Financing Injustice

At Christian Aid we are driven by a fundamental belief that the world can be made a better place. We can do much better than the way things are.

We need a radically different and rebalanced financial system which ensures that the very poorest are included and actively supported to thrive, and in which developing countries have an equal say in making the rules governing the global economy.

Creating a fairer global economy is a core part of the moral imperative to create a fairer global society. In 'An Unquenchable Thirst for More' (2017), we asked what enables a truly human life. We argued that we need to see the economy as a tool that enables people and the planet to flourish.[1]

Working together towards the Sustainable Development Goals (SDGs) represents a step on this path, and we are seeing real progress in some areas.[2] But there are clear trends that risk sending us in the opposite direction.

- Economic inequality, both within and between countries, continues to grow. This is driven by unequal ownership of capital, including transfers of capital from state to private ownership.[3]
- 40% of low-income developing countries are at high risk of, or already in, debt distress.[4] An increasing percentage of this debt is owed to private creditors.
- In the name of fiscal discipline, governments in more than two-thirds of countries have enacted drastic austerity measures.[5] Effectively, this is a decision to cut invesment in human rights and the SDGs, and it affects poorest communities the most.
- Failure to keep global temperature increases below 1.5°C endangers all aspects of the SDGs.[6] Tackling this implies fundamental changes to the way capital is managed and invested.

Governments and multinational institutions such as the World Bank are focusing overwhelmingly on mobilising private sector funding to deliver the SDGs. This focus risks exacerbating these negative trends.

We believe this focus prioritises the profit motives of the rich and powerful, ahead of the needs of the poor and vulnerable. There is still time to change direction, and we have a duty to speak out and call for a re-think.

Over the past 25 years, Christian Aid has campaigned for fairer trade, for the elimination of unjust debt, for an end to tax dodging by corporations and the super-wealthy, and for stemming illicit financial flows out of poor countries.[7] These campaigns have all been driven by the same burning desire: to create a world where the needs of the poorest and most vulnerable are put first,[8] where everyone has an equal voice, and where the wrongs of history are acknowledged and addressed. Our challenge to the way that the SDGs are funded continues in this tradition.

Financing for development: what is needed?

The SDGs are ambitious, looking towards a sustainable world where all women and men can thrive. They are not perfect, but they recognise that addressing social and economic inequality is vital, and that poverty and environmental destruction are not just problems for developing countries to solve but require all countries to act together.

Such ambition comes at a cost, but it is difficult to estimate the 'SDG financing gap' – the additional finance that will need to be mobilised for development if the SDGs are to be achieved.

The UN Conference on Trade and Development – in a report that focuses on the potential to attract additional private finance, mainly concentrated

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in power generation, climate change mitigation, telecommunications and transport – places the figure at $2.5 trillion.[9] In addition, the Overseas Development Institute has assessed the financing gap for three social sectors – health, education and social protection – as an estimated $2.4 trillion.[10]

Whatever estimates are used, the SDG financing gap is very substantial, and much of it is needed in developing countries. This certainly represents a challenge, but not an insurmountable one. Far from it. The resources exist; they just need to be redirected and managed to the right ends.

This means ensuring not only that enough funding is delivered, but that it is properly aligned with the full range of SDGs and with human rights frameworks. The Addis Ababa Action Agenda (AAAA), the outcome of the 2015 International Financing for Development Conference, outlines a framework for achieving this. It identifies actions that balance different areas – not only private and public finance, but also international cooperation and system change.[11] It is critical that the balance reflected in the AAAA is carried through into practical implementation.

The privileging of global private finance

Since the AAAA, key global actors – including powerful governments and global institutions such as the World Bank – have changed their tune. They have given clear messages that efforts to fill the SDG funding gap will prioritise global private sector finance, and that the estimated $80 trillion held by asset management firms (pension funds, sovereign wealth funds, hedge funds and private equity funds)[12] can and should be mobilised to finance development.

The World Bank's theory, in its 'Maximising Financing for Development',[13] is that private financing should be mobilised first and foremost because of its theoretical greater availability. This largely unchallenged assumption about the primacy of global investment for SDG financing is reflected in many other documents, policies and statements.[14]

This narrowing of the SDG financing agenda ignores half of the AAAA action areas. It is not primarily based on evidence or experience, but on the views of those with the greatest power to influence how the agenda is set: private investors and corporations seeking to open up new opportunities to make profit.

Can international private finance deliver the SDGs?

Can it deliver on quantity?

Historically, international private capital flows have been far smaller than private domestic investment;[15] foreign direct investment has typically accounted for less than 3% of GDP in developing countries.[16] In recent years, other international private capital flows – portfolio investment and bank lending – have proven short term and volatile.[17] While there are examples of successful impact investment platforms[18] – which use funds for social impact rather than profit – these are relatively small-scale; there is no evidence that they attract the high level of financing required for genuinely transformational impact.

