, Luxemburg, Madagascar, Mauritius, Nicaragua.

CURRENCY TRANSACTION TAX

Sony Kapoor

Some technical characteristics

Contrary to commonly held perceptions that a Curency Transaction Tax (CTT) can only work if implemented universally, it is possible to implement a CTT unilaterally on a currency basis. For currencies such as the British pound, the Brazilian real, the Indian rupee, and the Swedish, Danish and Norwegian krone it is a unique opportunity to implement the tax without first needing to bring other countries on board.

The strongest opposition to the CTT to date has come about from the United States, yet one further attractive feature of the proposition is that it does not really need the US to participate for the regime to be successful. This is because whenever the US dollar is traded in the foreign exchange market it is always against another (mostly major) currency. As long as a sufficient number of other major currencies such as the Japanese yen, the Euro and the British pound subscribe to the CTT regime, most US dollar transactions can easily be captured.

Using the money for development

The revenues generated from a CTT should be allocated directly to development. This would then be one of the most progressive taxes in the world – redistributing money from the richest market in the world to those who need it most – from those who have benefited most from globalization to those who have been left behind.

However, the main beneficiaries of the CTT would be the emerging (or middle income) economies that would stand to gain much more by freeing up hundreds of billions of dollars currently locked in unproductive foreign exchange reserves. The reduced cost of sterilizing reserve holding, lower opportunity costs and enhanced financial stability could generate annual dividends well in excess of a hundred billion dollars.

The total revenues raised by the CTT would depend on the degree of sign up, especially from the major currencies such as the euro, the British pound, the Swiss franc, the Japanese yen and the US dollar. It is fairly likely that a CTT can be implemented by a small group of countries (or even a single country such as Norway) in the short term, whereas a more widespread sign up is likely to take much longer. ■

is to foster the national pharmaceutical industry. Viewed in terms of development, though, it certainly also makes sense not to squander funds earmarked for action against epidemics on drugs manufactured by the pharmaceutical TNCs in the North. In this sense these tax revenues could be used to kill two birds with one stone: combating epidemics and strengthening the competitiveness of pharmaceutical production in newly industrializing countries.

Emission tax and CO_2 tax

In view of the air-ticket tax's low regulatory effect, the German Advisory Council on Global Change (WBGU) has come out in favor of a tax on aircraft emissions – from noise to exhaust-gas emissions (WBGU, 2002). This approach, it is argued, would create an incentive to build low-emission aircraft engines.

As far as international ecotaxes are concerned, one of the oldest and at the same time most popular proposals is for the imposition of a carbon dioxide (CO_2) tax. The main concern here would be the tax's regulatory effect, i.e. reduction of the most important greenhouse gas. Under the pressure of climate change, the CO_2 tax appeared, up to the mid-1990s, to have good prospects of being adopted. Subsequently, however, the Kyoto Protocol shifted the paradigm in favor of tradable emission rights. One of the protocol's main functions was, in other words, to fend off a CO_2 tax. With the Kyoto Protocol now in force since 16 February 2002, the situation could change. For one thing is certain: The Kyoto Protocol's reduction targets – assuming they were reached in the first place – are nowhere near sufficient to prevent a climate disaster. On the other hand, it is not yet clear what shape climate-protection strategies may take on in the coming years. This may well be a good opportunity to throw the CO_2 tax into the breach.

The proposal for a kerosene tax also enjoys a certain measure of popularity. There would be no problem levying such a tax on domestic and European flights. But levying it on international flights would entail legal problems in view of the fact that kerosene has been exempted from taxation in hundreds of bilateral air-transportation agreements.

Other relevant proposals include levies on the use of air corridors, taxes on maritime shipping, emissions, and movements of hazardous goods, and fees for the use of maritime straits.

Taxes with a regulatory economic effect

Alongside the CTT there are also debates underway on a good number of other taxes with regulatory economic effects, including international taxation of transnational corporations. A tax of this kind would have a very broad base. At present some USD 860 billion in taxes are levied on TNCs (Landau, 2004, p. 93). An across-the-board hike by only 5% would generate an additional USD 43 billion in tax revenues. In technical terms, a tax of this kind would be easy to collect – after all, TNCs are already being taxed – and it would also involve a high degree of distributive justice (Cossart, 2005). Its problematic sides would include the fact that it would prove difficult to introduce at the regional level – because it would mean competitive disadvantages for the companies forced to pay it; because revenues may fluctuate sharply due to cyclical factors; and because there is massive political resistance to any such tax, thanks in large measure to the influence of the TNCs and their lobby on politicians and the media.

Taxation of bank secrecy and offshore banking centers

Under the header "Bank Transparency as a Public Good" the Landau Report notes: "Bank secrecy exactly meets the economists' definition of a negative externality. In other words, bank secrecy can be seen as producing a 'global public bad.'" (Landau, 2004, p. 96). The proposal on transactions with countries with strict bank secrecy would certainly meet with broad acceptance if the one government or the other marshaled the courage to take the lead on the project.

There are a good number of other innovative proposals currently under discussion, most of them still at the idea stage, and therefore operating with only rough estimates. This is no reason to disparage these ideas. It would be important to further develop them, and above all not to lose sight of them. Such proposals include taxes on securities transactions or on portfolio investments.

Other possibilities would include taxes on direct investments and e-commerce.

Proposals on taxation of the use of inner space for satellites or for use of the electromagnetic spectrum may sound exotic. But in actual fact both cases are examples of public administration and control of public spaces, in principle of the same kind exercised when parking meters are installed on public streets. The International Telecommunication Union in Geneva already charges a fee for registration of satellites and allocation of broadcasting frequencies. These fees could easily be raised and converted into an annual tax.

What is international about international taxes?

The French air-ticket tax will be levied by the internal revenue authorities on every airline ticket purchased on French soil. In this regard the new tax may appear to be just another, normal national tax. Its innovative elements include the facts that it:

- is levied in concert with other countries. It is for practical reasons only that the course of implementation will be staggered, with France taking the lead and Chile and Brazil then following suit. In other words, the first characteristic of an international tax is that it is levied in concert with other countries, at least two countries. The aim of this ticket tax is to continuously raise the number of players, ideally to include all of the countries of the world.
- is earmarked for an international use, in this case for a subgoal of the Millennium Development Goals, viz. to combat AIDS, malaria, and tuberculosis.

The tax will be collected on a national basis, and sovereignty over the use of the revenues will lie with the nation-states concerned. In other words, international taxes do not necessarily require an international organization. However, other, more extensive configurations would also be conceivable. The tax could, for instance, be collected by a multilateral institution, and decisions on the use of the revenues from it could be reached on a multilateral basis. This, though, would call for far more multilateral integration than we have at present. The EU is now practically the only place where some rudimentary steps toward such a higher level of integration have been taken.

The political process

There is a considerable dynamics in the process to establish international taxation. Apart from civil society actors in many countries, the French government is playing a leading role. The international conference on "Innovative Development Financing" held in Paris between 28 February and 1 March 2006 and hosted by French President Jacques Chirac, was a breakthrough.

The Paris conference was the culmination point of a process set in motion by UNDP in 1996. This is a brief period of time, particularly if we consider the fact that in historical terms international taxation is a wholly new phenomenon. After all, until now taxation has been conceivable only in the national framework

Under heavy attack, above all by the finance community, the CTT has dominated the debate up

to this point. But in view of the political acceptance problems with which the CCT has had to contend in recent years, other taxes have also come in for discussion. In 2002, for example, the WBGU published a report taking a closer look at air-ticket taxes and other instruments of environmental policy (WBGU, 2002).

The most influential relevant study published thus far is the so-called Landau Report (Landau, 2004). Prepared on behalf of French President Jacques Chirac, the report analyzes the whole range of different concepts advanced for international taxes. It has at the same time served as the basis for a report submitted to the UN General Assembly by the so-called Lula Group, initiated by France, Brazil, Chile, and Spain. The group has now more than 40 members.

With the votes of 115 countries, the UN General Assembly in 2004 adopted a resolution calling for an examination of international taxes as an instrument of development financing. Problems associated with the need to fund the MDGs are exerting more and more pressure working to develop both new and additional sources of funding. The interim review of the progress made in five years of work in implementing the MDGs shows that it will not be possible to reach the goals using the conventional instruments of development financing (Sachs, 2005).

The IMF and the World Bank dealt with the issue at their annual spring meeting in 2005, and in the meantime an internal analysis has weighed the pros and cons of the various proposals advanced thus far (World Bank - IMF, 2005). While the report makes no recommendations, it does point to the political acceptance problems faced by international taxes. In fact, it is mainly the US that is adamantly opposed to any international taxes. To cite an example, in 2005 Washington demanded, successfully, that the term "international taxes" be deleted from the Final Declaration adopted by the UN General Assembly.

All the same, the French initiative has now sparked a new dynamic. A strategy based on a plurilateral approach is proving successful: starting out with a "coalition of the willing," a lead group is paving the way for and promoting the project, without first waiting for a universal consensus to emerge. To cite an example, the Paris conference saw the formation of a "Pilot Group on Solidarity Contributions for Development," an alliance extending beyond the hard core of countries that have already declared their willingness to adopt an air-ticket tax. Thirty eight countries have joined the group (including e.g. Belgium, Germany, the United Kingdom, India, Mexico, Austria, Spain, South Africa and Republic of Korea). This is an institutional framework designed to guarantee the continuity of the process. The group is also open for an involvement of civil society.

In July 2006 the Brazilian government held a follow-up conference, where the details of the International Drug Purchasing Fund (IDPF) and the further process were discussed. Norway will be the next chair of the pilot group and will hold a major conference in early 2007.[4]

Conclusion

Properly conceived and formulated, international taxes can - like national taxes - be used to generate regulatory effects. In other words, international taxes would provide policy-makers with an instrument that could contribute toward regulating the process of globalization. Adoption of an international tax would be a step toward the democratization and equitable configuration of globalization, on which Jacques Chirac has correctly noted: "The way globalization is developing today, it is not only not reducing inequality, it is deepening it further and further."

In addition, using the second basic function of taxes, viz. generation of revenues, an international tax could also serve to develop substantial new policy options.[4] It will, in particular, prove impossible to fund the Millennium Development Goals without the use of unconventional financing instruments. The front of the backers of international taxation is growing broader and broader. In adopting the air-ticket tax, France, Brazil, Chile, and others, have dared to take a first step into an entirely new paradigm.

However, the political resistance to the project is also a factor to be reckoned with. After all, the project is directed against a zeitgeist that generally sees taxes as no more than a "negative externality." In this sense, the debate over international taxes also has a fundamental sociopolitical dimension; the concern here is to replace the widespread and undifferentiated anti-etatist affect against taxes per se – neoliberalism's key to hegemonic power – with a democratically enlightened approach to the issue.

The German philosopher Arthur Schopenhauer once said: "Every good idea goes through three phases. In the first it is declared to be idiotic; in the second it is bitterly opposed; in the third it is implemented." As far as international taxes are concerned, we are presently somewhere between phases two and three. ■

4 Cf. Foster, J. "Beyond consultation: innovative sources" in this Report.

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Global tax evasion

Tax Justice Network
Mike Lewis

Much of the failure to finance development spending – particularly the failure of wealthy donor countries to provide promised increases in aid budgets – is a failure of political will. But states in the Majority World are unable to sustain their own spending on health, education and infrastructure substantially because they cannot raise adequate revenues for social spending themselves. This article argues that this fiscal crisis is fueled by a global financial architecture of tax evasion and capital flight largely sustained by the Minority World. And it presents evidence that combating the causes of this fiscal crisis could not only help bridge the current deficit in global development financing, but correct features of the international financial system which contribute massively to poverty and global inequality.

The last 25 years have witnessed both the growing cross-border mobility of capital, and the rise of a developmental model exhorting developing countries to offer tax incentives for foreign investment and domestic access to international financial flows. Both financial change and economic ideology have thus encouraged the proliferation of mechanisms enabling wealthy, mobile individuals and corporations to escape from contributing to state revenues.[1] Between the early 1970s and the end of 2004 the number of recognized tax havens has increased from about 25 to 72.[2] Correspondingly, the Organization for Economic Co-operation and Development (OECD) estimates that the volume of world trade which on paper appears to pass through tax havens has risen during this period from a few per cent to over 50%, despite these jurisdictions accounting for as little as 3% of Gross Domestic Product (GDP).[3] This extraordinary mismatch is an indication of the extent to which most major multinational corporations have taken advantage of the transnational mobility of their assets to launder their profits through low-tax regimes and tax havens, using a variety of mechanisms, from re-invoicing and transfer pricing (trading goods between companies owned by the same people or company at arbitrary, non-market rates, allowing an increase in the cost of goods or a reduction in their sales value in higher-tax states) to special purpose corporate vehicles and secretive offshore trusts.[4] And as this effectively stateless shadow economy has eroded the fiscal base of national welfare states, particularly in the Global South, so finding ways to tax this evasive wealth could itself provide the funds to finance the Millennium Development Goals (MDGs).

