PRIVATE FLOWS

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1. Background

The proportion of private capital flows from South to North has increased, and today makes out a significant amount of international private flows. Tax evasion and illicit capital outflows amount to an estimated 947 billion USD, which comfortably exceeds capital inflows. This obviously constitutes a major drain on national resources in developing countries, resources, which could have been put to use in providing much needed public goods.

These numbers are illustrated in the table below. Policies that seek to regulate or incite private capital flows for development purposes should therefore to a larger extend emphasize these trends.

Table 1: North-South flows (2011):

Flow	In	Returns	Result
Remittances	343	0	343
ODA	165	-25	140
FDI	490	-420	70
Portfolio equity		18	
Loans	710	-513	197
Illicit financial flows		**-947**	

The failure of OECD countries to live up to their commitments to allocate 0,7 % of their GNI to ODA on the one hand and continued pressure to live up to their commitments on the other has led many OECD countries to factor in some of these new flows as 'DACable' development assistance, claiming that these flows also contribute to development.

These claims are obviously controversial, as they resemble attempts to boost ODA figures. Having said this, given the reality of the increasingly significant role accorded to private finance in development there is still a need to ensure private finance respects and supports the human rights obligations and other commitments (international and towards their own citizens) of their home and host states. Moreover, with the emergence of the discussion on the specific human rights responsibilities of trans-national corporations, it is also important to ensure that international private finance actors are adequately covered by such a framework.

The Monterrey consensus emphasized private capital flows as a significant contributor to productivity enhancement, technology transfer and job creation in developing countries. However, the strong focus on export-oriented primary production of FDI in many LDCs results in low linkages with the host economy, limiting the real economic gains within the country. These industries furthermore generate minimal job creation, knowledge and productivity spill-overs and technology transfer, and have a very limited poverty-oriented focus. The high proportion of investments through M&As furthermore result in the lack of new capital formation, further being enhanced by the repatriation of earnings to the parent countries of the MNCs. A growing proportion of FDI flows are furthermore in the form of intra-company loans, which often are very short-term oriented. Furthermore, the reinvestment of earnings results in an artificial inflation of the FDI figures, diluting the transparency of the actual capital inflow. Lastly, large companies, backed up by the World Bank

and IMF policies, are often pressing LDCs to introduce lucrative tax exemptions for foreign investors, thus depriving a national basis for tax revenue.

The negative impact of Illicit financial flows and tax evasion is globally significant. The strong emphasis on domestic resource mobilization by developing countries was highly emphasized by the Monterrey consensus. Illicit financial outflow due to tax avoidance and evasion by multinational corporations (MNCs) has been estimated to be more than 1.3 trillion USD each year[1], compared to 134 billion USD received in ODA in the same period of time. The necessary international cooperation between tax authorities and multilateral bodies to effectively deal with this issue, as originally was agreed upon in the Monterrey Consensus, has until today not been implemented, and international instruments to deal with this, e.g. under the auspices of the UN, are needed. Outflows of profit made on FDI was equivalent to 90 per cent of total inflows in 2011.

Lack of respect towards **human rights** and inadequate labor standards continue to be major challenges in developing countries. Voluntary regulatory frameworks, such as UN guiding principles for business and human rights are put forward as best practice, however, MNCs are currently not held accountable for human rights violations under international human rights law. Regulatory and legally binding frameworks are therefore essential to keep firms accountable with regards to human rights. A resolution for a binding human rights framework was passed in the Human Rights Council in June, 2014, despite significant opposition from the US and European countries. The resolution supports the development of an internationally legally binding instrument, which will have the aim to regulate MNC activities according to international Human Rights law. Having said this, the time frame for the development of this tool is currently unclear.

FDI constitutes a challenge to the global sustainability agenda. As has already been mentioned, extractive industries make out the largest proportion of FDI inflows to LDCs. Combining this with unethical and unsustainable production methods, this not only creates minimal economic benefits, but also contributes to negative environmental impacts such as pollution and over-consumption of resources, as well as violations of land rights of local communities.