In fact, over the past decade, net global private sector flows have increasingly been directed out of developing countries. Figure 1 summarises general trends in cross-border net flows of private sector investment, although there is considerable variation from country to country. This picture is simply not compatible with the long-term investment needed for sustainable development.

Can it deliver on quality?

There are costs and benefits to foreign direct investment, and experience on the ground shows that development impacts from this kind of investment can vary significantly.[20] This depends on whether it increases productivity, replaces other domestic investment, or undermines opportunities for small and medium-sized enterprises; it also depends on the quality of any jobs created, and how far it results in other beneficial effects for the local economy.

International private finance channelled to developing countries does not necessarily create decent work.[21] And it may cause direct harm: examples include investment in the fossil fuel industries that are causing catastrophic climate change, or in extractive industries that can displace people or damage the soil or water on which their livelihoods depend.[22]

There are safeguards against negative impacts. For example, many multilateral development banks and donor government development finance institutions – key vehicles for incentivising private sector investment flows – have their own safeguarding frameworks for reducing harm. However, the emphasis on incentivising private investment flows means these frameworks are often used as exclusion criteria for the worst projects, rather than positively shaping investments.

Another reflection of the 'private first' approach is the increasing tendency of aid donors to shift their support away from governments and civil society organisations, towards private sector actors. Public–private partnerships for long-term infrastructure contracts, and blended finance – where aid is used to leverage

private sector finance – are assumed to scale up both investment and impact. This leads to an ever-widening definition of what counts as 'aid' and to some dubious uses of international development funding.

For instance, the UK Foreign and Commonwealth Office has used aid money to establish the Prosperity Fund, which aims to "remove barriers to economic growth" in developing countries, at the same time as creating "opportunities for international business, including UK companies".[23] The Prosperity Fund is financing 16 fossil fuel projects – ranging from shaping market regulation for shale gas fracking in China to assessing health and safety in oil and gas infrastructure in Brazil[24] – undermining both SDG 13 and the AAAA.

It is dangerous to assume that the financing flows leveraged in this way have similar development impact to other aid flows. Evaluation of the impacts is limited, but a recent review of blended finance suggests that donors may too easily assume that such funding adds value that would not otherwise have been realised.[25] Furthermore, as donors use their own bilateral or multilateral development banks as the default distribution mechanism for public finance used to subsidise private flows, they inevitably risk becoming more closely aligned to the trade and investment priorities of their own countries than to the national development strategies of poor countries.

