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Financing for (sustainable) development: France's contribution to the Addis Ababa conference

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The Addis Ababa Conference on Financing for Development, taking place in Ethiopia in July 2015, will open a round of high-stakes international negotiations including the United Nations General Assembly in September and the finalization of the Sustainable Development Goals (SDGs) in December at the Conference of the Parties to the Convention on Climate Change (COP 21), with a view to reaching a first comprehensive agreement in Paris. Without making Addis Ababa the focal point of three equally important events, it is, however, very likely that the results obtained here will have a major impact on subsequent proceedings. In this context, what can we expect from this conference? What political ambition should France have? This Policy Brief aims to shed some light on these issues.

FINDINGS AND RECOMMENDATIONS

- France has the potential to convey a unifying political message in Addis Ababa. Through its resources and flexible and diverse financing mechanisms, France is able to meet the requirements of sustainable development, provided that it can ensure, in particular: the underlying consistency of blended finance (a mixture of loans and donations); support for public policies at the operational level; as well as – more upstream – the strengthening of its efforts to elucidate the modus operandi of its financing operations that combine loans and donations. Blending could be particularly effective in mobilizing additional resources to the existing levels of official development assistance (ODA), public and private, provided they are associated with demands for accountability and traceability.
- Beyond blending, France could bring a package of proposals to the European Union, which has a leading role to play in the Addis Ababa negotiations, to fight against illicit financial flows (measures to tackle corruption and tax evasion, support for capacity building in poor countries, and promoting open government for the transparent management of state resources), an area in which France is acknowledged to have expertise.
- Finally, it seems both inevitable and appropriate that proposals are made for the targeting of ODA spending towards the most vulnerable countries, with a road map for the implementation of past and present commitments. These anticipated – and in some cases already drafted – proposals were stimulated in December 2014 by reforms, in which France was particularly involved, to revise the treatment of ODA loan concessionality by the OECD's Development Assistance Committee (DAC).

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1. FOLLOWING A TECHNICAL CONSENSUS, WHAT IS THE POLITICAL VISION?

Informed by the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF), the issue of development financing has been the subject of a separate report (United Nations, 2014) that drew up an inventory of funding needs and sources, and outlined in its final section some options for an integrated strategy. The ICESDF Report is relatively consensual and draws to a close the series of technical discussions among finance experts. It opens a political cycle, punctuated by the Addis Ababa conference in July 2015, and by the finalization of the list of sustainable development goals (SDGs) in New York in September, and the discussions on the financing of climate policies ahead of the COP 21 in Paris.

It should be noted here that the major development challenge, underlined by *The Future We Want*, is the implementation of international commitments (United Nations, 2012). In a context of the capping of public budgets, how can donor countries strengthen their contributions to the SDGs, to generate more commitment and ultimately success than was achieved by the less ambitious and underfunded Millennium Development Goals (MDGs)? It will be a wasted opportunity if DAC countries, particularly France, fail to provide valuable input to address this question. Proposed solutions should first of all enhance the substantial efforts made by the ICESDF, while highlighting France's assets to address these issues, especially in terms of: flexibility and innovation in mobilizing finance; strengthening the institutional expenditure framework; and supporting the fight against illicit financial flows and enhancing tax transparency.

2. WHAT ARE THE ESSENTIAL TOPICS FOR THE ADDIS ABABA AGENDA?

Two issues structure the ICESDF report, which have been conveyed to the negotiators: the first concerns the mobilization of additional funds for development; the second is the formulae for the allocation of available funds, particularly ODA, in situations where they are essential both to meet the need for direct subsidy and to create a leverage effect by indirectly mobilizing other local or private resources.

