INTERGOVERNMENTAL GROUP OF TWENTY FOUR
G-24

G-24 Technical Group Meeting

27-28 February, 2017
Addis Ababa, Ethiopia

SUMMARY REPORT

The Spring 2017 Technical Group Meeting (TGM) was held in Addis Ababa (Ethiopia) on February 27-28, hosted by the current G-24 Chair, Ethiopia. The three themes covered were infrastructure investments for economic growth, policies for structural transformation and productivity growth, and mobilizing domestic resources for development and international tax cooperation. Speakers for each of the sessions included external experts and G-24 member representatives.

In his opening remarks, Minister Abraham Tekeste placed the meeting against the backdrop of global commitments of the Addis Ababa Action Agenda to finance the transformative 2030 Sustainable Development Agenda. He also alluded to the fragility of the global economy, with challenges arising from the persistence of below-potential growth and new sources of risk in the pressure in major countries to disengage from multilateral cooperation arenas and institutions. Minister Tekeste highlighted the relevance of the G-24's mission and of the topics to be covered at this particular TGM in the quest to face such challenges. He conveyed his expectation that the TGM members would engage in peer learning, exchange knowledge and information, explore South-South cooperation, and reflect on the G-24's collective messages and actions in key areas of global monetary, financial and development affairs. He closed by expressing appreciation to representatives of member countries for joining the meeting in Addis and to guests and speakers for their participation and contributions.

Here follow summaries of the interventions and country perspectives that were on the agenda, and of additional country perspectives offered and discussions from each session.

Session 1a: Infrastructure Investments for Economic Growth

Mr. Lucio Monari, **Director of the Energy and Extractives Global Practice at the World Bank**, started the first session with a presentation on the World Bank's role in transformational engagements. The world will experience important demographic changes in coming decades: the global population will grow to 9.6 billion by 2050, with 72 percent living in urban areas compared to 50 percent today. This means the need for food will increase by 40 percent and water by 55 percent. Infrastructure needs will double and electricity production needs will increase by 80 percent. There will be an additional 1 billion cars on the road, putting significant pressure on transportation networks. The need for creating jobs, and building physical and natural infrastructure will benefit from advances in technology, but will be constrained by increased fragility, exclusion and natural resource degradation. These mega trends will affect the way we design infrastructure projects.

A critical pillar of the 2013 World Bank's Strategy is support for transformational engagements. These include steps to fundamentally improve the lives of poor and disadvantaged people, produce demonstration effects that can be replicated or scaled up, generate spillover effects on multiple sectors of the economy, stimulate private investment, and help countries and regions embark on a development path that is economically, financially, and environmentally sustainable. It is important to

note that there is no single policy prescription for catalyzing transformational change; such change involves complex and multidimensional socio-economic and political processes and interventions in systems that require contextualized and tailored solutions, adaptation, and active management of change processes. To date, the World Bank has engaged in projects in countries such as Kenya, Turkey, Laos, Kyrgyz Republic, Tajikistan, Pakistan, Afghanistan, and Ethiopia, and has successfully contributed to resource mobilization, project preparation, and capacity building.

In the case of the energy sector in Africa, there are four interlocking challenges: security of supply, universal access, operational competence, and financial viability. Each of these challenges is caused by a number of issues associated with lack of resources and capacities, and policy constraints.

Solar energy is an important element in infrastructure transformation in developing countries. This is especially true for countries where the cost of providing solar photovoltaic (PV) is falling. The installed costs of PV cells can be as low as US$1 million/MW when obtained through auctions and some bilateral deals. In some countries, competitive procurement has also brought down the price of consistent electricity delivery to below US$10/kWh over the last two years, with the declining trend continuing. It is important to note that the drivers of PV electricity prices are country and plant-specific. Factors such as net total investment costs, cost of capital, plant capacity factors, non-tariff costs, tax benefits, and some other parameters such as panel degradation, construction time, and PPA terms all play a role in determining the price of electricity. The World Bank has a structured process to help countries to scale up solar energy, with assistance ranging from project preparation to construction and operation.

Mr. M. Wa-Kyendo, **Officer-in-Charge and Chief Transport Engineer of the African Development Bank's Ethiopia Country Office**, followed up with a presentation on infrastructure in Africa, more specifically, a mapping of the needs and solutions to address Africa's infrastructure gap, based on the Infrastructure Outlook 2040 report produced by the African Development Bank, in collaboration with the African Union Commission and the United Nations Economic Commission for Africa.

Africa has a huge gap in infrastructure. According to the Infrastructure Outlook 2040 report, only 30 percent of Africa's population has access to electricity, compared to 70-90 percent in other parts of the developing world; the road access rate in Africa is only 34 percent compared to 50 percent in the developing world; transport costs are 100 percent higher within Africa than between continents; water resources are underused with only 5 percent of agriculture under irrigation; the fixed-line internet penetration rate is about 6 percent compared to an average of 40 percent in the developing world. The continent's key objectives in infrastructure investment in transport, energy, and telecommunications sectors include: completion of the trans-African Highway missing links, upgrading of key sections of multiple-lane roads, construction of one-stop border posts, increasing port capacity to handle post-Panamax container vessels, improving railway tracks and modernizing services and equipment, construction of major hydroelectric power stations, transmission lines, and continental power pools for inter-regional energy trade, installation of petroleum and gas pipelines, and the development of a continental, satellite-based air navigation system. To achieve these aspirations Africa would need US$360 billion to close key continental gaps in infrastructure by 2040. Most of the investments are needed in the energy and transportation sectors. From the perspective of Mr. M. Wa-Kyendo, obstacles to more financing include inadequacies in: local ownership or leadership in project identification and preparation, project championing, local resource mobilization, and good implementation capacity. Furthermore, political, social, and business risks, poor governance and business environments, and limits posed by debt sustainability frameworks weaken African countries' attractiveness to investors.