Finally, new priorities within international development point to **Public-Private Partnerships** (PPPs) as new ways to mobilize development funds. Experiences with these are however limited and the empirical basis for the optimism is weak. On the contrary, PPPs have turned out as very costly for public coffers, as equity funders have demanded instant returns. These costs have furthermore not been transparently accounted for. PPPs have primarily been seen as instruments to finance infrastructure needs. It however shows that these ventures have been expensive, corruption-ridden and with high failure rates. Many countries are characterized by high degrees of collusion between political elites and the business communities, and PPPs risk strengthening these ties, taking resources away from social sectors where public resources are needed, but quick gains are harder to make.

[1] The Norwegian Forum for Development and Environment

2. Analysis of existing commitments

Development Impact of Private Finance

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	EU Position
We urge businesses to take into account not only the economic and financial but also the developmental,social, gender and environmental implications of their undertakings. In that spirit, we invite banks and other financial institutions, in developing countries as well as developed countries, to foster innovative developmental financing approaches. We welcome all efforts to encourage good corporate citizenship and note the initiative undertaken in the United Nations to promote global partnerships. Para 23, p 10	We will strengthen national and international efforts aimed at maximizing linkages with domestic production activities, enhancing the transfer of technology and creating training opportunities for the local labour force, including women and young people. It is also important to enact and uphold, as appropriate,labour and environmental protection and anti-corruption laws and regulations in accordance with obligations undertaken in relevant internationalconventions. [...] We reaffirm that every State has, and shall freely exercise full permanent sovereignty over, all its wealth, natural resources and economic activity. We support measures to enhance corporate transparency and accountability of all companies, taking into account the fundamental principles of domestic law. [...] Para 27 p 12	The ongoing crisis has highlighted [...] the unsustainability of a narrow focus on short-term gains. We reaffirm the principles of sustainable development and underscore the need for a global consensus on the key values and principles that will promote sustainable, fair and equitable economic development. We believe that corporate social and environmental responsibility are important elements of such a consensus. Para 41 p 11	We recognize that a dynamic, inclusive, well functioning, socially and environmentally responsible private sector is a valuable instrument that can offer a crucial contribution to economic growth and reducing poverty and promoting sustainable development. In order to foster private sector development, we shall continue to pursue appropriate national policy and regulatory frameworks in a manner consistent with national laws to encourage public and private initiatives, including at the local level, to foster a dynamic and well-functioning business sector, and to facilitate entrepreneurship and innovation including among women,the poor and the vulnerable Para 268 p 47	The EU will promote human rights in all areas of its external action without exception. In particular, it will integrate the promotion of human rights into trade, investment, technology and telecommunications, Internet, energy, environmental, corporate social responsibility and development policy as well as into Common Security and Defence Policy and the external dimensions of employment and social policy and the area of freedom, security and justice,including counter-terrorism policy. In the area of development cooperation, a human rights based approach will be used to ensure that the EU strengthens its efforts to assist partnercountries in implementing their international human rights obligations. EU Strategic Framework and Action Plan on Human Rights and Democracy (25 June 2012)

Managing risks associated with private finance

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	EU Position
We underscore the need to sustain sufficient and stable private financial flows to developing countries and countries with economies in transition. It is important to promote measures in source and destination countries to improve transparency and the information about financial flows.Measures that mitigate the impact of excessive volatility of short-term capital flows are important and must be considered. Given each country'svarying degree of national capacity, managing national external debt profiles,paying careful attention to currency and liquidity risk, strengtheningprudential regulations and supervision of all financial institutions, including highly leveraged institutions, liberalizing capital flows in an orderly and well sequenced process consistent with development objectives, and implementation, on a progressive and voluntary basis, of codes and standards agreed internationally, are also important. We encourage public/private initiatives that enhance the ease of access, accuracy, timeliness and coverage of information on countries and financial markets, which strengthen capacities for risk assessment. Multilateral financial institutions could provide further assistance for all those purposes. Para 25 p 11	We will continue to strengthen modalities, including through the efforts of the country itself, the United Nations system and relevant multilateral agencies, to enhance and improve the level and objectivity of information regarding a country's economic situation and outlook. Para 28 p 13	The current crisis has been compounded by an initial failure to appreciate the full scope of the risks accumulating in the financial markets and their potential to destabilize the international financial system and the global economy. We recognize the need for even-handed and effective IMF surveillance of major financial centres, international capital flows and financial markets. Para 40 p 11	We recognize that the appropriate role of Government in relation to the promotion and regulation of the private sector will vary from country to country depending on national circumstances. Para 268 p 47	Use of innovative financing mechanisms will take account of debt sustainability and accountability and will avoid market disturbances as well as budgetary risks. Council Conclusions of 15 October 2012 para 1