The scale of global tax evasion

There remains an urgent need for empirical study into the scale of global tax evasion and avoidance. Research is hampered by the obsessive secrecy surrounding financial transactions and holdings in tax havens. Nonetheless some estimates of the scale of the problem have been made since the Social Watch Report last reported on global tax evasion and avoidance in 2004. Calculations made by the Tax Justice Network suggest that around USD 11.5 trillion of the private wealth of "High Net Worth Individuals" alone is currently held in tax havens, largely undeclared – and therefore probably untaxed – in their country of residence (Tax Justice Network, 2005, p. 34-37).[5] The benefits from taxing just this individual wealth – let alone the undoubtedly larger sums lost through tax evasion and avoidance by corporations – would far outweigh any realistic increase in aid budgets. The annual worldwide income earned on these undeclared assets is likely to be about USD 860 billion.[6] Taxing this income at a moderate 30% rate would produce around USD 255 billion annually: enough to finance the MDGs in their entirety.[7] Put simply, making just the very rich pay their due taxes could immediately fund measures to halve world poverty.

The global South's burden

Regional breakdowns of tax evasion are even harder to obtain than global estimates. Certainly much of the individual and corporate wealth siphoned into tax havens comes from wealthy countries in the Minority World. But countries in the South arguably suffer disproportionately from tax evasion and avoidance, both because they have proportionately more to lose from capital flight and dirty money flows across their borders to tax havens, and because their under-resourced tax authorities lack the institutional capacity to effectively prevent tax abuse. Oxford University economist Alex Cobham (2005) has used a simple economic model to scale global estimates of the tax revenues lost through individuals' offshore asset-holding and corporate profit-shifting across borders. He estimates that every year developing countries lose USD 50 billion in revenue to each of these mechanisms. Coupled with an estimated USD 285 billion in revenue lost through domestic tax evasion in developing countries' informal economies, Cobham estimates that this individual and corporate profit-laundering contribute to a staggering USD 385 billion in annual lost tax revenue across the developing world. Over 50% of the cash and listed securities of rich individuals in Latin America is reckoned to be held offshore (Boston Consulting Group, 2003). Data for Africa are scarce, but most analysts assume the ratio to be comparable to Latin America or higher. In 1999, *The Economist* estimated that African leaders alone have USD 20 billion in bank accounts in just one tax haven, Switzerland: over 30% more than sub-Saharan African countries were then spending annually in servicing their external debt (Owuso, Garrett and Croft, 2000).

This flight of the global South's financial resources and tax base is not only domestically catastrophic for welfare spending in these impoverished

1 This developmental strategy has not only eroded national tax revenues in the developing world, but has also increased some developing countries' vulnerability to international financial instability. One notorious example of this was the formation of the Bangkok International Banking Facility (BIBF) in 1992, as part of an aggressive strategy by the Thai government to improve the access of Thai firms to the international financial markets. BIBF banks could take deposits or borrow from abroad, and lend in foreign currencies in Thailand and abroad, functioning essentially as an offshore centre with tax incentives and regulatory exemptions on their international business. When the Asian financial crisis broke in 1997, the BIBF accounted for almost half of the country's foreign borrowing. The resulting debt crisis and economic reversal saw Thailand's GDP fall by about 12%, with serious employment and wage impacts, pushing over a million people in Thailand into poverty. See Oxfam GB (2000).

2 Tax havens are here defined as countries or territories whose laws may be used to avoid or evade taxes which may be due in another country under that country's laws. Features include jurisdictions where non-residents undertaking activities pay little or no tax; there is no effective exchange of taxation information with other countries; a lack of transparency is legally guaranteed to the organizations based there; there is no requirement that local corporations owned by non-residents carry out any substantial local activity (indeed, such corporations may be prohibited from doing business in the jurisdiction in which they are incorporated). Tax Justice Network, 2005, p. 12-13.

3 French finance minister D Strauss-Kahn, in a speech to the Paris Group of Experts in March 1999, quoted in Christensen and Hampton (1999).

4 For more on the mechanisms of multi-national tax avoidance, including transfer pricing, thin capitalization, re-invoicing, corporate inversions, special purpose vehicles, trusts, see Tax Justice Network, 2005.

5 Estimates made using figures on offshore wealth from Merrill Lynch / Cap Gemini's 1998 World Wealth Report and Boston Consulting Group's 2003 Global Wealth Report.

6 Based upon Merrill Lynch / Cap Gemini's and Boston Consulting Group's estimates that wealth holders expect returns on their assets of 7-8% per annum.

7 The UN Millennium Project estimated in 2005 that meeting all the MDGs would require an estimated USD 135 billion of Official Development Assistance, rising to USD 195 billion by 2015. See: <www.un.org/apps/news/story.asp?NewsID=15497&Cr=MDGs&Cr1=WHO>.

countries. It is internationally regressive, because these flows are overwhelmingly towards the Minority World. Although tax havens include a handful of developing countries like Uruguay or Sao Tomé e Principe, most are linked to wealthy OECD jurisdictions (35 of the world's 72 tax havens are linked jurisdictionally, economically or historically to the United Kingdom alone). The financial architecture of mainly wealthy jurisdictions thus sustains a global theft from South to North, siphoning capital resources from impoverished regions into bank accounts and offshore trusts from Switzerland to the UK's Cayman Islands. Amherst University economists James Boyce and Leoncé Ndikumana (2002) have estimated that between 1970 and 1996, the flight of private capital from 30 severely indebted sub-Saharan African countries accounted cumulatively for over 170% of the region's GDP. This has decimated both African investment and domestic tax revenues.[8] Much will have gone via Northern tax havens. With this rate of capital flight, Ndikumana argues that Africa – a continent we are continually told is almost irrevocably indebted – may actually be a net creditor to the rest of the world.

Systemic effects of global tax evasion

The figures discussed above make a powerful case that stopping international tax evasion and avoidance could provide both for the financing of the MDGs, and in the longer term for developing countries' own sustainable spending on health, education and infrastructure, providing sustainable revenues which might even outweigh the burdens of debt financing. But action is needed to stop tax evasion and avoidance not simply because it has the potential to bridge the development financing gap, but because unchecked, tax havens and tax avoidance positively damage economic equity.

Since internationally mobile capital benefits from tax havens and international tax avoidance mechanisms, they place wealthy individuals, who can afford to spread their assets internationally, at a distinct financial advantage over ordinary people. They provide market advantages for multinational corporations who can avoid tax through the international movement of their capital and assets, over nationally-based businesses. Even those who advocate growing private enterprise in developing countries as the route to reducing poverty must accept that tax havens and tax evasion damages developing countries' domestic business sectors and wealth accumulation (OECD, 2004). Finally, the banking secrecy and financial services provided by global financial institutions operating offshore provide the 'supply side' of political corruption, fraud, embezzlement, illicit arms trading, and the global drug trade. The lack of transparency in international financial markets contributes to the spread of globalized crime, terrorism, the bribery of under-paid officials by western businesses, and the plunder of resources by business and political elites. Wealthy donor countries continue to insist that corruption in the Global South threatens development; yet tax havens within wealthy donor country jurisdictions, as well as the Western companies and banks who operate in them, provide the 'pinstripe infrastructure' facilitating the money laundering of the proceeds of corruption and all types of illicit commercial transactions.[9]

More insidious still may be the systemic fiscal effects of international tax evasion and avoidance, which may be pressuring states to lower their own tax rates to attract direct foreign investment in a race to the bottom whose consequences for economic equity and development are discussed in much more detail in the chapter on tax competition in this Report.[10]

What can be done

Sustainable development spending – free from aid and debt dependency, and encouraging political accountability and participation in the global South itself – will remain difficult unless developing countries can mobilize their own domestic resources. This is made impossible by tax evasion and avoidance on an unprecedented scale. Global taxes and innovative finance mechanisms are vital to bridge the development finance gap in the short-term. But they must be coupled with a more traditional finance mechanism: wealthy individuals and corporations paying their due taxes.

This 'traditional' goal, however, will nonetheless require innovative legal and financial action. In contrast to other areas like intellectual property and market access laws, tax policies and law have strikingly failed to keep up with globalization, remaining resolutely national as capital has become transnational. National legislation may be useful in slowing the erosion of national tax bases by closing particular tax avoidance loopholes or ending tax haven legislation enshrining banking secrecy or tax benefits for non-residents. Equally, efforts by corporations towards greater transparency and social responsibility in paying taxes may be valuable, especially in economic sectors like the extractive industries, dominated by multinational companies with a history of siphoning profits from resource-rich developing countries to tax havens. The Extractive Industries Transparency Initiative (EITI) is a useful tool in this respect, although it continues to lack commitment from key countries and companies.[11] National commitments to tackling tax evasion within their jurisdictions should be monitored and reported by international financial institutions as part of global initiatives to tackle corruption, with public reports on tax haven jurisdictions' demonstrable efforts to implement transparency and anti-avoidance measures.

But properly tackling a problem generated by the international mobility of capital will ultimately require international and multi-lateral action. This will need to include:

- Automatic information exchange between countries of interest payments, dividends, royalties, license fees and other income paid by banks and financial institutions to citizens of another country.
- An internationally agreed basis for corporate taxation, taxing profits in the countries in which they are earned.
- A general anti-avoidance principle, enshrined in national or international laws, which would end the 'arms race' of tax avoidance loopholes being opened by creative accountants as soon as they are closed by revenue authorities

All these objectives would be assisted by the creation of a World Tax Authority, as proposed in 1999 by former IMF director of fiscal affairs Vito Tanzi. This body would be charged with ensuring that national and dependent territory tax systems do not have harmful international implications, and working towards international cooperation in these key areas of information exchange, corporate taxation and anti-avoidance.

International progress in these areas has been mixed in 2005. The United Nations should ideally provide the setting for a global tax authority by substantially strengthening the UN Committee of Experts on Cooperation in International Tax Matters,

8 This percentage includes interest earnings on the stock of flown capital.

9 See, for example, the recent report by the UK's All-Party Parliamentary Group on Africa (2006).

10 Cf. Wahl, P. "International taxation: the time is ripe" in this Report.

11 <www.eitransparency.org>.

which met for the first time as a formalized committee in December 2005. But the Committee is currently dominated by OECD countries and tax havens, and representation of the interests of developing countries remains inadequate. The OECD Initiative Against Harmful Tax Practices has made some progress towards creating a framework for negotiating tax information exchange agreements (TIEAS) on a bilateral basis. They have also widened their initiative to cover not only the small island tax haven jurisdictions, but also major players such as Switzerland and the United Kingdom, previously excluded from OECD tax haven lists. Their latest model tax treaty includes a banking secrecy override clause which could be effective in tackling tax evasion. In practice, however, very few TIEAS have been negotiated, and developing country governments will need considerable support in negotiating such treaties, and making effective use of the information provided.

Ultimately, if international institutions like the UN and the OECD are to respond adequately to the unprecedented global challenge of tax evasion and avoidance, then global civil society must force them, and national governments, to take action. The stakes, as this article makes clear, could hardly be higher: the risk of destroying welfare states across the global South; and the potential to fund measures to halve global poverty. ■

TAX JUSTICE NETWORK ACTIONS

In 2006 the World Social Forum in Bamako saw a proposal to form a continent-wide Tax Justice Network for Africa, to be launched at the 2007 World Social Forum in Nairobi, Kenya. This will be a major step in a new global development struggle, at whose forefront should be activists and campaigners from the Majority World. We invite you to join us. <www.taxjustice.net>.