To scale up financing for infrastructure would require efforts by multiple stakeholders. Governments would need to continue to mobilize domestic resources. For example, Ethiopia has used domestic resources to finance the US$4.2 billion needed for the Grand Ethiopian Renaissance Dam. Governments could also rely on multilateral development banks to de-risk projects with their financial instruments

and tap into resources from the private sector or from other governments. A recommendation was made for the G-24 to work on bringing together like-minded organizations or governments to promote infrastructure investment in Africa.

Mr. James P. Bond, **Senior Advisor at the Centennial Group,** made a presentation on sustainable financing of infrastructure in emerging economies.

He reiterated the call by other speakers for the developing world to invest more in infrastructure: developing countries will need to nearly double annual investment to US$1.9 trillion per year by 2030. Historically, public financial resources are the principal source of infrastructure finance in the developing world. However, countries will need to increasingly tap the private sector, such as institutional investors, for the additional resources needed.

Mr. Bond highlighted China's role in infrastructure investment in Africa. In 2015, Chinese investment made up 26 percent of all infrastructure spending in Africa, most of it in the energy and transport sectors. Between 2010 and 2015, China invested US$13 billion in the African energy sector, largely financed through public lending. Those investments are responsible for 30 percent of the continent's new capacity. From 2010 to 2020, 17GW of energy generation capacity financed by China will have been built, 56 percent of it renewable, mostly from hydro power. Notable transportation projects financed by China include the Tanzania Bagamoyo Port, the Kenya Standard Gauge Railway, and the Ethiopia-Djibouti Railway.

Depending on the revenue generating capacity of different infrastructure projects, it is important to optimize infrastructure investments by efficiently allocating funds across the public and private space. Projects with higher revenue-generating capacity, such as ICT, power generation, toll roads, etc., can be financed by private sources through a structure that capitalizes user fees: the user fees generated will service the debt and pay investors, and the private financing structure will allow financing to be recycled to new investments. A successful example is the Carretera Samara Toll Road in Dominican Republic.

To ensure affordability of the projects, it is important to manage costs, particularly by mitigating risks during the life-cycle of the projects. Since institutional investors' mandates and requirements usually stipulate a stable cash flow, moderately low risk, and the need for credit ratings for investment assets, Mr. Bond recommended that the infrastructure asset-backed securities be used as a tool to tap into their resources.

The presentation by **Mr. Ehtisham Ahmad**, **Senior Fellow, University of Bonn and London School of Economics,** focused on public investment for sustainable growth and drew on case studies in Chile, China, and some European countries. It sought to answer three questions: (i) What sort of investments are needed for sustainability? (ii) What does the concept of sustainability entail? And, (iii) How to finance sustainable investment?

In the cases of Chile and China, the development of business hubs has shown huge potential to enhance growth, generate employment, and improve the quality of life. However, the concentration of activities in the metropolitan areas also created issues such as congestion, pollution, and high levels of inequality, all of which raised the effective costs of production. Recent Chinese initiatives to improve connectivity in cross-border, national, and sub-national levels showed promise to better utilize labor, reduce inequality, improve access to domestic and external linkages, and develop global value chains. Lessons from Italy and Spain have shown that connectivity alone could not lead to sustainable new hubs nor generate more private investment in the less-developed regions. It is important to complement connectivity with local investments and public services, to create the conditions that attract private capital and workers, and to create a diversified economy.

There also needs to be a linkage between a country's macroeconomic framework and its green growth strategy, given that the selection of investment projects is inextricably linked with tax and public pricing decisions. A sustainable investment strategy should take into account distributional and environmental considerations. This will require methodologies for investment analysis that is inter-sectoral; incorporates an appropriate accounting ratio of capital and labor, an inequality aversion index, as well as an appropriate cost of public funds. To this end, Mr. Ahmad recommended the adoption of a consistent set of economy-wide shadow prices to guide investment. Enabling a more sustainable investment strategy would also require tax and structural reforms at both the national and local levels. And for tax reforms, lessons have shown that it is critical to coordinate between local government and national governments, and to set up an appropriate mechanism to compensate the losers and offset the transfers.

The scale of investment for sustainable growth requires catalyzing private sector resources. There has been considerable emphasis on Public-Private-Partnerships to relax the financing constraints of the public sector on infrastructure investment, while some considerations could also be given to the design of unbundled sequential contracts. However, the nature and design of the projects involving private sector also brings challenges, especially due to asymmetric information and the role of different stakeholders. Governments need to strengthen monitoring and evaluation of the buildup of liabilities, manage risks effectively by fully recognizing liabilities and own-source taxes for accountability, and rationalize a number of levels and layers of administration and their responsibilities to improve governance.

Mr. Chalouho Coulibaly, **National Director of BCEAO in Cote D'Ivoire,** presented his country's experience. In Sub-Saharan Africa, poor quality infrastructure costs each country 2 basis points of GDP per year and reduces productivity by about 40 %. Cote D'Ivoire has prioritized infrastructure investment that has resulted in good airport infrastructure, a competitive mobile telephone market, export of electricity to neighboring countries, and an enhanced road network. Infrastructure investment financed by Cote D'Ivoire's own resources increased by 37 percent between 2011 and 2015, government debt issuance has also facilitated the mobilization of funds, and bilateral and multilateral support increased from US$163 million in 2011 to US$630 million in 2015. Cote D'Ivoire has issued two Eurobonds, taking advantage of the favorable market environment. Mr. Coulibaly emphasized that at the national and sub-regional level, there is need to improve access to long-term financing through the creation and strengthening of national and regional development banks, and capital markets, to attract investments from pension funds and insurance companies.