3. Recommendations

Recommendations for FDI flows:

- Policy coherence with the human rights obligations of both home and host states and their international commitments with respect to sustainable development and dealing with climate change and promotion of domestic resource mobilisation should be prioritised.
- FDI enjoys tax breaks and tax holidays in many of the countries where investments are flowing, and this decreases the effectiveness of FDI in providing real economic benefits in terms of taxes for developing countries. There should be a responsibility charter for investors not to ask tax breaks when investing into developing countries, and developing countries should also work together to reduce tax incentives they offer and ensure they are cost efficient. World Bank/IMF recommendations to promote such tax exemptions should be abandoned. Presently transnationals are given unfair advantages vis-à-vis local businesses because of these tax breaks.
- The competitiveness of local SMEs has to be ensured to avoid potential crowding out of local firms due to foreign competition. For this reason, incentives and/or regulations should be developed to enhance linkages between foreign and domestic firms in order to increase knowledge and technology transfer and human capital development.
- Natural resources belong to the citizens of the country, and investments in extractive industries should therefore be regulated according to economic and social interests of all citizens, and in consultation with local civil society. Transparency standards such as IATI and EITI-standards should furthermore be highly emphasized.
- The impact of FDI on LDCs in terms of pro-poor impact should be monitored to manage and regulate inward FDI more effectively. Monitoring systems and indicators should therefore be set in order to evaluate the impact regularly as a basis for future policy development to fit national priorities.
- Illicit tax outflows significantly hinder the potential for domestic resource mobilization in developing countries, and requires increased attention from global policy makers. The specific actions put forward in the Monterrey consensus such as increased information sharing and cooperation between international tax authorities requires increased attention, and actions to recuperate illicit flows to originated countries should be specified and implemented. This could for example be done through auspices of UN bodies. Financial reporting standards requiring country-by-country financial reporting for MNCs should furthermore be to increase transparency.
- More transparency on FDI flows via SPEs, through 1) improved measurement of the volume of FDI via SPEs and the key drivers of the sector (tax, regulation, secrecy), and 2) see how SPE FDI can be deducted from overall FDI if the impact of FDI is considered to count towards reaching the SDGs.
- Attempts to factor FDI as ODA through "recipient benefit"-mechanisms, as suggested by OECD/DAC should be terminated.
- The countries should commit to the effective implementation of the UN Guiding Principles on Business and Human Rights by enforcing human rights due diligence via regulatory measures, requiring large and transnational companies reporting their human rights, social and environmental impacts and risks and providing effective remedy. The development of a regulatory and legally binding tool should be promoted, and a specific time frame for the development and implementation of this should be set. Furthermore, gender should be mainstreamed into the guiding principles for business and human rights.
- Effective implementation of OECD guidelines for socially and environmentally responsible corporate behavior. A procedure for dispute settlement between corporations and local

communities/individuals should also be established.

- Non-financial reporting should be mandatory by MNCs, in order to document environmental impacts of their operations and promote investment in CSR activities.
- Leveraging of national funds for PPPs should be subject to careful scrutiny, aa national influence on investment design and priorities beyond quick profits tend to be overlooked.
- PPPs, combining ODA with private finance have so far not lived up to expectations in terms of promoting pro-poor development, and have appeared to be costly and challenging to divert towards pro-poor development. We therefore recommend a reassessment of these ventures. Therefore ensure a nuanced approach to so-called "blending mechanisms, and apply more binding regulatory frameworks for PPPs.

Recommendations regarding lending policies:

- We suggest that much more emphasis should be put on mobilizing alternative means of financing through international innovative financing mechanisms, instead of focusing on private loans. These could include a number of taxes on fossil fuels (and abolishment of subsidies), tax on financial transactions.
- In current negotiations in OECD/DAC to modernize the DAC-rules, it is discussed that concessional loans should be possible to include as 'DAC´able ODA. We strongly oppose this, and suggest that it is only the grant element of these transfers that be counted as ODA.
- Loans are most effective within productive sectors. Loans to e.g. health and education sectors should therefore be handled with care, as traditional ODA grants seem more suited for this type of support.