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Beyond consultation: innovative sources

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Financing for Development: the formal process

The Financing for Development process, led by the United Nations was begun in the context of the Asian crisis in the 1990s. In 1997-1998 the General Assembly moved to plan an International Conference on Financing for Development, which was held in 2002, in Monterrey, Mexico, along with a People's Forum which brought several thousand civil society people together. Social Watch had many participants at these events and has followed the process quite closely, facilitating civil society representation and input. Since Monterrey regular high-level meetings, research and special events and an ongoing Financing for Development Office within the Department of Economic and Social Affairs at the UN in New York have continued.[2]

Some notable characteristics of this process include:

- *A comprehensive agenda.* Monterrey included a remarkable range of development finance issues, including many, like debt and financial crisis, Overseas Development Assistance (ODA), etc., which preoccupy civil society, trade and development dimensions. It also included systemic issues which can includes many development implications as well as issues of governance, including the governance of international financial institutions, representation and relative power of developing countries, etc.
- *Institutional coverage.* The Financing for Development (FFD) process includes not only the UN and its agencies but the World Bank and the International Monetary Fund (IMF), the World Trade Organization (WTO) and more recently United Nations Conference on Trade and Development (UNCTAD). The process is a big tent. For civil society organizations concerned with how the whole international system works, it offers an opportunity not present elsewhere.
- *"Stakeholder" engagement.* From the planning period for Monterrey to the present day the process has included participation and voice for civil society organizations as well as the private sector. The FFD office has engaged with representatives of these sectors in developing study projects and consultations and has taken care to utilize NGO networks to secure nominees to speak at its various meetings. The process is relatively open; organizations can gain access even if, as has been the case for many in 2001 and since, they do not have Economic and Social Council (ECOSOC) consultative status.
- *Site for initiative.* Although the process has not been able to move the whole membership of the UN in a given direction, or to make the World Bank, IMF or WTO accountable to that body, it has provided an ongoing forum for the testing and launching of initiatives, like those in innovative financing, which we examine below.

Why are we raising Financing for Development at this time?

The Monterrey Conference agreed that there should be a major review of implementation in five years, which would normally have been this year, 2006. In fact, it is likely to be held a couple of years late. The UN will debate and, it is hoped, decide on a review conference at the General Assembly which begins in September 2006. There is an invitation on the table from Qatar and a general target date of 2008-2009.

At this stage it is important to assure:

- that there is *a high level conference* to review the Monterrey "consensus"
- that the *agenda is comprehensive*, including systematic issues and issues of governance
- that there is a *full preparatory process* for that conference which will involve preliminary sessions to prepare the evaluation of progress and proposals for further action
- that *civil society organizations (CSOs) are a full part* of the preparatory process and that organizations like those represented in this report and their many allies and associates, take advantage of that process to engage governments to ensure these initial objectives.

The CSOs in Monterrey in 2002 made it very clear that while they appreciated the comprehensive agenda, accepted the opportunities to participate in roundtables and other forums and appreciated support for the people's forum, they did *not* endorse the so-called "Monterrey Consensus" which was adopted by the inter-governmental conference. It is fair to say that many CSOs maintain the same position today, taking the opportunity to engage, but continuing to challenge the results endorsed by governments and the international economic institutions.

The Financing for Development process is the product of initiatives from developing and middle income countries. It has obvious weaknesses and limitations. However it offers opportunities for engagement which are not present elsewhere, particularly for those who are concerned with governance, democracy and transparency, with how the different parts of the system work either for or against development. It can also be a forum in which new proposals are put forward and support built.

Breaking taboos: innovative instruments broach the idea of global taxes for global goods

> Following years of adhering to the widespread illusion that globalizing the economy would be enough to solve all development problems, the international community is finally accepting the need for solidarity. The solution is new financing mechanisms that mobilize part of the benefits of globalization. The proposals were considered completely unrealistic a very short time ago. They were even taboo in certain international organizations. Now they are discussed in all the major international forums… With these contributions, we are going to extend our solidarity base using a fraction of the new wealth created by the globalization process, a large part of which escapes States' taxation. We are going to use the most advanced techniques of our modern economy in the interests of the poorest.[3]

When Presidents Lula Da Silva of Brazil and Jacques Chirac of France announced Action against Hunger and Poverty at a meeting at the UN in 2004, the thought that it might take concrete shape within two years in a linking of innovative instruments to provide additional development funding and specific priority health needs (HIV/AIDS, TB and malaria) seemed a dream indeed. Hostility to the idea

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2 See <www.un.org/esa/ffd> for detailed information.

3 Speech by M. Jacques Chirac, President of the Republic. Paris International Conference "Solidarity and Globalization: Innovative Financing for Development and Against Pandemics." Paris, 28 February- 1 March, 2006. Available from: <www.diplomatie.gouv.fr>.

of new, possibly global, levies like the Currency Transaction Tax (CTT) was palpable, particularly in Washington. The idea of a tax on air travel or a carbon tax seems equally unrealistic.

On 1 July 2006 France implemented its air ticket levy, Chile began one in January, more than a dozen other countries have pledged similar measures, and an international "Leading Group on Solidarity Levies to Fund Development" has more than 40 government members. The Group is growing and developing a drug purchase agency or UNITAID which will use funds resulting from the levies to invest in providing consistent supplies of affordable drugs to those in need of them.

The levy

At the Paris Conference, President Chirac convened a large international ministerial conference to mark progress on this agenda and build momentum. The involvement of a significant number of AIDS-related, development and finance-reform NGOs was demonstrated in both speakers and participants.[4]

The French government detailed its intention to begin a levy graduated according to class and destination of service on air tickets.[5] Together with Gordon Brown of the UK it confirmed that the UK would contribute to the trust fund created by the air ticket levy, and that France would contribute to the UK's innovative International Financing Facility for Immunization. The French-initiated fund would be aimed at issues of consistent and sustainable supplies of life-saving drugs for people with HIV/AIDS and other diseases.

The International Drug Purchase Facility (IDPF) or UNITAID

In a joint declaration (2 June 2006), Brazil, Chile, France and Norway established the "foundations" of the IPDF, which has been named UNITAID in all languages. Noting the at least six million people with HIV who need anti-retroviral treatment (currently available to only 1.2 million), the sponsors stated "it is imperative to change the scale at which treatment is available, which in turn, implies a change in scale in the mobilization of resources."[6]

4 The Paris Conference was attended by approximately 600 people, including representatives of 93 states, 3 heads of state, more than 70 ministers, the UN Secretary-General and representatives of many multilateral organizations and NGOs.

5 Cf. Wahl, P. "International taxation: the time is ripe" in this Report.

6 Interestingly the declaration was made by two foreign ministers (Brazil, France) a health minister (Chile) and a development minister (Norway). This cross-sectoral mix is typical of the approach of these initiatives.

UNITAID aims to assist in the consistent provision of essential drugs for HIV/AIDS, TB and malaria in poorer nations. It claims the principles of: solidarity, complementarity, sustainability, predictability, additionality, adaptability, partnership, independence, accountability and aid effectiveness – no small order.

It seeks to use new innovative additional funds to provide predictable and sustainable sources of financing to pool drug purchases, provide a new impetus for drug prequalification processes and to support strengthened national regulatory agencies for drug quality control. It hopes to promote the diversification of generic products, induce price reductions and attract new manufacturers.

Current thinking is that organizationally, the facility will be a "small body legally embedded in an existing organization." The facility will be governed by a combination of a Board with responsibility for oversight over the trust fund and the secretariat and a consultative forum, meeting at least annually involving "donors and other stakeholders", allowing "for reporting and broad accountability." Interim forms of these structures will be established for the first year and the World Health Organization (WHO) has agreed to act as secretariat and trustee of the funds. The issue of representation of CSOs, people living with HIV/AIDS and vulnerable groups in the governing structures remains in debate.

The sponsors have already informally involved interested NGOs and people living with the diseases, welcomed participation of pharmaceutical companies, major multilateral organizations in the field like WHO, the Global Fund, UNAIDS, UNICEF, the World Bank and UNDP, and constructive contributions by both the Gates and Clinton Foundations.

From intention to implementation

The number of countries agreeing to launch a "Solidarity Levy" on air tickets continues to expand. South Korea has joined the group of 15 countries intending to launch this year; India, Guatemala and China are among others rumored to be considering it.

The UNITAID facility continues to develop as well. While the French levy is expected to contribute approximately USD 250 million annually initially, Spain has agreed to fund USD 100 million a year for the first four years with no levy, Norway USD 25 million, Brazil USD 12 million and Chile USD 4 million. France indicates that 90% of its levy resources will go to the International Drug Purchase Facility (IDPF) and 10% to the International Financing Facility (IFF) for immunization.

On 2 June 2006, as part of the lead up to the Football World Cup in Germany, the FIFA through 1995 Player of the Year George Weah underlined the sports organization's commitment to human rights by announcing that two UNITAID branded official match balls will be exchanged by the two team captains before the kick-off of each of the 64 matches.

Civil society organizations concerned with the financing side of this activity have met not only in Paris in February but at the first Plenary Meeting of the Leading Group in Brasilia, in July, 2006.

Progress and challenge

While governance issues for the new facility remain in debate, CSOs have made further trenchant critiques of the current response to HIV/AIDS as it is shaped by existing policies and WTO agreements on intellectual property. As a number of spokespeople have indicated, what is the use of raising significantly greater resources for drug purchase if countries are still paying companies two or three or more times the lowest price, and the money is essentially recycled North, leaving many without treatment.

It has been forcefully suggested that the UNITAID initiative will only succeed in contributing significantly to the achievement of universal access to treatment by 2010 if a) it combines efforts with other purchasers, gaining greater leverage, b) it works to support governments in utilizing all flexibilities and openings in the existing Trade Related Intellectual Property (TRIPS) regime and opposes further extensions thereof, c) works to break patent barriers.

Whether governments muster the will to make the most effective and efficient use of the resources through these steps is quite unclear, and probably – like the achievement of the Doha declaration on intellectual property and health – dependent on the extent of civil society agitation and pressure.

It's not just about air tickets

The innovative financing initiative is about a *menu* of practical projects, from Gordon Brown's IFF and IFF for immunization, Chirac's air ticket levy, through the Chilean interest in a new round of Special Drawing Rights, and the German Development Minister's continuing interest in a Currency Transaction Tax (CTT), among others. Non-Governmental organizations are vitally interested in several of these initiatives and raising other themes including a carbon tax, debt cancellation and an international tax agreement and "tax justice". A good deal of interest in advancing government action against tax evasion

and tax havens has been expressed both in the Paris and Brasilia conferences.

Looking forward

What is of interest overall?

- As President Chirac noted in Paris in March 2006, these initiatives *break through* a taboo (forcefully pressed by the US) which had prevented negotiation and action about international levies like the CTT for several years.
- The overall initiative came from a *productive combination of South-North* leadership (Presidents Lula and Chirac) joined by Chile, Spain, Germany, Algeria, and ultimately many more.
- The initiative on the air ticket levy broke through one of the main conceptual limitations on international levies, that is that they must be universally supported to be initiated. The principle of *an international tax, nationally administered*, moved past the barrier.
- The linkage *between new financing instruments and urgent health issues* is the essential ingredient for political support and implementation.
- The leadership to date has encouraged the participation of non-governmental and other stakeholders.
- The approach has been one of a menu of possibilities, with different countries taking the leadership on one or more choice items.

These innovative financing for development efforts by "like-minded" coalitions have benefited from the support of the UN Secretary-General, have sprung in part from the encouraging framework of the UN's Financing for Development process and office, and have utilized the UN to brief, encourage and report on participation and progress. CSOs at the July Leading Group meeting in Brasilia argued that this should be the year of "pilots". Once having moved the airlines levy and UNITAID into operation, in a relatively short time, governments were encouraged to maintain the momentum by initiatives to implement a pilot Currency Transactions Tax and conferences and initiatives on tax evasion, tax havens, transfer pricing and other "leaks" of vital resources from South to North.

The proposed review Conference of Financing for Development in 2008-2009 should highlight what conditions have made these initiatives possible and how others might be encouraged. It offers the opportunity to broaden the agenda to consider longer term issues of global economic governance and economic policies for equitable sustainable development. ■

The new aid modalities for MDG financing: will the European Union keep its promises?

Eurostep
Simon Stocker [1]
Europe External Policy Advisors (EEPA)
Mirjam van Reisen

In 2005 the European Union (EU) positioned itself as the global leader in mobilizing resources for achieving the Millennium Development Goals (MDGs). The EU is currently negotiating its funding framework for 2007-2013, covering almost entirely the period up to 2015. The nature of these negotiations gives a strong indication, in terms of available funding and the prioritization in their implementation, of whether increased commitments to the achievement of the MDGs are being made.

EU pledges in funding

For the first time, a timetable was set for reaching the long-standing UN target of 0.7% Gross National Income, by the EU as a whole. While the majority of donor countries have not achieved or surpassed this target, those that have are members of the EU.[2] With an interim target for the EU to reach an average minimum level of 0.56% by 2009, the current commitment is for the 15 "old" member states to reach the 0.7 % target by 2015, coinciding with the deadline for achieving many of the MDGs, including the principal one of halving the proportion of people living in absolute poverty.