Studies have shown a strong link between the growth rate and private investment, and this is arguably the case in Cote D'Ivoire. The country has experienced robust growth with an increase in the growth rate from -4.2 percent in 2011 to 9 percent between 2012 and 2015. Over this period, total investment increased from 9 percent of GDP to 20 percent, with private sector financed capital expenditures constituting about 65 percent.

PPPs are important in Cote D'Ivoire. Since 2014, the government has approved 94 large-scale projects valued at US$21.4 billion, primarily in transportation, telecommunications, electricity, water, and sanitation. The willingness of the government to address the lack of infrastructure through PPP contracts makes infrastructure an important driver of growth for the economy.

Mr. Ramy Afifi, **Senior Program Coordinator of the Ministry of Investment and International Cooperation in Egypt,** presented the experience of Egypt on the Upper Egypt Local Development Program. The first and most significant transformation in the program will be a gradual shift toward greater autonomy and accountability at the Governorate (local) level for prioritizing investment and expenditure decisions based on an improved local participatory planning process. The second

transformation will be a change in the Governorates' role in promoting private sector-led growth and job creation. The program will encourage social and economic development through institutional and administrative reforms to improve service and infrastructure delivery and through targeted social programs aimed at improving livelihoods of the neediest. The program also provides support for SMEs and industries to improve their competitiveness through technical assistance services, value chain development programs, technology and innovation, training, skills development, and sector-specific strategies. The program is expected to support the modernization of existing industrial zones management and infrastructure.

Mr. Afifi emphasized the importance of the legislative aspects to back up the plans and strategies for developing infrastructure, and the roles of the private sector and administrative reforms. Egypt also benefitted from the Philippines' experience on PPPs that was shared during the last TGM in Cartagena.

In the subsequent discussion, participants emphasized the importance of south-south exchange and the role of the G-24 to foster these exchanges, while sharing additional country experiences. For example, **Mr. Rodrigo Carriedo**, **Alternate Executive Director at the World Bank**, highlighted the important role of infrastructure project pipelines and institutional reforms in attracting private investors. A critical role for the MDBs is to help governments build capacities to prepare and structure bankable projects. In the case of Mexico, recent structural reforms, especially in the energy and telecommunication sector, have enabled more private investment. The design and development of the special economic zones, along with the enabling connectivity, is also expected to foster economic growth in the long run. **Mr. Saurabh Vijay**, **Advisor at the World Bank**, informed the participants about the Indian government's recent initiative to develop two websites — one on infrastructure projects and the other on PPPs[1] — to facilitate investment. The websites offer investors and interested parties access to databases related to infrastructure projects in India such as information on Public Private Partnerships, e-repository of concession agreements, knowledge products, guidance notes, model documents, etc. Currently, there are more than 1,300 PPP projects in various stages of delivery in India. He pointed out the need to focus on another kind of infrastructure — digital connectivity. To this end, India's experience with transformative projects — such as the Aadhaar-Unique Identification project and its linkage to other government programs, such as financial inclusion — could inform other countries' efforts in similar areas. In India, one important challenge to be tackled is the country's relatively underdeveloped bond market. The limited financing space offered by the institutional investors is hindering India's effort to diversify the sources of infrastructure financing from banks. International financial institutions can play a useful role in scaling up infrastructure in developing countries, Mr. Vijay suggested — for example, by innovative leveraging of credit rating and balance sheets of MDBs. For G-24 to advance its work as a Group, it was suggested that the Group could link up with G20 initiatives such as the Global Infrastructure Hub, for brainstorming and policy advocacy on innovative ways to finance infrastructure in member countries. **Ms. Marilou Uy**, the Director of the G-24 Secretariat, introduced the list of infrastructure initiatives in G-24 countries compiled by the Secretariat. The purpose of the list is to facilitate information and knowledge sharing, and to show the extent of aspirations in infrastructure investment among G-24 countries. This list will be followed up going forward. MDBs are encouraged to organize focused workshops and seminars in association with the G-24.

Session 2: Policies for Structural Transformation and Productivity Growth

In introducing the session, **Mr. Maxwell Mkwezalamba**, **Executive Director for Africa Group 1 Constituency at the IMF** and moderator of this session, remarked that structural transformation was closely related to infrastructure finance, the topic of the preceding session. He encouraged participants to share their country perspectives and to state their views on the role that global cooperation, and the

[1] Please refer to https://infrastructureindia.gov.in/, and https://www.pppinindia.gov.in/

international financial institutions in particular, played and could play.

The first presentation was provided by **Mr. John Page, Senior Fellow at Brookings Institution and UNU-WIDER**, who focused on the emergence of new activities akin to manufacturing and what that meant for diversification paths.

In countries at low levels of income, the differences in productivity between sectors are large. They have, therefore, the greatest potential for structural transformation. The movement of resources from low- to high-productivity employment drives growth as productivity differences among sectors converge. The question is how to get such a process started.

There is a key difference between structural change in East Asia — where it was synergic to within-sector productivity growth — and in Africa and Latin America, where it went in the wrong direction (e.g., in Africa, from agriculture to low-productivity services). Also, in East Asia industry led the process of structural change while in Africa it played a minor role and in Latin America it prematurely stagnated. The problem with a limited role for industry is that this is a sector that plays a fundamentally different role in structural change. It is the only sector where it has been possible to observe convergence to high-income productivity levels over long periods (regardless of geography, regions or institutions). This feature is more relevant to poor economies than to rich ones.