An LDC/vulnerable countries/fragile states package. The proposal that has been advocated by France and the European Commission for several years is to concentrate the most concessional public resources in countries where such resources are essential. Whether they are identified according to a UN-recognized category, or they meet specific criteria of vulnerability and/or fragility, these countries that lie beyond the economic catch-up and emergence processes are now appearing as special cases of a more global agenda for which a specific "package" of means and measures could be negotiated. At the very least, Addis Ababa should provide an opportunity to reaffirm existing commitments to the least developed countries (LDCs), either in terms of resources or preferential agreements. The reform of ODA loan concessionality adopted by the OECD DAC in December 2014 aimed, inter alia, to make the loan granting process take better account of a state's effort (and to differentiate this effort according to the geography of intervention) and to encourage countries to lend more to the poorest (a better valuation of loans to so-called "risky" countries). This reform fits into the perspective of such a package.

The mobilization of domestic resources. The average tax burden is 35% in OECD countries and about 15% in sub-Saharan Africa. Illicit financial flows out of developing countries account for up to ten times the amount of ODA. The regulation of predatory transfer pricing practices by some companies is now high on the agenda, something that was inconceivable only five years ago. Account transparency for individual countries is finding its place in the post-2015 agenda negotiations. The mobilization of domestic resources is a politically sensitive issue because it implies substantial policy and institutional reforms. To be properly addressed, it requires: 1/ the implementation of a real transformational agenda for economies and societies, meeting the requirements of sustainable development and leading to the reform of public finance (collection and expenditure); 2/ the considerable strengthening of administrative capacity, whether local or national, to raise taxes and to spend funds, and democratic institutions that control state spending, including national auditors and parliaments; 3/ the reinforcement of the ability of governments to adopt reforms in the financial sector and the incentivizing of tax policies for the mobilization of private domestic resources; 4/ the development of international standards for the fight against tax evasion and corruption: more regulation and corporate transparency; tackling the erosion of the tax base and the transfer of profits (Base Erosion and Profit Shifting (BEPS) Project); budget transparency; open data policy. France should put forward a package of proposals on this issue because it has already been heavily involved in similar processes at the G20, the OECD and the European Union.

Public-private partnerships (PPPs) and new partnerships for development. The accounting equation of sustainable development shows that the probable SDGs will require substantial financing. Although conceptually fragile and methodologically questionable, a needs-based approach appears politically attractive for certain countries: it simplifies the substance of the negotiations and returns each country to the simple binary status of being a funder or a recipient. Given the gap between the funding needs and the actual ODA amount, the first consequence of such an approach would be to put the PPPs and the contribution of private funding onto the Addis Ababa conference agenda. The issue would no longer be focused on the amount of ODA, but the leverage or the catalytic effect of ODA on private funding (domestic or international). The second consequence concerns the opportunity to define through the SDGs a specific and functional contribution of ODA, depending on whether or not it is easily substitutable for other funding sources. This classification, while unable to provide quantifiable commitments, would enable the differentiation between non-substitutable donations, funds with a known leverage/catalysis effect and funds which have only a marginal catalytic effect. One question remains: how can we move from these "theoretical" contributions to the effective involvement of the private sector?

3. WHAT EXACTLY DO WE MEAN BY PPP AND BLENDING?

There are two possible blending approaches. The first distinguishes between sources of financing according to their institutional nature: blending then corresponds to a mixture of public and private funding. This approach is not satisfactory because it is often misleading. Indeed, loans are a part of France's ODA funding, which are themselves refinanced through private savings on capital markets. However, public funding is not only made through grants. Equally, private financing does not always involve loans, as demonstrated by the Bill & Melinda Gates Foundation (BMGF) grants, which have a not-for-profit aim, and therefore differ little from ODA.

The second approach emphasizes the distinction between the different financing tools and instruments: loans, grants, guarantees and equity investments are combined within the same operation. It is then possible to establish a PPP typology and to identify existing innovations more precisely, their range and potential.