The European Commission funds for overseas development aid (ODA) will remain the same, and therefore the increase in funding will be channelled largely by the EU Member States directly.

TABLE 1. EU aid pledges at a glance

TARGET YEAR	EU 15 MEMBER STATES (AUSTRIA, BELGIUM, DENMARK, FINLAND, FRANCE, GERMANY, GREECE, IRELAND, ITALY, LUXEMBOURG, NETHERLANDS, PORTUGAL, SPAIN, SWEDEN AND THE UNITED KINGDOM)		EU 10 MEMBER STATES (CZECH REPUBLIC, CYPRUS, ESTONIA, HUNGARY, LATVIA, LITHUANIA, MALTA, POLAND, SLOVAK REPUBLIC AND SLOVENIA)	
	INDIVIDUAL MINIMUM	COLLECTIVE AVERAGE	INDIVIDUAL MINIMUM	COLLECTIVE AVERAGE
2006	0.33%	0.39%	-	-
2010	0.51%	0.56%	Country specific	0.17%
2015	0.7%	0.7%	0.33%	0.33%

Note: All percentages are ODA as a proportion of Gross National Income.

Source: Joint European NGO Report (2006). *EU aid: Genuine leadership or misleading figures?*

Broadening the definition of development aid?

The commitment to supporting the MDGs are also confirmed in revised development policy statements adopted by the EU at the end of 2005. The European Consensus on Development (European Parliament, 2005), which sets out the EU development policy for the coming years, and the EU Strategy for Africa (Council of the European Union, 2005) both give prominence to the centrality of the MDGs in the EU cooperation strategies towards developing countries and in the use of its aid. However both these documents also give increased emphasis to issues related to security in the context of the "war on terror" and proliferation of weapons of mass destruction, and migration. The guidelines which are used for the programming of EU development aid from 2007 to 2013 include guidelines on the war on terror and migration, demonstrating the European Commission is serious in its intent to use development money for these purposes (Eurostep, 2006).

EU policies are increasingly in agreement to integrate the European Commission and Member States' development funds, in line with the Paris Declaration on harmonization of aid. Therefore the widened scope for development to include the war on terror and migration has implications not only for the aid from the European Commission but equally for aid given by all 25 EU Member States.

In addition, considerable funds are set aside by the European Commission to fund transport and infrastructure works. In its programming to African, Caribbean and Pacific (ACP) countries, a third of all allocable funds are aimed at such works. While these fit the ODA criteria, their significance for the achievement of the MDGs is less clear, and the rationale – from the perspective of the MDGs, for these programmes is lacking.

At the same time the definition of development is challenged as well to include new aspects of spending within ODA thus increasing the possibility for donors to increase their levels of ODA without necessarily providing additional finance to developing countries. The European Commissioner, Benita Ferrero-Waldner, recently stated that the Commission wanted to broaden the definition of development to allow it to use funds designated for development in the context of a new legal framework to govern the EU development aid. While the Commission has failed to provide any specific reasons why a change in the definition would be needed, they do say it specifically relates to the EU cooperation with countries such as China and India – large growing market economies to which the EU would clearly like to have increased market access (EEPA, 2006b).

The Paris Declaration

The European Union is spearheading the implementation of the 2005 Paris Declaration on aid harmonization, alignment to Poverty Reduction Strategy Papers (PRSPs) and National Development Programmes, and donor coordination. The European Commission intends to programme 50% of its aid for 2007-2013 through general or sectoral budget support. The European Commission also argues that through budget support, it will target the MDG sectors.

In its 2006 Resolution on corruption the European Parliament warned that corruption and shifts in the budget may undermine the effectiveness of budget support in achieving the MDGs and recommends that only sectoral budget support focusing on the MDG sectors, especially health and education, be agreed. Given the size of funds intended to be allocated through budget support for the period up to 2013, the EU is taking a formidable risk in that if budget support does not work to increase investment in MDG sectors, there will be insufficient corrective measures to turn investment to the MDGs.

The European Commission is setting up incentive tranches for countries which receive budget support and perform well. It is crucial that the performance indicators give high priority to the MDGs, if the MDGs are to be achieved through budget support. If not, incentive will be lacking for partner countries to invest in the MDGs (European Commission, 2006).

In addition the question needs to be raised as to how performance is measured, and which indicators are used to measure performance in budget support. This might be an important area for Social Watchers to develop further expertise.

1 Simon Stocker is Director of Eurostep and Mirjam van Reisen is Director of Europe External Policy Advisors (EEPA).

2 Denmark, Luxembourg, the Netherlands, and Sweden all provide at least 0.7% of their GNI annually in ODA. Norway is the only country outside the EU that is a member of this club.

Cross-cutting issues are particularly vulnerable through budget support, given that these are not treated as sectors. Social Watch and Eurostep published a report identifying this question in 2005, called 'Accountability Upside Down' (Eurostep/Social Watch, 2005), which lead to a conference organised by UNIFEM with the European Commission in 2005 identifying how gender equality would be implemented by the new aid modalities. The conference identified a number of instruments, in particular gender budgeting and monitoring the implementation of international instruments promoting gender justice, CEDAW, the Beijing Platform for Action and the Millennium Declaration. The Social Watch Gender Index was presented as a tool for performance indicators on gender equality.

Currently, Ghana is a pilot country for the EU to implement budget support in a co-ordinated fashion with EU Member States. Given that the revision of the Paris Declaration will also take place in Ghana in 2008, it is clear that the EU is hopeful that results with budget support in this country will prove to be successful. It will be important to identify whether budget support is helping to produce shifts in the national budget in the direction of the MDGs, and whether these budget shifts lead to greater investment in the MDGs and increased output towards their realization.

SOME CONSIDERATIONS REGARDING BUDGET SUPPORT

Cecilia Alemany (Social Watch)

A trend of the New Financial Perspectives 2007-2013 of the European Union is the fact that budget support is becoming widespread as an instrument for channelling cooperation in the developing countries. This mechanism involves reducing the high costs of mediating and administering co-operation, and points to expanding the strategic lines of national budget performance.

Although there are already some successful cases, the efficiency of budget support is still not clear. For one part, the requirements for payments can vary and in some cases present a new bottleneck, and for another, oversight mechanisms need to be clarified not just for the sake of the EU as the donor but also for the civil society and the local citizens.

Citizen oversight of budget support and budget performance is viable in some countries and even formal settings, while in others it seems that the conditions are still not ready because governments do not always have a culture of consultation or of policies of transparency. In addition, budget support will also be applied to some governments in which there are high rates of corruption. It would seem contradictory that while the EU points to the problems of governance in some developing countries, it simultaneously injects direct funding into their budgets.

On the other hand, budget support is part of the donor countries' trend toward aligning and harmonizing the donors (a trend that surged from the Paris Declaration) and assumes that the donors will negotiate in many cases in conjunction with the national authorities. This presents the logic of efficiency from the perspective of the EU, but one cannot ignore that this limits the receiving countries´ room for negotiation and conditions cooperation even more on the will of the donors. In a certain sense, while the empowerment of the national counterparts, efficiency, harmony and alignment of international cooperation are all heralded, the social organizations of the developing countries might ask themselves if this is not a resurgence of the ancient conditions of aid disguised in politically correct language. ■

Trade

The trade agenda is a key issue for the EU, in which the European Commission plays a central role.[3] Within the current Doha Round of the World Trade Organization (WTO) the EU has continually stressed that it is taking an approach to trade defining new trade rules that champion the interests of developing countries. This is not the view of most developing countries, however, who criticize the EU for maintaining an agricultural trade subsidy regime that gives unfair advantages to European producers, thus undermining the competitiveness of producers in developing country. A recent document on the EU budgetary proposals made a direct statement that EU trade policy was motivated by defensive and offensive measures to protect its own key interests (EEPA, 2006b).

The EU *Everything but Arms* trade regime for Least Developed Countries (LDCs) has failed to provide any real meaningful options for producers from those countries as it fails to tackle the constraints on producing goods to an acceptable EU standard.

Alongside the WTO negotiations the EU has been negotiating with different regional groups to establish regional free trade agreements. For the African Caribbean and Pacific (ACP) group of countries, the scope for negotiating Economic Partnership Agreements (EPAs) was embodied in the Cotonou Agreement, as a successor agreement to the Lomé Convention. The EU forced the inclusion of the EPA negotiations on the ACP so that by 2008 the EU trade arrangements would become compatible with WTO rules. In the face of substantial criticism that within the EPA negotiations the EU was once more failing to address the supply side constraints of ACP countries, the EU countries have stated that they will provide aid for trade to support adjustment costs of the EPAs once they are in place. However, this will be financed from the existing aid budget and therefore the compensation for losses of the ACP countries will be paid from the development budget and will therefore reduce the funds for the MDGs. Already, within the current budget negotiations the 'additional' money promised to compensate for the reform of the EU sugar arrangement with ACP countries, is arranged to be financed by a cut of resources for social development, affecting especially MDG sector funding for health and education. This is in addition to other cuts on the budget line which specifically targets the MDGs (EEPA, 2006a).

Debt cancellation

While the EU 2005 commitments on achieving the MDGs have been welcomed, concern remains on how these will be put into practice, and moves to change the framework in which the EU co-operation is pursued. A report published in May 2006 analized the current use of EU aid. Put together collectively by a number of NGOs from across Europe, the report concluded that a third of all official aid provided (some USD 14.4 billion[4]) in 2005 from the EU (Members States and European Community taken together) did not reach developing countries and remained within the donor country. Such expenditures include debt cancellation (USD 9.6 billion of which most was the cancellation of Iraq's export credit debts), financing the costs of migrants arriving from developing countries (USD 1 billion), and costs of education for foreign students (USD 1.2 billion). While these costs can be counted as official aid according to the definitions established by the OECD/DAC,[5] this does not provide resources for use in developing countries targeted at achieving the MDGs. For instance in the case of debt cancellation donor governments made a commitment at the Monterrey Financing for Development Conference in 2002 that debt cancellation would be implemented through the use of new resources. Since these were debt write-offs, these cancellations did not translate into additional funds being available for the MDGs. The countries being granted debt cancellation would not have been able to repay the debts that were cancelled, and so the additional levels of aid registered by donors was simply a bookkeeping exercise that inflated ODA levels.

Conclusions

Unfortunately, everything indicates that the implementation of the pledges is merely an accounting trick, rather than an increase in investments in the MDGs. The "war on terror" and migration issues are included

3 The European Commission is responsible for managing EU's trade policies and for negotiating trade rules and agreements on behalf of the EU.

4 Equivalent to EUR 12 billion.

5 The Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD).

GENDER BUDGET INITIATIVES IN CEE/CIS REGION

Network of East–West Women (NNEW)

After the first women's budget was established in Australia, in the mid - 1980s it has become an inspiration for several of the current initiatives all over the world. However it took a bit longer to implement the idea in Europe and especially in Central and Eastern Europe. The Commonwealth Secretariat (ComSec),[1] to which Australia belongs among others, has had an explicit programme of support for gender budget initiatives since 1996. The United Nations Development Fund for Women (UNIFEM) has not had an explicit programme but has, nevertheless, provided support of various kinds under other programme headings.[2] In 2005 the Council of Europe published a Gender Budgeting Report,[3] so the strategy of Gender Mainstreaming and Gender Budgeting itself are becoming more and more influential. Also in some countries in the CEE/CIS region Gender Budgeting has become quickly popular, especially in Kosovo and Georgia.

Kosovo[4]

Women's NGO Shoqata Afariste e Gruas SHE - ERA[5] has prepared the first analysis in Kosovo of Gender Budget and the impact of fiscal policies on the poverty level of rural women in the municipality of Gjakova. Their study presents the findings of research in Gjakova, focusing on the possibility of applying a gender perspective to the budget allocations of the Gjakova municipality. This research identified causes, problems and opportunities for introducing a gender balance in the allocation of resources, starting at the local level with a focus on the Department of Agriculture. The research revealed that the application of gender balanced policies in the agriculture development sector has five main constraints: the need to empower women farmers in the rural areas of Gjakova, a lack of ownership by women over the land they farm, municipal budget limitations and inadequate support from the local government towards rural agriculture development, the constant need to build the capacities of the Municipal Gender Office, the need to build the capacities of civil society for advocacy on gender balanced budgeting in municipal policies of all sectors.