Nowadays, boundaries of industry as a sector are changing and part of what used to be industry is shifting into other activities. The reasons could be the outsourcing of services that used to be part of manufacturing, changes made possible by manufacturing technology and growth of tradable services.
Technology and falling transport costs have created a class of tradable services and agro-industry that are more similar to manufacturing ("industries without smokestacks") than to traditional services or agriculture, and whose firms share many of the characteristics of manufacturing regarding, e.g., capacity for technical change, response to agglomeration, and possibility of learning from foreign investors. Thus, for low-income countries trying to industrialize today there will be a potentially broader array of activities. Because characteristics of firms across these activities are quite similar, they also tend to respond to similar drivers of industrial productivity and location. The basics, such as infrastructure and skills, institutions and regulations, matter. But they have to be put together with other drivers: competition and learning through exporting, firm capabilities (management matters, and one should not treat the firm as a black box) and agglomerations, because industries like to cluster, which brings productivity gains.

Some new directions for industrial policy in Africa involve: (i) mounting an "export push"; (ii) building firm capabilities — the export push can help firms cope with demanding buyers, repeat relationships, and domestic value chain relationships; and (iii) creating clusters, which entail a collective action problem where public policy will be needed to get a group of firms to act together (e.g., creating an SEZ).

Mr. Adam Elhiraika, Director of the Macroeconomic Policy Division at the Economic Commission for Africa, focused on the need to strengthen the State's role in structural transformation.

The State's role in structural transformation should be clearly defined, he argued. An important reason that countries such as Ethiopia, Rwanda, Kenya, and Morocco were making some progress was because they had rediscovered the role of the State.

Africa is highly integrated in world markets but mostly at the lowest level, i.e., exports of primary commodities. The continent's notable growth over the last 15 years has not been due to manufacturing, but to high prices of commodities and extractives (as well as improved macroeconomic management). Africa's growth deceleration since 2015 has been primarily due to the slower growth of commodity-

dependent countries such as Angola, Algeria, and Nigeria, which further supported the need for Africa to diversify. Poverty and inequality remain high, in spite of progress, presenting risks to political and social instability.

There is some evidence that structural transformation and improved productivity are taking place, but at a slow and inconsistent pace, especially compared to the rest of the world. Governments need to do more to build capacity, enact industrial policies, and tap participation in global value chains (GVCs) to support structural transformation. Intra-regional trade in processed goods is the first step in moving up the value chain.

Sixty per cent of intra-Africa trade is in manufactured goods, whereas only 12 percent of the continent's exports to the rest of the world involve such goods.

A number of global partners are supporting Africa in this process. China is a key partner supporting science and technology, trade, agricultural transformation, manufacturing and commodity processing, financing and infrastructure. However, unless African countries define their own objectives and priorities they will not make good use of that and other partnerships.

To develop strategies for structural transformation, African countries should go back to national development plans. This did not imply shunning the role of markets, only that they should ensure the State's role in facilitating the development of skills, infrastructure, etc. To do so, countries should have a plan to engage with others and seek also to diversify partners and define advantageous areas of engagement. They should build credible accountability, oversight, and other governance institutions as well as improve public sector management.

Mr. Elhiraika said there is a need also for industrial development strategies that were long term, flexible, and coherent with other strategies. He proposed focusing investments in infrastructure and skills, and coupling these with improved access to markets and development finance, institutional configurations for productive public-private partnerships, and regional integration and intra-regional trade. Only this way would Africa's 54 small states be able to compete internationally.

Mr. Ricardo Gottschalk, Economic Affairs Officer at UNCTAD's Division of Globalization and Development Strategies, was the next speaker and addressed the question of what it takes to catch up in today's world.

Global conditions are not as favorable as in the past for export-led growth strategies, he said. Key reasons are insufficient global demand, the risk of increased protectionism, and much slower growth in international trade. A few countries may end up competing to sell the same products to stagnant markets. Countries are also vulnerable to more volatile capital flows and the prospect of tightening global financial conditions.

The countries that caught up under the trade and financial openness that characterized globalization were mostly from East Asia, not from other regions. One of the reasons is how those countries engaged in GVCs. Second, levels of investment in these countries were high enough to support rapid and transformative growth.

Trends in the composition of output show that the countries that grew fast and for long periods went through a structural transformation process measured as changes in Manufacturing Value Added to GDP. In those that grew slowly, MVA/GDP decreased, meaning a reduction or stalling of industrialization. Another measure of catching up is productivity in manufacturing. Taking US as a benchmark, Asia has converged but Latin America and Africa diverged.

The role of international trade can be important in changing the pace of industrialization and increasing productivity but outcomes are not assured. Cross-country evidence showed no correlation between positive changes in manufacturing exports to GDP and the share of Manufacturing Value Added (MVA) to GDP, but pointed to a positive relationship between the change in share of net exports of manufactures and change in the share of MVA to GDP. Asian countries showed the largest increases in the periods 1991-94 and 2011-2014. These countries' participation in GVCs is associated with increased shares of their MVA in manufacturing exports and in total GDP, in contrast to what happened in other developing regions. (Another reason for these countries' success was the high levels of investment to sustain rapid and transformative growth).