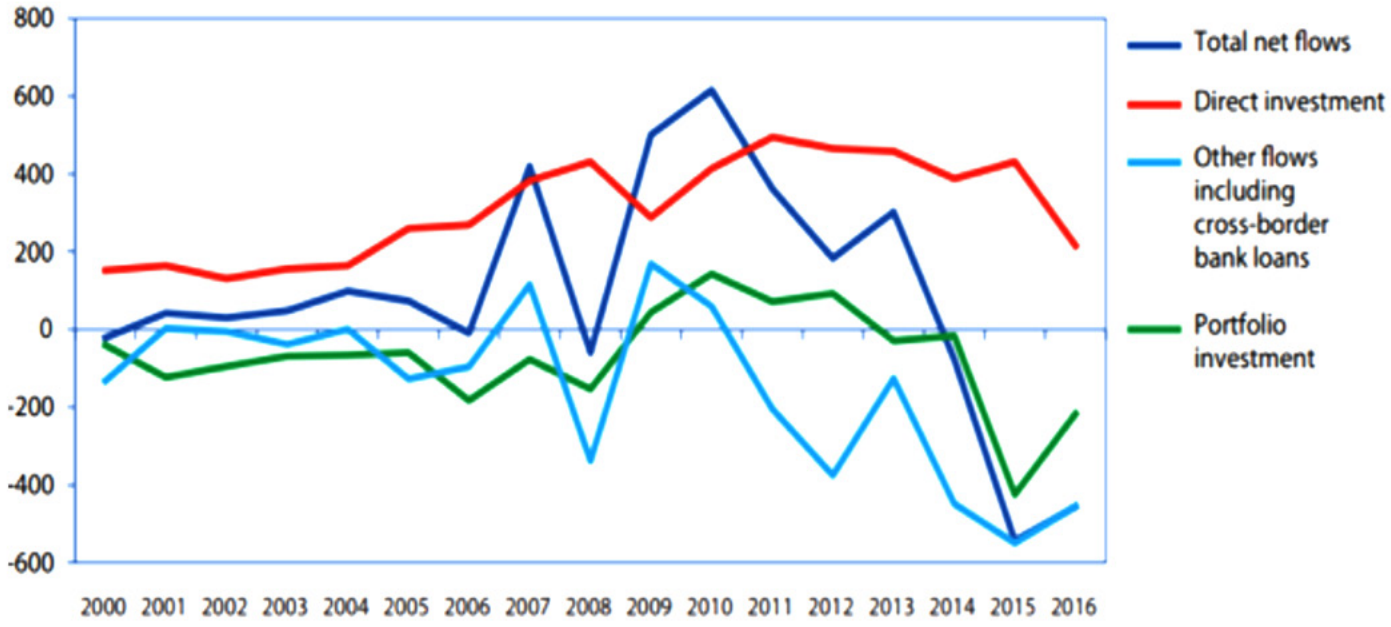
An alternative vision

The AAAA states that "cohesive, nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts."[26] Financing for development should be both informed by and accountable to local agendas. While this will always be challenging in practice, it should nonetheless be a key principle for decision makers at all levels.

Putting this principle into practice will entail two key shifts in thinking by those who debate and plan financing for development.

First, donors and civil society must reject the idea that the mobilisation of global capital is the only solution to financing the SDGs. We must show that much more can be done to increase public and private finance from within national boundaries. We must also emphasise the importance of debt restructuring, tackling tax dodging and ensuring that aid promises are met as ways to liberate finance for development.

Second, those pushing for the rapid scaling-up of global private capital flows into developing countries must understand that the quality of finance matters as much as, if not more than, the quantity. We need to find new ways to measure the impact of finance which reflect the full breadth of ambition represented by the SDGs.



Source: IMF World Economic Outlook database, October 2016, and UN/DESA calculations.
Note: The composition of countries is based on the country classification located in the statistical annex of the United Nations World Economic Situation and Prospects.

Fig 1. Cross-border net financial flows to developing countries and economies in transition, 2000–16 ($ billions)[12]

Alternatives to private finance

More effort is needed to develop progressive, gender-sensitive[27] and effective taxation systems. A country's tax potential is not determined by GDP alone; taxation levels are a political choice, which in turn reflect power dynamics within and between countries. There is tremendous variation in systems of tax collection, tax-to-GDP ratios and tax progressiveness across low and middle-income economies, and significant potential for improvement. Increasing tax revenues progressively has been directly linked to increased expenditure on both health and education.[28] We therefore recommend that the implementation of the AAAA should focus on improving tax collection structures – the main gap in the tax capacity of developing countries – with the intention of bringing more personal and corporate income and wealth into taxation.

An overlapping issue is the challenge of stemming the tide of illicit financial flows – estimated to cost Africa, for example, $50 billion a year.[29] While some steps have been taken in recent years, the Financial Transparency Coalition has laid out an agenda for what else is needed.[30]

Directing flows of credit towards productive economic transformation is important, and national development banks may have a key role in this because of their legal mandate to reach socio-economic goals. But relatively little is known about this sector.[31] Exploring how to develop a stronger network of regional and national development banks, accountable to local development plans, and channel finance through them is an important part of developing an alternative vision for SDG funding.

The debt crisis in developing countries also needs more focus.[32] Above a certain level, debt financing costs mean that funding is moved away from essential public services. Debt bailouts from the International Monetary Fund, the World Bank and other institutions can create a vicious circle where private companies and governments are encouraged into irresponsible lending by the socialisation of risk. Instead, the IMF should require debt restructuring or cancellation by previous lenders as part of its bailout programmes, when clear assessments of debt sustainability – that include human rights and debt legitimacy – show that debt restructurings are required. 'Vulture funds' that prey on debt-distressed countries also need to be regulated.

Finally, there is a need to re-think the role of official development assistance which, while insufficient on its own, still has an important role to play. This will mean meeting commitments, rebalancing and reallocating.[33]

Improving the quality of finance

We do not reject a role for global private finance in meeting the SDG funding gap. But our core proposition is that this kind of finance must be 'good investment': it must have impact that goes beyond 'do no harm' and adds value, enabling poor countries to tackle the root causes of poverty; build stronger, more resilient national economies; and ultimately capture a more equal share of global income and wealth. We believe that investment and the regimes that govern it should be judged – by donors, civil society and developing country governments – on the difference they are shown to make, in five separate but overlapping areas:

- **Do no harm**. An absolute minimum requirement that investment should respect human rights and the environment. This is the core foundation of good investment, but it is not enough to ensure that investment is good.
- **Develop resilient and diverse national economies**. Good investment results in progressively higher-value goods and services being produced within domestic economies, and increases tax revenues which can be used to fund essential public services.
- **Tackle inequalities**. Good investment helps to ensure that the benefits of economic development are fairly shared. It enables poor and marginalised women and men to participate in the economy on fair terms by creating decent work and addressing different kinds of inequality.
- **Build a low-carbon, environmentally sustainable economy**. Good investment supports structural changes to production and consumption patterns, so that economic development can happen in a way that is consistent with maintaining the environmental life-support systems on which we all depend.
- **Accountable governance of investment**. Good investment is subject to careful scrutiny to ensure that it does not undermine national development priorities. Investors can be held to account to ensure that when something goes wrong, people who are hurt can get justice.