1 Fifty-three independent states working together in the common interests of their citizens for development, democracy and peace: www.thecommonwealth.org

2 Budlender D., "Review of gender budget initiatives", Community Agency for Social Enquiry, 2001, http://www.internationalbudget.org/resources/library/GenderBudget.pdf

3 "Gender budgeting: Final report of the Group of specialists on gender budgeting (EG-S-GB)", Directorate General of Human Rights, Strasbourg, 2005

4 For further information, contact Mirlinda Kusari: lindawba@yahoo.com

5 The Story Behind the Numbers: Women and Employment in Central and Eastern Europe and the CIS: "Gender Budget analysis and the impact of fiscal policies on the poverty level of rural women in the municipality of Gjakova in Kosovo", Shoqata Afariste e Gruas/ Women's Business Association, Gjakova, Kosovo, 2006

Poland[6]

Network of East-West Women has raised the topic of Gender Budget in Poland. The Association coordinated "GdaÒsk Gender Budget Initiative", which main objectives were to point out to areas which demand improvement and present recommendation for action and advocacy. In the Report[7] many issues having an immediate impact on the lives of the inhabitants were raised. Due to the complexity of the research NEWW applied an interdisciplinary approach to the analysis. Among the most important problems that the inhabitants of Gdansk have to face are: lack of programs for seniors (both women and men), unequal treatment of women and men on the labour market and poor professional activation of women, long term unemployment of women and men. This report was an invitation to further discussion on the problems vital to GdaÒsk and finding possible solutions. It was also a suggestion that analyses of that type can be a tool to fight discrimination. The project presented Gender Budgeting as an excellent instrument for the city, local authorities and local community to advocate and apply more transparency in spending meant for the benefit of the local community. ■

6 For further information, contact Zofia Lapniewska: zofia@neww.org.pl

7 Balandynowicz-Panfil K., Opacka U.:ÑGdaÒsk Gender Budget Initiative", Network of East-West Women, Gdansk, Poland 2005

in aid programmes as a "broadening" of the definition of ODA next to long-standing priorities in infrastructure which remain in place. New aid modalities piloted on a large scale in the follow-up of the Paris Declaration – which the EU is spearheading – de-link aid to allocation in particular areas. While these new aid modalities may provide some opportunities, the hypothesis that these might advance the MDGs is untested. Given that the EU is by far the largest contributor to ODA, the largest sponsor of the MDGs, and currently heavily involved in large-scale testing of the new aid modalities, it may be concluded that there is considerable risk that the investment in MDG sectors will remain minimal, and that ODA is not targeted towards their achievement. In addition, the direction of the trade negotiations seems to fail to assist developing country partners and where compensation or extra measures are due, these are taken from existing development finance and redirected from direct investment in MDG areas.

The achievement of MDG 8 by the EU can therefore be regarded as extremely weak and currently lacking conviction and political will to implement the pledges made for the realization of the MDGs. ■

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The Arab region: at the crossroad of development security and human rights

Arab NGO Network for Development
Ziad Abdel Samad
Kinda Mohamadieh [1]

The Millennium Summit in the year 2000 set out a global development plan based on a set of Millennium Development Goals (MDGs), which countries worldwide committed to achieving. The International Conference on Financing for Development (Monterrey, 2002) was convened for the purposes of looking into mechanisms to finance this development process. It resulted in the Monterrey Consensus, which highlighted several key issues, including: points of action for mobilizing domestic financial resources; mobilizing international resources for development, including foreign direct investment; addressing international trade flows as an engine for development; increasing international financial and technical cooperation; addressing issues of external debt; and addressing the coherence and consistency of the international monetary, financial, and trading systems. Later, during the UN World Summit held in September 2005, donor countries renewed their commitment to improve aid effectiveness through harmonization of procedures and alignment of aid with developing countries' priorities, and to scale up development assistance aimed at building national capacities (such as "aid for trade"), prioritizing the least developed countries (LDCs) and countries hit by crises and the HIV/AIDS pandemic.

However, two different viewpoints emerged among the developed and developing countries in their approach to the issues under discussion. The developed countries promoted a link between more aid and trade liberalization policies, while the developing countries stressed the need for more unconditional aid. Their major concern was the increase in conditionalities imposed by the World Bank and the International Monetary Fund (IMF) through aid flows. As a consequence, the pledge made by the developed countries at the 6th World Trade Organization (WTO) Ministerial Meeting in Hong Kong (December 2005) for an aid for trade package for the LDCs was highly questioned. Developing countries expressed their concern that this package would significantly constrain them in the negotiation process. They were also concerned that this aid would be administered through the international financial institutions, which would allow for even more conditionalities to be imposed on them through these institutions.

The core challenge is to restructure the flow of aid and its management by increasing the linkages between aid and human development needs. By enhancing these linkages and the efficiency of the mechanisms used, aid will be more responsive to national needs, and governments will be more accountable for the expected results of aid flows.

It is worth noting that aid and debt have been tackled by the MDGs through targets 13 and 15, which fall under Goal 8: develop a global partnership for development. Target 13 is aimed at addressing the special needs of the LDCs, which includes tariff- and quota-free access for LDCs' exports; enhancing the programme of debt relief for Heavily Indebted Poor Countries (HIPC) and the cancellation of official bilateral debt; and making available more generous official development aid (ODA) for countries committed to poverty reduction. Target 15 calls for dealing comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. These items draw a connection between the international development framework and the debate around aid and debt, but the targets do not address several key points in the aid issue. When discussing more generous aid for countries committed to poverty eradication, there is no clarification as to the specific poverty reduction strategies envisioned. Does it refer to strategies based on the approach of the international financial institutions and used to exert pressure on developing countries, or to strategies based on genuine national goals and needs? There is also no clarification or guidance as to the kind of national and international measures that may be considered as linked to debt sustainability. This ambiguity allows developed nations and international institutions to continue linking debt alleviation to other constraining measures, such as enforcing economic liberalization, privatization, and other structural adjustment measures.

One of the main challenges facing aid efficiency is that aid flows are highly linked to international political considerations. Donors' pledges are not consistent from year to year and fluctuate greatly based on political factors and emerging priorities. Moreover, aid cannot be viewed in isolation from the conditions imposed by the international trading system and developed nations' foreign policies. Developed nations and international institutions give with one hand – aid – and take with another – the costs of forced integration in the international trading system. This creates an aid system that is superficial at best and manipulative at worst. All of these factors have resulted in the failure by most developed countries to meet their pledge to commit 0.7% of their gross domestic product (GDP) to ODA, a promise that dates back to the 1970s.[2] According to figures from the Organization for Economic Cooperation and Development (OECD), in 2005 the US allocated just slightly more than 0.2% of its GDP or USD 27.5 billion to ODA. Only the Netherlands, Norway, Sweden, Luxemburg, and Denmark surpassed the target of 0.7% of their GDP and reached 0.8% and beyond. Japan dedicated around 0.3% of GDP or USD 13.1 billion to ODA. Italy and Spain dedicated the same percentage, which amounted to USD 5.1 billion and USD 3.1 billion respectively. France and the United Kingdom came closer to 0.5% of their GDP, representing USD 10.1 billion and USD 10.8 billion respectively.

US and EU aid policy towards the region

The International Conference on Financing for Development took place at a time when numerous considerations in the global and regional policy-making process and on the economic, political, and security fronts were being rearranged, following the terrorist attacks of 11 September 2001. In fact, it was noted in the Monterrey Consensus that after the attacks of 9/11, "it is more urgent to enhance collaboration among all stakeholders to promote sustainable economic growth and to address long-term challenges of financing for development." The UN General Assembly, gathering on 16 November 2001, in the aftermath of the 9/11 attacks, concluded that terrorism must be addressed in parallel with poverty, underdevelopment, and inequality.[3]

In this context, the Arab region has been the subject of heightened international attention, especially from the US and the EU. Various initiatives have been proposed as solutions or gateways for change and democratization in the region. The perception has emerged that terrorism threats are rooted in radical Islamic movements that are entrenched in the Arab region. The high influence of these movements has been attributed to a lack of good governance and democracy, as well as weak developmental conditions and high levels of poverty.

Accordingly, the US and EU policies focusing on democracy in the Arab region have clearly adopted "the idea of using development assistance

1 Ziad Abdel Samad is executive director of the Arab NGO Network for Development; Kinda Mohamadieh is the Network's programme manager.

2 The donor governments promised to spend 0.7% of gross national income on ODA at the UN General Assembly in 1970 (*UN General Assembly Resolution 2626)*, over 35 years ago. The deadline for reaching that target was the mid-1970s.

3 The 56th UN General Assembly Plenary, 57th Meeting (PM), press release GA/ 9971, <www.un.org/news/Press/docs/2001/ga9971.doc.htm>.

as a foreign policy tool."[4] Yet, in disregard of the Millennium Declaration adopted by 189 heads of state in September 2000, both the US and the EU ignore the need to interrelate peace and security along with democracy and poverty eradication. Their initiatives call for peace building and peaceful conflict resolution, yet at the same time, they practice and support foreign occupation of land, expansion of military bases, and consistent double standards in the implementation of international laws and resolutions related to the rights of citizens in the Arab region, whether in Palestine, Iraq, or Arab countries with foreign military bases. As a result, the policies they have established to confront terrorism and promote development and democracy in the Arab region do not touch on one of the main factors behind the rise of terrorism: the feelings of humiliation and hatred that some citizens of this region have accumulated due to the above-mentioned practices.

In February 2002, the US Senate resolved that "the United States foreign assistance programmes should play an important role in the global fight against terrorism to complement the national security objectives of the United States."[5] During 2004, the US administration presented its new strategy entitled "The Greater Middle East Initiative". The initiative was proposed as a tool for achieving political reform and facing Islamic fundamentalism, which was considered, according to the initiative itself, as the roots of increasing terrorism in the world. In addition, there were several European initiatives, including the EU "Strategic Partnership with the Mediterranean and the Middle East", which is based on the Euro-Mediterranean partnership known as the Barcelona Process.[6]

The US presented its Greater Middle East Initiative at the 2004 Summit of the G-8 countries, where it was further developed as a result of scepticism and suggestions from the EU. The reformed initiative, now called the "Broader Middle East and North Africa Initiative", included some new rhetoric. It referred to the Palestinian conflict and the occupation of Iraq as major problems that need immediate solutions. It also highlighted that democratization cannot be a process imposed from abroad, but rather, it needs to be an internal dynamic taking into consideration local participation and reflecting local needs and cultural aspects. For its part, the EU initiative was further developed into the "European Neighbourhood Policy", which was proposed in the framework of the EU enlargement of May 2004. This policy is supposed to be based on national action plans covering a number of key areas for specific action: political dialogue and reform; trade and measures preparing partners for gradually obtaining a stake in the EU internal market; justice and domestic affairs; energy, transport, the information society, the environment and research and innovation; and social policy and people-to-people contacts. However, this rhetoric is still not reflected in efficient mechanisms in either of the initiatives.

It is worth noting that all these proposals and reform initiatives (the US initiative, the Euro-Mediterranean partnership initiative, and that of the G8 countries) included three main issues:

- The promotion of democracy and good governance (including topics such as free elections, parliamentary exchange, freedom of expression and independent media initiatives, freedom of association, civil society enhancement, etc.)
- The building of a knowledge society (through a basic education initiative)
- Expanding economic opportunities, the creation of forums, trade initiatives and financing for growth initiatives.

MEDA and MEPI: Case studies of aid initiatives

The two main active aid arms of the US and the EU reform initiatives in the Arab region are the US Middle East Partnership Initiative (MEPI) and MEDA, the main financial instrument for the Euro-Mediterranean Partnership. MEDA has been in place since the 1995 Barcelona Convention and was upgraded from MEDA I to MEDA II in 2000. Since its launch, MEDA has invested in programmes to support political, economic, and educational reform efforts and women's empowerment in the Middle East countries. Under MEDA I, the EU committed more than EUR 3.4 billion for the period 1995-1999, followed by EUR 5.35 billion earmarked for MEDA II, which covered 2000-2006. In addition, the European Investment Bank provided EUR 7.4 billion in loans for the Euro-Mediterranean area.[7]

During the period 1995-1999, some 86% of the resources allocated to MEDA were channelled bilaterally to "partner" states in the Middle East (Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia, the Palestinian Authority, Turkey and Israel). Another 12% of the resources were devoted to regional activities in which all Mediterranean partners and EU member states were eligible to benefit. The remaining 2% were set aside for technical assistance offices. In the meantime, the European Parliament launched the European Initiative for Democracy and Human Rights (EIHDR) in 1994. Currently, the EIHDR is funded with EUR 132 million for activities worldwide, of which approximately 10% goes to the Middle East. The EIHDR functions as a unit within EuropeAid, which was established by the European Commission in 2001.[8] It is worth noting that MEDA funding is used primarily for government programming, while the EIHDR funding (the relatively insignificant sum of EUR 1.3 million for the Middle East) goes to non-governmental organizations (NGOs).[9] According to a study published by the US Institute for Peace,[10] the EU has not accorded high priority to contacts with Arab NGOs, and funding has been given only to those groups with a decidedly secular, pro-Western outlook and to apolitical organizations such as environmental groups.