The main message in Mr. Gottschalk's presentation was that the benefits of international trade are not automatic but contingent on a number of international conditions, domestic factors, and policies. On the domestic front it is important that countries have clear, targeted, and selective policies: industrial policies that help economies to become more prosperous, diversified, and resilient to shocks. It is important that these policies are not conducted in isolation, but as part of a wider package that includes macroeconomic policies in support of structural transformation by ensuring domestic aggregate demand, providing stable and competitive exchange rates, avoiding compressed wages, and providing long-term finance for productive sectors rather than short term for speculative activities.

Ms. Daria Taglioni, **Lead Economist in the Trade and Competitiveness Global Practice, World Bank**, focused her presentation on the relevance of global value chains (GVCs) to G-24 countries.

The emergence of GVCs is an important, disruptive trend arising from increased globalization as well the ICT revolution and fall in communication costs. Global value chains brought about vertical specialization in trade, vertical specialization in FDI, trade in services and knowledge, and innovation networks.

The trend brought about a new source of dynamic comparative advantage: the strength that can be derived from data. With weak resources, countries managing services trade, enterprise characteristics, and intangible assets can gain a comparative advantage. GVCs also led to a smaller critical effort for moving from the agricultural sector to the manufacturing sector. This means that a big leap can be achieved with smaller steps since countries do not need to build an entire production process at home, just to plug into a complex global system.

The implication is that "parts and components" that a country produces are frequently customized to what buyers need and are willing to buy. Also, the sequence of decision-making goes more in the direction from buyer to producer (not the other way around). Contracting costs in global production are very high (among parties with distinct legal systems), and agreeing on intellectual property is important in global value chains. A weak contracting environment has led to a greater share of global value chains being made intrafirm (meaning that production is within the boundaries of a single firm). Trade agreements of growing depth have been the main vehicle to bringing to bear new disciplines that allow the process to connect parts of the production chain across borders. Note that GVC-related trade is on average higher for country pairs that have signed "deeper" agreements.

The development promise of GVCs lies in their matching production teams across countries and these countries' ability to quickly learn to do complex things. A key issue is how to capture more of the value added in GVCs. At times, the domestic value added as share of ICT exports may be a misleading measure, as it could shrink but the magnitude in growth of total value added will make up for that and more. Countries also need to consider the distributional impact of how they participate in GVCs.

The policy implications are different for countries at different stages of engagement. For resource-intensive sellers, FDI attraction and connectivity are priority issues. As countries become more

sophisticated, the quality of logistics and education quality become more important. And, as countries move to become manufacturing sellers or hubs, they will need strong innovative capabilities As an economy becomes more complex, policy-making also needs to become more complex at the same pace, which is more difficult, and could lead to the "middle-income trap." Ms. Taglioni further discussed the range of policies that needed to be considered for GVC engagement in the digital era.

It is important for a country to clearly understand the geography of its international production, i.e., not to think in abstract terms or to simply copy the processes of another successful country. Each country should try to answer these three questions: (i) Which countries' value-added do we use in our exports? (ii) Which countries' final demand is sourced by value-added from our exports? And (iii) is our involvement in GVCs stimulating economic growth? What are the distributional impacts of such involvement? Investment in data on value-added — which may be hard to come by — could be extremely useful in deriving answers to these questions and, thus, policymaking for lower- and middle-income countries (at the moment a good part of advice is based on analysis of rich countries).

Mr. Manuel Montes, **Senior Advisor at the South Centre**, examined the kind of obligations developing countries should accept in order to protect foreign investors.

Investment agreements initially were intended to protect investors from arbitrary expropriation by the host country without due process. However the number of issues covered by such agreements has sharply increased over the years. By the end of 2015 there were 3,304 investment treaties. The main problem with investment treaties is an imbalance between rights and responsibilities awarded to investors. NAFTA Chapter 11 and the Trans-Pacific Partnership are paradigmatic of the ample degree of protection offered to investors by modern investment treaties; both enabled (or would enable) investors to sue host countries before international arbitration tribunals. At the same time, although many countries sign such agreements in the hope of attracting foreign investment, a number of authors have tried to establish evidence as to the impact they would have in achieving that objective and found, at best, a very weak link.

Some of the challenges investment treaties raise deserve particular attention on the part of finance policy-makers. Investors may use treaty provisions to challenge: (i) legitimate tax measures, thus threatening mobilization of domestic resources; (ii) capital account and macro-prudential regulation measures, thus depriving countries of tools to preserve financial instability, and (iii) sovereign debt restructurings, thus introducing uncertainty in a country's process to prevent and resolve sovereign debt crises. Additionally, monetary awards in litigated cases have often become a large financial cost for sued states, which grows larger with compounded interest for delayed payments.

Investors have availed themselves of such protections to challenge social policy measures (black empowerment policies in South Africa, minimum wage policies in Egypt, water provision in Bolivia). Some dimensions of the treaties also foster inequality, for instance, the ability of foreign investors to seek types of redress unavailable to national companies.

Some alternatives to reform the system can be found not just in theory, but in the emerging practices of several countries that are choosing to go a different way: for instance, withdrawing from NAFTA-style treaties and denouncing the jurisdiction of arbitral tribunals to entertain disputes; relocating investor protections in domestic legal systems; allowing only state-to-state dispute resolution; and requiring exhaustion of domestic remedies before a lawsuit can be filed with an investment tribunal.

Mr. Fisseha Aberra, Director for International Financial Institutions at the Cooperation Directorate of the Ministry of Finance of Ethiopia, shared some observations from his country's experience.