Together, these propositions form a framework for assessing investment impact that goes well beyond the unwritten assumption in many of the existing codes and standards that seek to influence private sector investment practices: that as long as investors 'do no harm', their impact in developing countries will be largely positive.

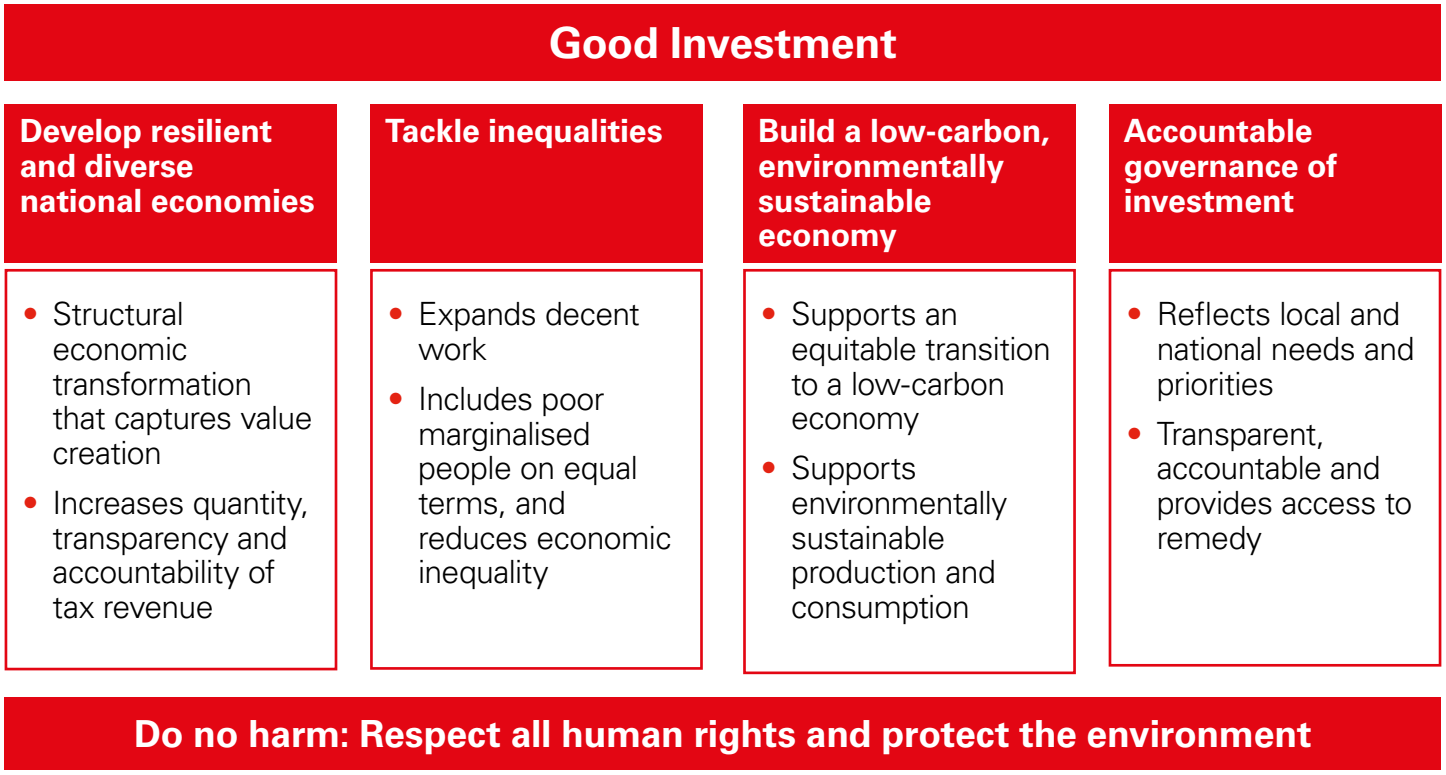


Figure 2. Framework for good investment

Good investment for those who need it most

We need a radically different and rebalanced financial system which ensures that the very poorest are included and actively supported to thrive, and in which developing countries have an equal say in making the rules governing the global economy.

This will require a huge change in the way that those who hold economic and political power are permitted to use that power. We need stronger global and national governance mechanisms, harmonised standards and strengthened disclosure and accountability mechanisms for development finance institutions. None of this will happen without a stronger and more informed civil society in developing countries, which is equipped with the knowledge and tools to hold governments to account and ensure that our economies work better for the good of all, rather than a few.

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We work globally for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice.

We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

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