The eligibility criteria used for selecting countries to receive support for economic transition and the establishment of a Euro-Mediterranean free-trade area under MEDA II included undertaking a reform programme approved by the Bretton Woods institutions (the IMF and World Bank) or implementing programmes recognized as analogous, in coordination with those institutions, but not necessarily financially supported by them, in accordance with the scope and effectiveness of the reforms.[11] At the same time, the connection between the level of democratization and reform in a country and the funding it receives is not explicit. For example, "Egypt, despite its poor record on reform, has received a disproportionate amount of aid over the years because of its critical role in the Middle East peace process".[12] Also, Tunisia is considered as a model for the partnership by several European governments, despite the clear violations of democratic processes and human rights that it consistently commits. For example, it was clear that these conditions were dismissed by French President Jacques Chirac in his press briefing during a visit to Tunisia in December 2003, when he saluted "the progress and radical changes in this country… and the efforts the Tunisian authorities have set to …modernize Tunisia".[13]

In view of the above, it is clear that the flow of aid is directly linked to the extent to which recipient countries accept and integrate policies and conditionalities imposed by the World Bank and the IMF, which are based on market liberalization approaches and the prioritization of privatization policies and the interests of multinational institutions.

It is interesting to note how the Euro-Mediterranean Partnership divides the "Arab Region"; it includes countries of the Middle East and North Africa (Morocco, Tunisia, Algeria, Syria, Lebanon, Jordan, Palestine, and Egypt) and excludes Gulf

4 Hirvonen, P. (2005). *Why recent increases in development aid fail to help the poor.* Global Policy Forum, p. 7.

5 *Ibid*, based on the US Senate Resolution 204, 5 February 2002.

6 The partnership includes eight Arab countries, in addition to Turkey and Israel, and 25 European countries. The Barcelona Process was launched in 1995 and aims at establishing a free-trade market between Europe and the Mediterranean countries by 2010.

7 EuroMed Special Feature (2001). *From Meda I to Meda II, What's New?* Issue No. 21, 3 May. Available from: <ec.europa.eu/comm/external_relations/euromed/publication/special_feature21_en.pdf>.

8 Yacoubian, M. (2004). *Promoting Middle East Democracy: European Initiatives.* Special Report No. 127, p. 4. Available from: <www.usip.org/pubs/specialreports/sr127.html>.

9 EuroMed Special Feature (2001). *Op cit*, p. 7.

10 <www.usip.org>.

11 Euro-Med financial cooperation figures. Available at the gateway to the European Union: <europa.eu.int/comm/external_relations/euromed/meda.htm#2>.

12 EuroMed Special Feature (2001). *Op cit*, p. 8.

13 Press briefing given by Mr. Jacques Chirac upon his visit to Tunisia, 4 December 2003. Available from: <ambafrance-uk.org/article.php3?id_article=4670>.

States like Iraq, among other Arab countries. Jordan has been included in the Partnership without any clear justification or criteria: the geographic aspect is not evident, nor is the cultural aspect, which is not prioritized by the partnership, nor is there any economic advantage for Jordan when considering the complementarities aspect among the southern Mediterranean countries. On the other hand, Libya was excluded from the process. The embargo imposed on Libya by the US and EU was reviewed when the Libyan leadership changed its international policy to better suit the US and EU agendas, especially in relation to its nuclear policy. Moreover, European countries that are not on the Mediterranean, such as the UK, Sweden, Finland, Belgium, the Netherlands and others, are part of the Partnership.

These questions left unanswered leave the partnership open to subjective calculations, which are often based on the interests of the European partners and not the region as a whole. This artificial geographic definition of the Euro-Mediterranean region, which is clearly driven by the geopolitical interests of European states, helps to increase the divisions between Arab countries instead of creating a more equitable playing field for all the countries involved and facilitating cooperation and coordination between them.

Although the Euro-Mediterranean Partnership has set three main tracks of action, including the issues of peace and security, economics and free trade, as well as development and cultural aspects, progress since 1995 has been concentrated on the economic aspect. Bilateral trade association agreements were signed and ratified with all the partner countries (except Syria) with the aim at creating a free trade area. It is worth noting here that the assessments of the association agreements have shown negative short-term and medium-term impacts on the southern partner countries. The Sustainability Impact Assessment Study (SIA) for the Euro-Mediterranean Free Trade Area (EMFTA), due to be established in 2010, indicates that this free trade area might generate only slight net gains in regional economic welfare, but significant social and environmental costs in the Arab nations and Turkey.[14] It is clear that without adequate economic preparedness, as well as the ability to sustain successful development policies and a stable and secure environment, governments are not able to set adequate economic and national policies that allow them to benefit from free trade agreements. Therefore, the priority from the European perspective is obviously based on their own economic and trade interests and not on building a true and sustained partnership.

Moreover, one cannot disregard the European tendencies to integrate "peace building" within the partnership, given that the new European Neighbourhood Policy includes the Mediterranean Arab countries and Israel in common plans towards the year 2010. The EU position on the Middle East peace process states that its main objective is a "two-State solution leading to a final and comprehensive settlement of the Israeli-Palestinian conflict based on implementation of the Road Map, with Israel and a democratic, viable, peaceful and sovereign Palestinian State living side-by-side within secure and recognized borders enjoying normal relations with their neighbours in accordance with UN Security Council Resolutions 242, 338, 1397, 1402, and 1515 and on the principles of the Madrid Conference."[15] However, the EU does not react to the double standards in the implementation of international laws and resolutions related to the Middle East conflict, particularly with regard to the rights of the Palestinians. It also ignores the need to introduce radical political, economic and social reforms in the region as a whole. Therefore, it is evident that the European initiative does not aim at spurring reform, but rather at buying stability and avoiding massive illegal immigration. The Barcelona Process started by focusing almost exclusively on aid and trade;[16] this is still reflected in today's European policies towards the region.

For its part, MEPI was launched in 2002 as a US presidential initiative with support from the Congress. It is operated through the US Department of State. MEPI set in motion more than 350 programmes in 15 countries of the Middle East and the occupied Palestinian territories. It works through partners that include local and international non-governmental organizations, businesses, universities, international institutions, and in some cases, the governments of the region. According to the official website of the programme, to date, the U.S. Congress has committed around USD 300 million to MEPI over four fiscal years. MEPI's funding comes in addition to the bilateral economic assistance that the US provides annually to the Middle Eastern countries.

MEPI channels funds into projects tackling four main pillars: democracy, covering democratic elections, free media, and independent judicial systems; economics, including foreign direct investment, local investments, and job creation; education, which encompasses training, improving curriculum contents, and promoting employable skills; and women's empowerment.

The US strategy was initially aimed at tackling democracy issues within the framework of the Broader Middle East Initiative. While the initiative re-divides the region and brings in Israel as part of one framework along with Arab countries, its strategy neglects the need for stability and development, and so it does not tackle core issues that could serve peace building. It maintains the bias towards Israel, and neglects the provocations caused by the Israeli occupation. It also maintains the double standards in implementing international laws, since it is obvious that many UN resolutions were forced to be respected and implemented using all tools, including military action, while others have been suspended for decades without implementation.

The Broader Middle East and North Africa Initiative – the US initiative adopted by the G8 after modifications, also referred to as the "Partnership for Progress and a Common Future" – lacks a real sense of local participation, especially from civil society organizations. Furthermore, it fails to address core issues aimed at fighting poverty and achieving development. US funding directed towards civil society organizations, unlike other foreign funding, creates a significant level of tension among these organizations in the Arab region. This is evident in certain Arab countries more than others. This situation owes to the belief by some groups that the funding received from the US does not serve the priorities set by Arab civil society groups, but leads these groups to be implementers of an agenda set according to US priorities in the region. In this context, the funding administered to civil society groups via the G8 initiative is leading towards the fragmentation of local civil society due to participation in various parallel initiatives in partnership with civil society organizations from the G8 countries. These initiatives focus on governance and transparency issues, dialogue for democracy, women's participation, judiciary reform, etc. In addition to the lack of coordination among these initiatives, local civil society groups are becoming mere implementers of policies set by the funding groups without a local and participatory consultation process. This raises issues related to the relevancy of capacities and expertise of the local civil society entities implementing the proposed programmes and activities. Consequently, it raises serious questions on the effectiveness of the outcomes and expected results of this work.

The connection of aid to militarization and terrorism

The US was the first to draw upon the connection between militarization, terrorism and aid. It imposed a condition upon countries and institutions that benefit from its aid programmes whereby the beneficiary must commit not to work with organizations and individuals that are judged by the US administration as linked to terrorism.

The EU is also linking aid to fighting terrorism, with European ministers warning countries that their relations with the economically powerful bloc will suffer if they fail to cooperate in the fight against terrorism. An EU official was quoted as saying, "Aid and trade could be affected if the fight against terrorism was considered insufficient," leading to accusations of "compromising the neutrality, impartiality, and independence of humanitarian assistance."[17] It is worth mentioning that in May 1995,

14 Martin, I., Byrne, I. and Schade-Poulsen, M. (2004). *The Social Impact of the Euro-Mediterranean Free Trade Areas: A First Approach with Special Reference to the Case of Morocco.* Routledge, Taylor & Francis Group.

15 EU's position on Middle East Peace Process, section on external relations. Official website of the European Commission: <ec.europa.eu/comm/external_relations/mepp/index.htm>.

16 EuroMed Special Feature (2001). *Op cit*, p. 8.

17 Bianchi, S. (2004) "Politics-EU: War on Terror Threatens Aid". IPS, 25 March. Available from: <www.ipsnews.net/interna.asp?idnews=23031>.

the EU developed a democracy and human rights clause governing relations with third countries that stipulated the suspension of aid and trade in the event of serious human rights violations (COM 95(216)23 May 1995).[18] In practice, these two approaches could come in serious opposition to each other, as will be explained later in this section.

The categorization used to link aid to terrorism is not based on a specific, clear and objective definition of terrorism and terrorists. It is thus of the utmost importance to call upon the United Nations to adopt a fair definition that takes into account all the factors, realities and circumstances that generate terrorism. Not only are the links between terrorism and development not fully explored or explained by the US and the EU, but also the definition currently adopted by the UN focuses on individual terrorism and neglects state terrorism; it focuses on the violation of human rights and of international and domestic laws at the individual level, but does not talk about the violation of international rights and laws by states.

What do anti-terrorism measures mean to the Arab region?

The efforts undertaken in the name of fighting terrorism in the US have included measures that are judged as restricting civil liberties and individual freedoms and thus impacting the civic and political rights of US citizens. Now, through their aid programmes, the US and EU are trying to impose counter-terrorism measures on their partners – which include the Arab countries – as "key elements of political dialogue". This was stated in the declaration that resulted from one of the EU foreign ministers meetings in Brussels in March 2004.

In the view of development and humanitarian NGOs, this could impact the EU's aid policy, as it poses the risk of aid being used as a tool in the war on terror (as stated by Howard Mollet, policy analyst at British Overseas NGOs for Development). While trying to achieve "coherence" between development policy and foreign policy, the EU is not able to guarantee clear boundaries between coherence, cooption and subordination, and there are also no guarantees that these purposes will not be financed through existing development funds. In fact, the EU has indicated that counter-terrorism concerns will be integrated into "all relevant external assistance programmes."[19] Some Arab governments with long track records of human rights violations will use the security demands of the US and the EU to continue imposing additional restrictions on individual freedoms, including freedom of association and expression, in the Arab region. The current EU and US policies bolster the ability of Arab governments to violate the basic human rights of their citizens.

On the other hand, countries such as Turkey, Jordan, Pakistan, Indonesia and the Philippines, which are considered critical in the "war on terror", have seen significant increases in credits and aid from the US, some of it from the Economic Support Fund (ESF), a category of security assistance used during the Cold War to give support to key geopolitical allies.[20] The increases in military and ESF funding come largely at the expense of humanitarian and development assistance, whose core programmes, such as education and child and maternal health, were estimated to be reduced by about USD 400 million in 2005, according to a budget analysis by Inter Action, a coalition of 160 US relief and development groups.

All these measures are being implemented with little attempt to examine the root causes of terrorism and the factors that generate it. This will never lead to winning the war against terrorism. Moreover, reducing social and economic aid will exacerbate the lack of basic necessities and increase poverty, which is a main factor behind criminality, delinquency and terrorism.