Reforms in Ethiopia started in the early 1990s and entailed market-oriented reforms as well as a reorientation in public sector focus to, *inter alia*, emphasize agriculture, address the service delivery gap, rebalance the budget towards more capital and infrastructure expenditure, and raise domestic resource mobilization. The reforms were highly effective: real GDP growth jumped in 2003 from a 20-year average of near 3 percent to an average of nearly 10 percent over the following 10 years. Dramatic improvements in poverty and average life expectancy indicators were observed in the period, too.

A Growth and Transformation Plan passed in 2011 is the vision that currently guides development in the country. In spite of challenges — such as a predominantly agriculture-based, low productivity economy, low quality of social services and infrastructure, limitations in capacity and inflation — between 2001 and 2016, Ethiopia has consistently increased the share of industry and services in the economy. Gross National Savings, in contrast to falling averages in Sub-Saharan Africa, has kept on growing, as has total investment, contrary to the stagnation of Sub-Saharan Africa's aggregate levels. Domestic resources went from financing 61.2 percent of the budget in 2006 to almost 87 percent in 2016.

Ethiopia's strategies relied on an expansion of manufacturing and diversifying exports with emphasis on high-value exportable. The ongoing development of two major energy projects will allow Ethiopia's energy supply to generate an exportable surplus over the next years. Ethiopia is also building industrial parks to promote light manufacturing, and upgrade and upscale engagement in value chains. Ongoing development of a railway line from Addis Ababa to Djibouti will be the first train in Africa to run on 100 percent renewable energy and will speed and facilitate the 90 percent of Ethiopian exports and imports that take place via the Djibouti route.

Mr. Jorge Estrella, IMF Executive Director for Southern Cone countries, reviewed the experience of his country, Peru.

In Peru, poverty declined from 54 percent to 20 percent while GDP more than doubled over the last 20 years. This happened after Peru, learning some lessons from failed policies of the 1980s, took several steps to develop the economy and reduce poverty.

The first was macroeconomic stability: a flexible exchange rate, fiscal discipline, low inflation, independence of the Central Bank. Second, a market friendly economic framework, including privatizations in the 1990s yielded enormous improvements in productivity (although some regulations after the 1990s increased the rigidity of the labor market). Third, bolstering the rule of law, which did not enjoy much trust: Peru signed numerous international treaties with countries to guarantee investors due process. Fourth, Peru created a flexible capital market that does not restrict companies' ability to send their profits abroad.

In addition, Mr. Estrella said, the economy was made more open with the signing of Free Trade Agreements – Peru has around 70, including with the US, China, and the European Union. It also liberalized tariffs unilaterally. Exports are crucial because domestic markets are too small to allow any substantial measure of development. This requires preparing the infrastructure for access to markets, and addressing connectivity issues, also within the country. Regarding public investment and Public-Private Partnerships (PPPs), Peru learned that it is important to look at the quality of projects, and that PPPs should be self-sustainable — that is, not to imply government funding, and to follow without exception the properly established evaluation processes. Increasing human capital has also been important — for instance, by introducing a meritocracy in the educational sector, which is still public and of rather low quality.

Peru has been able to diversify its economy. It may look like the country has concentrated exports in minerals (copper, gold, and silver) and agricultural products, but examining the share of commodities

in exports in a time of high prices is misleading. Moreover, processing in exports from those sectors has increased, as well as the share of labor and employment that goes into them.

One of the themes in participants' interventions at the end of the session was the changing scenario for diversification and the new shape that diversification might need to take. For instance, **Mr. Tarik Ladjouzi, Deputy Director in Charge at the Ministry of Finance of Algeria**, reflected on the experience of his country, a mono-hydrocarbon exporting country where diversification was at the heart of a recently-adopted model for economic growth. This required overcoming the isolation of the resource sector to forge linkages with other parts of the economy and investing the financial flows to that sector into other domains. **Ms. Mohua Roy, Advisor at the IMF ED Office of India**, suggested identifying where technology — which had been so disruptive — could help create a comparative advantage for certain services (e.g., addressing growing demand for caring services) and the planning, educational, and skills-development challenges to enable the respective economies to benefit from such changes. Others considered essential in exporters of primary goods intending to transform them to access the technical training to do so. In resource-dependent countries, brokering a marriage between the abilities that companies at home have with those abroad may be the key to breaking out of the resources sector's isolation. The experience of some countries showed that diversifying demand — through diversifying partners — was an important component, especially when uncertainty casts a pall on traditional trade relationships and the related value chains. Participants also shared national alternatives they were implementing to rebalance investment agreements.

Session 3: Mobilizing Domestic Resources for Development and International Tax Cooperation

The last session of the meeting focused on mobilizing domestic resources for development and international tax cooperation.

Mr. Michael Keen, **Deputy Director of the Fiscal Affairs Department at the IMF**, opened the session by focusing on revenue mobilization issues in developing countries and offering a primer on the Destination-Based Cash Flow Tax (DBCFT).

The IMF currently leans towards the use of the term Revenue Mobilization (RM) instead of Domestic Resource Mobilization (DRM), which most people tend to assume does not include international tax. Currently, there is heightened interest in supporting revenue mobilization, as shown by the subject's centrality to realizing the SDGs, the commitment by donors in the Addis Tax Initiative to double support for RM by 2020, and the increasing number of initiatives by the G20 and other organizations. The IMF has scaled up RM efforts, with tax policy assistance given to over 100 countries each year.

The IMF's objectives for RM are to increase revenue for client countries, enhance tax systems efficiency gains and growth, achieve fairness and for state building. There is some progress in tax revenue collection in lower-income countries, now with a median average of 15 percent (tax revenue to GDP), with a noted general movement away from trade to tax revenue, though the former is still a significant share of government revenues. Recent IMF research points, very remarkably, to a tax revenue-to-GDP rate of around 13 percent as a tipping point, above which growth performance significantly improves. This can be seen as providing empirical support for the standard recommendation to countries with low tax-to-GDP levels to aim for levels of about 15 percent.