- The most traditional blending form is that which consists of a variety of instruments from a single institution. Blending then translates as subsidized loans, which is the main business of development finance institutions such as the International Development Association (IDA) and the French Development Agency (AFD).
- The second form of blending involves combining funding from financial and non-financial partners. This is the model of the Global Environment Facility (GEF); it is also that of seven blending facilities of the European Commission (EC). The EC has dedicated €1.6 billion in grants, financial institutions have financed €12 billion in loans, for a total of €40 billion of investments financed by blending. The future is likely to see an increase in the allocation of funds to these facilities. We could also mention the guarantees of the southern bank loans (AFD), BMGF's debt buy-down and the Green Climate Fund.

This typology highlights a common misconception regarding blending, which is that it only involves the transfer of public money to the private sector to finance development. It also underlines the complexity of this type of operation and the need for a transfer of knowledge on these topics.

4. UNDER WHAT CONDITIONS CAN BLENDING MEET THE FUNDING ISSUES?

A first condition is that of the additionality of the resources of grants and loans. There is a real suspicion of profit-seeking (public or private), and the possibility of eliminating the risk of such behaviour (the generation of windfalls and excess profit) is probably zero.

The second condition is to move away from the accounting approach of financing to focus instead on the quality of funded projects. This requires a clarification of responsibilities (leader/follower) and "accountabilities" between blending partners. Improving the transparency and accountability of the private sector is essential.

The third condition is to support the transaction costs associated with these blending instruments, particularly the costs induced by complex financial arrangements, traceability and accountability, and the capacity building of contractors. Blending should enable the funding of projects that the private sector alone is unwilling to support due to the perceived risks. To be credible, an approach aiming to ensure that all or part of the investments required to meet development goals prior to "passing on the baton" to the private sector, must conduct a parallel policy to dilute and diminish economic risks. Integration and regional cooperation, particularly in terms of infrastructure, for example, could reduce these risks.

Finally, efforts should be undertaken to demonstrate the effectiveness of the blending of loans/grants. PPPs and blending are not new and the results are very uneven (United Nations, 2014). An increase in the number of pilot projects is important, including those relating to the most sensitive areas and issues. Blending must also be local and incorporate devolved and decentralized financial systems. It must be accompanied by the support of local authorities and a reinforcement of their technical and financial abilities – without which there would be a risk of an increase in bottlenecks at this level, a level that is essential for implementation. More broadly, blending negotiations will not be possible without a reform of public policies that determine their performance (enabling environment).

Finally, we must be vigilant regarding the macroeconomic sustainability of the (re)constructed debt and of a possible "over-indebtedness by blending".

5. WHAT POLITICAL AMBITION CAN FRANCE LEGITIMATELY BRING TO ADDIS ABABA?

France has proven expertise on key elements of the agenda and is highly regarded in these areas:

- The area of priority for French intervention is mainly LDCs; the differentiated partnership approach, i.e. by adjusting priorities and instruments to the type of country, which has been adopted by France and then by the European Commission for several years may appear unoriginal, but it is in tune with the issues at stake at Addis Ababa.
- French expertise in public policy, particularly fiscal, and the quality of its administration, make France an ideal partner for the strengthening of public policies.
- AFD's blending experience is well known, even if it does not cover all possible instruments.

France could carry a clear message to Addis Ababa by:

- specifying the balance between the different aid modalities to meet the SDGs: blending may not be suitable for all sectors;
- supporting, through the "evidence of proof", a blending "culture", which for many remains veryvague, by highlighting its advantages (flexibility, adaptability, etc.) and its drawbacks, as well as possible mechanisms to limit profit-seeking and windfall effects;
- showing that blending can take many forms, that there are a diverse range of methods and degrees of blending, and that innovations are possible (seed capital, inclusion of local SMEs, etc.) that are not limited solely to financial engineering;
- reinforcing long-term public policies (national and local): support to administrations and local authorities in particular.
- showing that this "package" (blending and policy support) is particularly suitable for the necessary structural changes needed to meet the requirements of sustainable development (SDGs and climate in particular).
- putting forward a package of proposals for the fight against illicit financial flows, to move beyond blending.
- finally, it seems inevitable that proposals are put forward to better target the most vulnerable countries with ODA expenditure with a roadmap for the implementation of present and past commitments.

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