Aid and relations with Israel

For the United States, the concept of "opening up" (to neighbouring countries) goes hand in hand with a resolution of the conflict with Israel. Relations with Israel are an indicator for relations with the rich and "civilized" world. Following their peace agreements with Israel, economic aid to Egypt and Jordan increased dramatically. Israel and Egypt remain the largest bilateral recipients, accounting for nearly USD 5 billion in aid. It is worth noting that most of the USD 3 billion earmarked for Israel goes to military credits.[21]

In the Palestinian case, in the context of negotiations for an "agreement at all cost", Palestinian moderation is rewarded with a great many promises, but only trickles of support. This has created an atmosphere of intimidation and doubt following any attempt for an independent position on the peace process.[22] The double standards and subjectivity of aid processes and mechanisms were clearly reflected after Hamas was democratically elected by the Palestinian people, with the US and EU threatening to stop the flow of aid to Palestine due to these election results. Although the US has always claimed to be a champion of democracy, the Palestinian elections did not gain its recognition due to the obvious conflict between Hamas and Israeli interests.

The 2007 foreign aid bill approved by the US House of Representatives Appropriations Committee includes USD 2.46 billion for Israel, of which USD 2.34 billion goes to military aid and the rest to civilian aid. US aid for Israel is calculated according to a formula set in the late 1990s, which aims at eliminating US civilian aid to Israel. This is based on the assumption that the US Congress would not support civilian aid for long to a country with a developed economy like Israel's. Under this formula, US military aid for Israel would increase by USD 60 million a year to a ceiling of USD 2.4 billion a year, beginning in 2009. Israel will receive its last USD 60 million of US civilian aid in the 2008 US fiscal year. Egypt will be receiving the second largest aid amount from the US, totalling USD 1.7 billion, of which USD 1.3 billion is earmarked for military purposes. It should be noted that the US House of Representatives, whose foreign aid will total USD 23.1 billion in 2007, will dedicate the limited amount of USD 3.4 billion to fight AIDS, tuberculosis and malaria; USD 522 million for stabilization efforts in Iraq; and USD 962 million for Afghanistan.[23]

The impact of the aid flow as currently managed

The Monterrey Conference placed equal stress on three pillars that serve financing for development: (1) more free trade, including foreign direct investment, but with a more democratic, transparent and fair trading system; (2) more aid, with the main focus on the quality of aid and on non-conditional, non-tied official development assistance; and (3) sustained debt relief. However, through a quick analysis of the aid policy towards the Arab region, one can easily conclude that it is highly linked to strategically calculated political decisions, and focuses on enhancing free trade, which remains one of the main objectives for any aid channelled to the region. This aid policy is hardly conducive to development, because trade alone cannot guarantee growth and sustained development. The trade policies conducted by the US and the EU do not reflect any serious willingness to help developing countries, since they insist on subsidizing their own agricultural sectors, misusing antidumping measures, abusing intellectual property rights, and modifying the rules of trade in services. This was reflected in the trade negotiations at the successive WTO ministerial and mini-ministerial meetings in Doha, Cancun, Hong Kong and Geneva. Moreover, the economic reforms being tied to much of the ODA flow are perceived by different governmental stakeholders and decision makers – from the international financial institutions to local governments – as a matter of economic and trade liberalization and more privatization. This assumption highly limits the role of the state in economic regulation and reduces the available policy options. It also shrinks social reforms to the mere establishment of safety nets to face the negative effects resulting from

18 EuroMed Special Feature (2001). *Op cit*, p. 4.

19 Bianchi, S. (2004). *Op. cit.*

20 Lobe, J. (2004). "US Foreign Aid Budget Takes on Cold War Cast". IPS, 3 February. Available from: <www.ipsnews.net/interna.asp?idnews=22232>.

21 Shah, A. (2006) "The US and Foreign Aid Assistance". Global Issues that Sustain Everyone, Sustainable Development. Available from: <www.globalissues.org/TradeRelated/Debt/USAid.asp#AidisActuallyHamperingDevelopment>.

22 Abou Chakra, S. (December 2005). "Alternative Priorities". Paper prepared for the ANND as a contribution to the *Annual Report on the Reality of Aid Security, Development, and Cooperation.*

23 This paragraph is based on the article "US aid for Israel USD 2.46 billion in 2007", *Globes Online, Israel Business Arena*, 28 May 2006. <www.globes.co.il>

these economic reform policies. Furthermore, ODA is increasingly being conditioned by the "war on terror", and the reaction to the results of the elections in Palestine is an interesting example. Finally, the debt issue was never seriously negotiated; it remains, as in the case of Lebanon, a way to exert more conditionalities towards liberalization and privatization.

The United Nations General Assembly repeatedly stressed the inter-linkage between security, development, and human rights at the September 2005 World Summit. The correlation between security and development is the basic principle of modern political and sociological thought. Problems of security and development can only be tackled together, in a comprehensive effort to face conditions that, on one hand, cause stability and instability, and, on the other, stimulate or hinder development.[24]

The areas into which aid is being channelled by the donor community overlap with several areas that civil society organizations in the Arab region are working to promote and strengthen, such as good governance, freedom of expression, sound electoral systems, the independence of the judiciary, and the empowerment of women, among others. However, the surrounding environment being enhanced by the donor countries themselves is hampering the process of change in the Arab region. Three main factors have a direct and negative effect on the impact achieved by aid flows for the purposes of financing for development in the region. These are:

- The double standards of the US and the EU with regard to the UN resolutions and the 2004 International Court decision[25] addressing the rights of the Palestinian people. Moreover, Israeli nuclear weapons remain a taboo subject, while insecurity in the region and tendencies towards militarization and strengthening defence policies persist.
- The link between aid and terrorism is weakening the ability to sustain an efficient and effective flow of aid based on the national needs of recipient countries, and not on the foreign policy demands of the rich donor countries. This approach is also providing new justification for the prioritization of defence and security policies at the expense of development and social security, which has long been the main dilemma in the Arab region.
- The undemocratic regimes in the Arab region, which continue to repress freedoms, violate rights, and limit the space of civil society organizations, are continuously being supported by various donor countries for reasons related to energy and oil sources or the military bases located in several Arab countries.[26]

No efforts will genuinely help the region unless the rights of all peoples are protected in accordance with international conventions, laws, and UN resolutions. Change requires the introduction of radical reforms at different levels: political, economic, social and cultural. In order for any reform agenda to be effective, it must be comprehensive and take all of these dimensions into consideration These reforms should be aimed at establishing regimes that respect human rights and democracy and adopt policies leading to social justice. From the perspective of Arab civil society organizations, there is no opposition to any initiative calling for democracy and respect of human rights. Peace, security, and adequate socio-economic policies in addition to democracy and human rights would be the main factors needed for their success. Moreover, change requires the implementation of a fair and comprehensive solution for the Palestinian-Israeli conflict and a real and effective end to any form of foreign occupation in Iraq.

Ideally, aid should complement local development plans. This requires addressing "national" obstacles hindering these plans, such as lawlessness, the absence of democracy, and the prevalence of corruption, in addition to the lack of expertise and scarcity of technology. If conditionalities were related to issues such as the freedom to vote, the right to free expression and association and the independence of the judiciary, rather than privatization and the removal of subsidies that support basic services, then the aid regime could become the developmental lever needed by poor countries. Local development plans should answer the needs of the majority of the population that lives below the poverty line in most countries of the region. Foreign aid for these plans will contribute to raising the living standards of real people, and not merely raising general economic indicators that only actually benefit a minority in the upper classes, mainly because of the lack of a fair redistribution of wealth. It is essential to stress that foreign aid should be aimed at poverty reduction policies, and this will depend on the harmonization of the policies, practices, and procedures of the development assistance agencies, as well as on national public capacities to absorb, manage and distribute this aid.

For its part, civil society can play a crucial role in the process of reforming aid mechanisms, guaranteeing their outreach, and making them more responsive to local and national needs, and therefore more sustainable within the development policies of developing countries. ■

24 See reference 20.

25 The International Justice Court issued a statement in 2004 concerning the construction of the separation wall by Israel. It was stated that the wall is a main obstacle for economic, social, and human development in the occupied Palestinian territories. Moreover, it causes humiliation among Palestinians, generating more tensions and increasing insecurity and instability.

26 These undemocratic behaviours of the Arab governments are generating more corruption and contributing to the misuse of the aid flow. The lack of transparency and accountability are the direct reasons behind the lack of responsibility.

What if developing countries could finance poverty eradication from their own public resources?

Global Policy Forum Europe
Jens Martens [1]

For decades development cooperation has been based on the assumption that countries of the global South need to be *helped* in their development with monies coming from the rich North. A symbol of this "partnership" (a euphemism for what are too frequently paternalistic donor-recipient relationships) is the 35-year-old unfulfilled promise by developed countries to allocate 0.7% of their gross domestic product (GDP) to official development assistance (ODA).[2] Since the time this pledge was made, the discourse about development financing has concentrated on the question of how to mobilize more money for the South, whether through an increase in ODA or through new financial instruments like global taxes.

Yet, however useful, "aid" is not the solution. It is not sufficient and, in the long term, Southern countries can only overcome their dependency on rich donors when their governments are able to mobilize enough domestic resources to guarantee universal access to reasonable quality essential public goods and services. New perspectives are needed.

The basic starting points for achieving this goal include, among others, an effective tax system that enables governments to raise the necessary resources, and transparent and democratic ("participatory") budgets that focus on the financing of key development tasks. The most urgent of those tasks are outlined in the so-called Millennium Development Goals (MDGs), and they address issues such as education, health, nutrition, safe water provision and social security.

However, up to now the mobilization of domestic resources and the strengthening of fiscal policies for the purposes of poverty eradication and social redistribution has been met by several internal and external obstacles.

Billions lost through tax evasion

Southern countries lose billions of dollars of potential income every year. Some of the main causes of those *leaks* are the following:

- Ineffective tax systems fail to reach landowners, foreign corporations and wealthy individuals. This comes hand in hand with a corrupt financial administration that is not in a condition to actually stop tax revenue from falling.
- Through tax cuts and frequent tax exemptions for foreign investors, developing countries forego revenues without ensuring the corresponding development benefits of the investments thus promoted. This is particularly true in the more than 3,000 currently existing export processing zones (sometimes called "special economic zones"), where workers' rights and environmental regulations are frequently abolished. The competition to attract foreign investment becomes a "race to the bottom" in tax terms. Transnational corporations profit from this practice, but the local populations seldom see the benefits.
- The globalization of corporate activities allows firms with a transnational presence to manipulate the prices of their internal transactions so that the profits are accounted for in the countries where the taxes are lower, in a move known as "transfer pricing". While markets and production are globalized and money can circulate around the world in seconds, tax policy is confined within national borders.
- Even countries with properly functioning tax systems lose billions of dollars every year due to capital flight to tax havens.
- Finally, the pressure towards trade liberalization and tariff reduction deprives many countries in the South of vital income. In Africa in particular, customs revenues provide an important percentage of government income. Dropping tariffs and providing no replacement leaves a gap in the budget.

  The resources that are actually lost through capital flight, tax avoidance and tax fraud can only be estimated, as there are no official statistics on these phenomena. The dimension of the problem, however, can be assessed from the following figures:

- If low-income countries were to revise their taxes, strengthen their financial administrations and abolish tax exemptions for transnational investors so that the proportion of public revenues within gross domestic product (which was 12.0% in 2003) was brought to the average level of the rich countries (25.7% in 2003), their governments' income would increase by approximately USD 140 billion per year.[3]
- The tax income of the developing countries would increase by over USD 285 billion per year if the informal economy could be integrated completely into the formal economy and taxed accordingly. Even if this is unrealistic, partial integration would already bring in many billions in additional income.
- Manipulating the accounting of the prices of intra-firm transactions or falsely declared import or export prices led to shortfalls in revenue of USD 53 billion in one year in the USA alone. For developing countries no numbers are available so far, but the tax losses for public budgets are considerable in any case.
- On a worldwide level, capital flight to tax havens results in losses to governments of an estimated USD 255 billion a year due to uncollected income and property taxes. Of this total, roughly 20% – or approximately USD 50 billion – would most likely correspond to the countries of the South (Cobham, 2005a, p. 10).