The IMF also focuses on a wide range of specific issues in tax policy and administration. These include such measures as enhancing the effectiveness and efficiency of tax incentives, improving the VAT, and strengthening the capacity of tax administrations. The institution has undertaken a number of initiatives to make tax support more effective. These include the joint Platform for Collaboration on Tax (joint with the OECD, UN and World Bank) and the development and use of new analytical tools,

including RA-GAP helping countries assess gaps between tax legally due and actually collected), ISORA (collecting comparable information on the performance of revenue administrations worldwide, in collaboration with CIAT, IOTA and the OECD) and TADAT (providing detailed assessments of the performance of countries' systems of tax administration).

Mr. Keen proceeded to explain the elements of the Destination-Based Cash Flow Tax (DBCFT). DBCFT targets rents – profits in excess of the minimum required, through an immediate expensing of investment (instead of depreciation), no interest deductions, and a border tax adjustment (BTA) whereby imports are taxed, but exports are not. This tax is in economic terms equivalent to a broad-based VAT plus a wage subsidy at the same rate.

The DBCFT has several upsides in that it eliminates debt bias by firms, it does not distort the level or location of investments and substantially mitigates a wide range of BEPS possibilities. On the other hand, the tax has some issues. It is almost certainly inconsistent with WTO rules and perhaps also tax treaties (though the VAT plus wage subsidy approach does not have these problems). Importantly, while BEPS problems are lightened for the adopter of the tax they are worsened for non-adopters. And there remain many design issues to address.

Mr. Valpy FitzGerald, Professor of International Development Finance at Oxford University and member of the Independent Commission for the Reform of Corporate Taxation, spoke on the economic consequences of tax competition for emerging economies; cooperative policy responses to this problem; and the potential effect of possible U.S. corporate income tax (CIT) reform.

Direct taxation of corporate profits and personal wealth matters for economic development. Modern growth theory suggests a positive effect of CIT on growth, if spent on areas such as education and infrastructure. As a progressive tax that acts as a withholding tax on dividends, CIT promotes social justice by facilitating poverty reduction and redistribution between rich and poor countries.

International tax competition is arguably a zero-sum game with high costs for emerging markets. Economic studies suggest that MNEs transfer 30 percent or more of income earned from affiliate entities in high-tax jurisdictions to those in lower-tax jurisdictions. According to the OECD, base erosion and profit shifting (BEPS) causes revenue losses worldwide of US$100-US$240 billion annually; and the IMF estimates losses of 1.3 percent of GDP (US$200 billion) and 1 percent (US$400-US$500 billion) for non-OECD and OECD countries, respectively. Spillover effects of a country's tax policy on other countries include BEPS and pressure to change domestic tax policies, leading to a global welfare loss. As a result, domestic direct tax collection is almost impossible without international tax cooperation on both CIT and personal income tax (PIT). To facilitate international tax cooperation the Independent Commission on Reform of International Corporation Tax (ICRICT) proposes the following: putting a floor under tax completion; eliminating all tax breaks on profits; establishing a level playing field; and ensuring participation of the civil society.

On the Destination-Based Corporate Tax (DBCT), a component of the U.S. tax reforms, Mr. Fitzgerald noted that the tax entails a full CIT (possibly at 20 percent) on imports, none on exports, full costing of investment, and none on loan interest. The reform explicitly intends to pass tax cost on to import suppliers, attract back flight capital, and reduce outsourcing to cut supply chains. For EMs this means that transfer pricing on imports to US should disappear, but could emerge on exports; expected revaluation of the dollar could lead to winners (net dollar asset holders) and losers (net debtors); exports of price-sensitive products are liable to be impacted (but not higher tech products) and there should be less of an effect on FDI.

Mr. Fitzgerald recommended a number of possible G-24 initiatives. These include facilitating peer-country learning on international tax negotiation; working towards consensus on common principles of

corporate tax and positions on international tax arrangements; advocating progressive income tax reform as a central feature of sustainable economic development strategies; and discussing multilateral institutional changes required to better reflect G-24 interests.

Mr. Eric Mensah, **Tax Commissioner at the Ghana Tax Authority**, delivered the first country intervention in this session. His presentation focused on Ghana's perspective on the challenges of domestic tax policy-making, including taxing multinational companies (MNCs).

Ghana, like many developing countries, is faced with a DRM challenge of bridging the financing gap in infrastructure development and balancing national budgets. To address this issue, Ghana implemented two policies: the first, a bond issuance from international financial markets, and the second, an offer of tax incentives to encourage FDI. The process for the bond issuance lacked due diligence due to heightened pressure to meet set goals. As a result, it has resulted in very high debt stock of over 74 percent and a currency depreciation of 9.6 percent in 2016.

Under the second policy, over the past eight years most contracts for major infrastructural projects have incorporated substantial tax holidays. Additionally, in the extractives industry, Ghana has extended stability agreements — agreements to hold tax arrangements constant for 15 years, to the major mining companies. Overall, this policy has been associated with lower-than-expected revenues from MNCs, failure to meet set targets for infrastructure projects and illicit financial flows due to trade misinvoicing.

At the international level, Mr. Mensah pointed out that new initiatives in international tax are not adequately calibrated to the needs of developing countries; primarily, regarding the allocation of taxing rights on cross-border income and other BEPS issues such as tax incentives and technical services fees. Additionally, developing countries are not part of the norm setting in international taxation and they have limited capacity to engage meaningfully in setting new international tax rules and agenda.