In contrast to these numbers, the United Nations Millennium Development Project has estimated that in order to achieve the MDGs, low-income countries should be spending USD 180 billion in 2006 on essential services, or USD 43 billion more than in 2002. Those domestic expenditures would still need to be supported by an increase in ODA by USD 73 billion (between 2002 and 2006). Thus the fulfilment of the MDGs requires both a substantial increase in development assistance and substantial additional tax revenues in the countries of the South. In other words, only if the tax loopholes are plugged and tax evasion is drastically reduced in the countries of the South can the MDGs still be achieved.

Nevertheless, functioning tax systems, the reduction of capital flight and the effective taxation of the rich elites and transnational corporations do not guarantee that governments will actually use the additional revenues for the fight against poverty and the development of their countries. And that is because parallel to the obstacles on the income side, there are various problems on the expenditure side which can prevent the use of public revenues in a way that actually contributes to development.

Reallocation in budgets would bring in billions for social development

Many governments of the South do not spend a substantial portion of public income on measures that fight poverty. Instead, a major part of the usually meagre public revenues flow into debt servicing,

1 The author is Executive Director of Global Policy Forum Europe.

2 Resolution A/RES/2626 (XXV) of the UN General Assembly (1970).

3 For the poorest countries, however, in which the majority live at the margins of minimum acceptable standards of living, an increase in the proportion of tax revenues within GDP to the level of the industrialised countries is hardly probable.

into subsidies that do not help development and harm the environment, and into military budgets. This is partially due to the pressure from foreign creditors (including the IMF and World Bank) or hostile neighbour states. But part of the responsibility for the misuse of resources lies with the governments of these countries themselves. The sums at stake are enormous:

- In 2004 the governments of Africa, Asia, Latin America and the CIS (former Soviet Union) spent USD 333.7 billion on servicing their foreign debts.
- The subsidies of non-OECD countries to agriculture, water, energy, forestry, fishery and other environmentally relevant sectors have been estimated at USD 340 billion per year.
- The annual military expenditure of the countries of the South reached a volume of USD 193 billion in 2004.
- At the same time, public expenditures on education and health remain stagnant in many developing countries. Costs are being transferred, particularly in the area of health, from the public to private budgets. This affects the poor above all.

A reform of government budgets would set billions free for poverty eradication and social development programmes. The cost estimates of the implementation of the MDGs entail that public budgets for essential services must more than double between today and 2015. This can only be possible in the countries of the South if, along with higher tax income, they also reduce their debt service payments, cut harmful subsidies, and lower their military expenditure. The possibility of reforming the resource allocation in the national budgets of developing countries should not however obscure the fact that in the budgets of the rich countries there are far larger possibilities of savings and better utilization of funds. Some USD 725 billion per year is spent on subsidies, which are problematic for both social and environmental reasons. The military expenditure of the rich countries was USD 842 billion in 2004, which is more than four times greater than the defence budgets of all of the countries of the South put together. The Bush administration spends USD 10 billion *per month* on the war in Iraq and Afghanistan alone, more than what the United Nations and all their development programmes and funds spend in an entire year.

Steps toward global tax justice and eco-social fiscal reforms

In recent years, NGOs, social movements and international expert committees have formulated comprehensive recommendations for global tax justice and eco-social fiscal reforms. Realizing these requires a paradigm shift in the international discourse on development financing and the implementation of the MDGs, which lies along the following lines:

1. *Build efficient and fair tax systems*. A basic condition for the strengthening of public revenues is a broadly based tax system. The rich and the large landowners should pay more. Capital and resource consumption should be taxed more than labour. A flat value added tax is regressive and burdens the poor. The governments and parliaments of the countries concerned carry the responsibility for undertaking this kind of tax reform. Development cooperation should actively support these reforms through capacity building and technical assistance.

2. *Strengthening of tax administration and public financial management*. A tax system is only as effective as the administrative machinery that implements it. In many countries such tax administration still needs to be built, or at least strengthened. This involves the legal framework, the staff and the technical infrastructure. Only in this way can the untaxed shadow economy be reduced, tax avoidance overcome and tax evasion prevented. Development cooperation can provide crucial technical and financial support here.

3. *Effective taxation of transnational companies*. Tax exemptions or tax incentives for transnational investors in export processing zones are counterproductive in this regard. They should be abolished, if possible in an internationally coordinated way (see below). Furthermore, laws against manipulative transfer pricing should be introduced and the necessary technical capacities must be created. In view of the rapid technological development, international support and cooperation are urgently necessary here.

4. *Tax compliance as part of corporate responsibility*. The debate on corporate social responsibility and accountability has concentrated so far on fundamental environmental and social standards, human rights and corruption. Taxation questions have so far played a minimal role in this debate. Only the OECD Guidelines for Multinational Enterprises demand in chapter X: "It is important that enterprises contribute to the public finances of host countries by making timely payment of their tax liabilities. In particular, enterprises should comply with the tax laws and regulations in all countries in which they operate and should exert every effort to act in accordance with both the letter and spirit of those laws and regulations. This would include such measures as providing to the relevant authorities the information necessary for the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle." These norms should apply to all corporations, particularly those participating in the UN-promoted Global Compact. A company that evades taxes through accounting tricks should not be labelled as "socially responsible".

5. *Binding rules on the transparency of payment flows*. Taxes and royalties from foreign investments in the oil, natural gas and mining sectors are of great importance to commodity-rich countries. These taxes are frequently not published by the governments nor by the companies involved. But lack of transparency facilitates corruption and tax evasion. Since the disclosure of information could create a competitive disadvantage to an individual company, it does not make sense to rely on voluntary initiatives, and governments should make it mandatory for a corporation quoted on the stock market – in particular oil and mining firms – to disclose all information about the taxes and royalties they pay, as well as fees and other financial flows between them and public institutions in all countries.

6. *Fight against corruption and bribery*. In order to reduce the losses due to fraud, corruption and bribery, stronger rules and procedures are necessary both in the countries concerned and at the international level. The United Nations Convention Against Corruption plays an important role here. It came into force on 14 December 2005 and has been signed by 140 countries and ratified by 60 (as of August 2006). It must now be ratified as rapidly as possible by more countries and then converted into national law. A monitoring mechanism needs to be established in order for the Conference of States Parties to be able to examine its implementation country by country.

7. *Strengthening international tax cooperation*. The success of national tax reforms depends on improved international cooperation between governments, since the freedom of transnational capital movement limits the possibilities of success of a government acting alone. In the global tax race to

the bottom, governments that compete alone in this race are inevitably the losers. In contrast, a better coordinated tax policy would benefit the large majority of countries (with the exception of some of the more aggressive tax havens).

8. *Improved information exchange among revenue offices*. A first step in the fight against tax evasion would be the introduction of an automatic information exchange between revenue offices and the different countries in which an investor operates. Countries and territories which are not prepared to participate should be properly sanctioned by the United Nations.

9. *Introduction of an international minimum tax on corporate profits*. A minimum of harmonization and a new basis for taxing corporations are necessary in order to counteract the harmful tax competition to attract foreign investors. Different principles can be put into practice, such as, for example, the principle of "unitary taxation" or the universal application of the residence principle. The introduction of a minimum tax on corporate profits or a special tax for transnational companies would be politically meaningful, but it requires a harmonization of the tax systems.

10. *Establishment of an international tax organization*. As of now there is no intergovernmental forum on a global level to deal with questions of taxation. The OECD carried out pioneer work with its activities against harmful tax competition, tax havens and manipulated transfer prices. However, the activities against tax havens are at best moderate and the countries of the South are not equal partners in the OECD. In order to close this global governance gap, the creation of an International Tax Organization was proposed in 2002 by the Zedillo panel in its report in preparation for the Monterrey Conference on Financing for Development. So far it has only succeeded in upgrading the United Nations ad-hoc committee of tax experts into the Committee of Experts on International Cooperation in Tax Matters in 2004. Further steps toward an intergovernmental tax forum under the auspices of the United Nations are still pending.

11. *No more pressure to liberalize in international trade negotiations.* As long as the budgets in many countries, particularly in Africa, depend on customs revenues, forced trade liberalization leads to substantial income losses. The governments of the affected countries cannot compensate for these cuts in the short term. The European Union and the USA should therefore stop pressuring these countries to reduce their tariffs in the negotiations of the World Trade Organization or in regional or bilateral trade agreements. Instead, the countries concerned (in accordance with the principle of "Special and Differential Treatment" for poor countries) should be able to determine the speed and the range of further liberalization steps independently.

12. *Abandon flawed fiscal policy conditionalities*. The IMF usually demands indebted countries to reduce their public expenditures and privatize public services, such as water provision, for example. At the same time, it requires the reduction of tariffs and the uniform introduction of the value added tax to compensate for the income losses. The neoliberal policies of the IMF have been weakening the income basis and thus the political space of governments and have contributed to the increased gap between rich and poor in many countries. The IMF and other donors should draw the proper conclusions from these experiences and abandon this interference into the fiscal policy of recipient countries. At the same time, a comprehensive independent evaluation should assess the concrete consequences of the interventions of the IMF and World Bank on the budgetary policy of individual countries of the South.

13. *Debt sustainability should depend on ability to reach the MDGs*. In many countries substantial parts of the national budget must be used for debt servicing and are therefore not available for the fight against poverty and the financing of the MDGs. An independent evaluation of the sustainability of the debt of these countries is urgently needed to replace the notoriously unreliable evaluations of the IMF and World Bank. The UN Secretary-General demanded in his report to the Millennium+5 Summit in 2005 that debt sustainability be defined in such a way that a debtor country has to service its debt only after having secured the resources needed to achieve the MDGs. Domestic indebtedness of the state has to be considered in this regard together with the external debt.

14. *Eliminate harmful subsidies - also in the South*. Every year subsidies devour several hundred billion dollars in the countries of the South. A huge part of them serve environmentally or socially damaging purposes, such as financial incentives for transnational companies or the lowering of oil prices. In the context of an eco-social fiscal reform, such subsidies must be diminished. Development cooperation can promote this process, for example, by providing support for the introduction of energy-saving technologies.

15. *Reduce military expenditure and strengthen peacebuilding*. Large sums for expenditure on education and health could be freed up by the reduction of the military budget in many countries. A condition for this, however, is stronger support for these countries in the context of civilian conflict prevention, peacekeeping and peacebuilding measures. The new UN Peacebuilding Commission can play an important role, if it is equipped with the necessary financial resources. At the same time, the largest weapons-producing countries (in particular the five permanent members of the Security Council) have a responsibility to improve the regulation and control of their arms exports and to support a global arms trade treaty.

16. *Transparent budgets and gender budgeting*. Free access to all budget information and effective controls (e.g. by audit offices) are basic conditions in order to increase the accountability of governments in the use of public funds. Only in this way can it be guaranteed that additional public revenues are actually used for the purposes of the fight against poverty and the implementation of the MDGs. Governments should therefore ensure the effective participation of civil society in budgetary planning, especially in the context of national strategies for the implementation of the MDGs. With the help of gender budgeting analysis it should be determined in particular whether and to what extent governments comply with their commitment to promote gender equality. Similarly, it should be determined if budgets comply with the obligation for the fulfilment of economic, social and cultural human rights.

17. *Budget support.* The provision of ODA in the form of direct budget support can strengthen the institutions and the political responsibility (and *ownership*) of the recipient governments. In this way, transaction costs can be reduced, "projectitis" overcome, and donor coordination improved. Budget support is only meaningful, however, if the criteria of transparency specified above are fulfilled, if citizens have a democratic say, and if independent control of the utilization of funds is ensured. In addition, the capacities must be present for the effective use of the additional budget resources, or they should be built. Finally, it must be guaranteed that budget support is assured on a long-term basis, so that the recipients can plan their budgets

with the certainty that the funds will be available, and are not bound to harmful political conditionalities.

The implementation of this and further steps to global tax justice and eco-social fiscal reforms will not be easy and can only result from social and political mobilization. Although the majority of the population will benefit from the outlined reforms, they will adversely affect those who are the beneficiaries of the present system. These include corrupt elites in some countries of the South as well as wealthy individuals who place their fortunes in tax havens and those transnational companies that maximize their profits through manipulative transfer pricing and production outsourcing in export processing zones. On the other side of the spectrum stand many millions of people whose living standards would improve noticeably through increased government expenditure on public education and health care, active social policies and more national investments in public infrastructure. Whether the necessary paradigm shift in international economic, financial and development policy takes place will depend considerably on the pressure exerted by civil society groups, particularly in the face of the political influence wielded by powerful lobbyists acting on behalf of the wealthy and the transnational corporations who benefit from the current status quo. With civil society campaigns and networks, such as the Tax Justice Network, Publish What You Pay, and the initiatives on participatory, gender and human rights budgeting, the first important steps toward this direction have been made. ■

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