Mr. Mensah then outlined recommendations for the role of IFIs and the G-24. Continued collaboration between the IFIs and regional tax bodies is important, as well as strengthening regional tax bodies to be more proactive. There is also need to revisit the question of a global tax body, as discussed the Third International Conference on Financing for Development in Addis Ababa. Despite being a very controversial issue, Mr. Mensah recommended that the G-24 should spearhead the upgrading of the UN Tax Committee into an intergovernmental body on tax. Current quasi-global tax institutions are not norm-setting bodies, but focus mainly on implementation. An intergovernmental tax body, where every jurisdiction is truly "equal at the table", is needed.

Mr. Rodrigo Carriedo, **Alternate Executive Director for Mexico at the World Bank**, followed with an overview of his country's participation in international tax cooperation.

With globalization and more complicated tax systems, cooperation has become crucial to ensure that profits of multinational enterprises (MNEs) are taxed where value is created. Mexico's involvement in international cooperation efforts has two pillars.

The first pillar is the Base Erosion and Profit-Shifting (BEPS) initiative, which tries to stop companies from applying aggressive tax arbitrage strategies to minimize tax burden. Mexico plays a dynamic role in the implementation of the BEPS Action Plan through its technical work on the OECD platform. Mexico has already implemented some of the measures included in the Action Plan to neutralize hybrid mismatch agreements, it has included requirement for disclosing potentially harmful operations, while its system already includes controlled foreign companies as well as some mechanisms to address profit-shifting. In June, Mexico is to sign the Multilateral Instrument whose objective is to implement

more effectively the BEPS action that relates to tax treaties. Transfer-pricing guidelines will be automatically applied in Mexico to the extent that they will be in accordance with domestic legislation.

The second pillar is the promotion of agreements for Automatic Exchange of Information (EOI) on tax matters. Mexico has in place 17 agreements for EOI and 55 agreements for avoiding double taxation and prevention of fiscal evasion that include an EOI clause. Mexico has been part of the Multilateral Agreement on AEOI since 2014. It was also an early adopter of the Common Reporting Standard. From September 2017 onwards, Mexico will exchange information on an automatic basis. Mexico approved necessary legislation for the implementation of Country-by-Country (CBC) reporting. Fifty seven countries, including Mexico, have signed CBC reporting agreement, which will give to tax administrators a global picture on key indicators of MNEs (crucial for the whole initiative to work).

Mexico has been implementing capacity-building programs, especially in the LAC region, in line with the Addis Tax Initiative. It provides support to other countries through two main channels: Mexican participation with expertise and technical support in tax matters to tax administrations and the OECD Multilateral Tax Centre, headquartered in Mexico, which hosts a number of events on tax matters, annually. Lastly, Mr. Carriedo emphasized that institutions like the World Bank and IMF are fundamental for G-24 countries to be actively involved in modernization of international tax rules.

Mr. Ehtisham Ahmad, **Senior Fellow at the University of Bonn and London School of Economics**, concluded the session with a presentation on the political economy of tax reforms and meeting the SDGs.

Tax reforms are at the center of the SDG agenda — not just in raising revenues but also influencing behavior of firms, households and governments at different levels of administration. In addition, appropriately designed tax systems can help to stop the "cheating" with respect to taxes, leakages from the natural resource sector, and in generating accountability for spending decisions.

Drawing on South-South experiences to highlight and address the difficulties G-24 countries face in meeting DRM objectives, in many countries, concerns for equity and promoting investments have led to multiple rates, high thresholds, exemptions and zero rating in the VAT, and significant "holes" in the income taxes. This not only limits revenue potential, it creates incentives for arbitrage and cheating (affecting firms of all sizes).

The very successful reforms in China in 1993/4 focused on a simple VAT, using big data techniques and invoice matching. Provincial losses were avoided by a skillful balancing of stop-loss provisions, revenue-sharing and equalization transfers to generate broad-based support and sustainable growth. The latter was facilitated by focusing on coastal hubs and freeing-up the labor market, leading to 700 million people being lifted out of poverty in two decades. The basic principles were adapted in Mexico in 2007 and in the highly innovative and comprehensive 2013 reforms.

Both the recent Chinese and Mexican reforms focused heavily on the VAT as a way of reducing taxes that add to the cost of doing business, and generate "information" on the value-chain. This involves an integration of SMEs, using a simplified system of electronic invoices, into the "formal" tax system. This has important benefits for closing holes in the CIT and natural resource taxes.

Mr. Ahmad emphasized that a significant reform agenda remains at the sub-national level in most G-24 countries, with a need for sub-national "own-source" revenues, rather than transfers or shared-revenues, for accountability, financing basic services and anchoring access to credit for local investments.

Participants discussed the nature of tax actions by advanced economies, their distributional effects and potential impact on developing countries. It was argued that the distributional impacts of reforms could only be understood by looking at the whole set of tax measures (e.g., will there be a tax on capital gains? Is there a need to have corporate income tax if personal income tax is properly taxed?) In addition, impacts will also depend on whether the adjustment happens through prices or through the exchange rate, both equally plausible scenarios. The ability of developing countries to levy withholding taxes could be contested, depending on whether one accepted that the proposed US tax was covered by tax treaties or not. The response of the European Union — whether it would follow or resist the implementation of similar reforms — would matter in determining overall global impact.

H.E. Mr. Admasu Nebebe, State Minister of the Ministry of Finance and Economic Cooperation of Ethiopia, delivered the closing remarks.□