OPINION ARTICLE

Financing Sustainable Development: Prioritization and Sequencing[1]

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Policies towards sustainable development are multiple and require multiple resources. The countries of the region face the need to prioritize and sequence such policies taking into account their vulnerabilities and capacities.

Leo Tolstoy in his work Anna Karenina pointed out that happy families are all alike, but each unhappy family is unhappy in its own way. In fact, when we group countries according to their similarities according to comprehensive development indicators, we can see that, just as developed countries resemble each other, so do underdeveloped countries.[3]

However, as development is multidimensional, in the multiple dimensions of the process towards sustainable development, each country is at a different point in the process and therefore not all processes will be the same. It is as if they were poles in a sphere, developed countries at one pole, underdeveloped countries at another, each country can take different paths towards the other pole depending on its specificities with respect to each development factor (human capital, natural capital, technology, institutions, etc..., and the way in which these factors are combined). The same is true for the transition to sustainable development, capacities, vulnerabilities and constraints.

All developed countries are very similar to each other, and have similar capacities and few vulnerabilities, while underdeveloped or intermediate developed countries are each vulnerable in their own way, have their own capacities, vulnerabilities and constraints. And their own way of combining them through norms. The constraints, vulnerabilities and capacities are specific to each country and therefore the sustainable development path is also specific to each country. The prioritization and sequencing of policies is specific to each country.

However, there are some common characteristics to the financing alternatives of such policies that allow for the suggestion of a certain **prioritization at the international level and sequencing at the national level:**

At the international level:

1. Developed countries have many capacities and undeveloped countries have many vulnerabilities. The concept of vulnerability must be considered by

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[3] The author is grateful for the comment of OAS Secretary General Luis Almagro on this point.

developed countries in their cooperation policies and in their positions in international financial institutions so that countries may have access to funds for sustainable development and non-reimbursable funds at a differential and lower cost.

2. There are countries that contribute more with their productive structure and consumption patterns to the perverse effects of climate change and environmental degradation than others; and there are countries that suffer more from the consequences (droughts, floods, natural disasters) than others. In this scheme, those who generate the negative externalities should pay more and those who suffer the consequences should receive more.

There are countries, such as those of the Caribbean and Central America, that are in the group of those that suffer most from the consequences and at the same time are the most vulnerable. They should have a special window with special conditions in all international financial institutions and cooperation policies.

In each disaster, the situation of each country post-disaster compared to the previous situation depends on the degree of exposure of each country, the vulnerabilities that reduce the probability of recovery and the capacities for response. In the absence of special conditions, the countries of Central America and the Caribbean will emerge from each shock with more vulnerabilities and less capacity to face the next one.

The countries of the region periodically face external shocks and a real vicious circle. They face shocks with high vulnerabilities and low response capacity, which causes them to emerge from the shock with more vulnerabilities and less capacity to face the next shock. The same vicious circle occurs within countries between the vulnerable population and those with more capabilities.

Each external shock increases inequality within and between countries due to differences in levels of exposure to shocks, structural vulnerabilities and response capacity. Our region regularly receives shocks caused by natural disasters; in recent years, it has also been impacted by migratory movements and periodically suffers the consequences of falling export prices for its products and the ups and downs of financial markets.

It is not the Gross Domestic Product (GDP) per capita that defines the levels of exposure, vulnerabilities, and response capacity, and therefore this should not be the criterion for preferential access to markets, financing and cooperation. Development is a multidimensional process, as is underdevelopment and the process of exiting underdevelopment. This has already been accepted by organizations such as the United Nations, which has abandoned GDP per capita as an indicator of development to evolve over the years towards a Human Development Indicator, which includes multiple dimensions. The entire international community must assume the multidimensionality of the problem when it comes to cooperation and preferential access to financing and trade. Within the multiple dimensions, the risk of exposure to external shocks, the vulnerabilities of countries, productive sectors and households, as well as the response capacity of States, must play a predominant role.

Developing countries cannot by themselves break the vicious circle that allows them to cope with shocks and invest in capacities for development. This vicious circle must be broken by changing the per capita GDP criterion so that developing countries can access, in each shock, concessional financing, preferential trade and cooperation and thus free up resources on an inter-temporal basis to reduce vulnerabilities and invest in capacity building that will enable them to follow a development path that is less vulnerable and less vulnerable to external shocks.

At the national level:

1. Regulatory changes that promote changes in business processes and consumption habits are difficult to implement because economic agents will always struggle to maintain the status quo and not address changes of certain cost, uncertain private benefits and uncertain probability of appropriating the greater social return generated by the changes. It is therefore important that regulatory changes promote investments and activities in accordance with **sustainability criteria such as ESG criteria**.[4] ESG criteria refer to the characteristics that companies develop to be socially and environmentally sustainable. The acronyms are related by the words Environmental, Social and Governance.
    - It is also important to internalize environmental regulatory changes in export destination countries, for example, rather than entering into a costly process of internal negotiations with an uncertain outcome. It does not seem advisable to begin with profound regulatory changes; it seems preferable to leave this for a second stage.
2. Changes in the public budget are also difficult, they have a high inertial component and, in general, changes in the margin are made due to short-term priorities. During the pandemic, for example, there was a notorious reduction in spending on environmental protection in Latin America and the Caribbean.[5] However, new investments, for example, can be designed according to **sustainability criteria.** For example, in public works concession tenders, companies' bids can be scored by incorporating **ESG criteria**.
    - The tax system should be redesigned according to the desired structure and dynamics of production and income, also in accordance with **sustainability criteria.**

Any tax system must combine acceptably the four principles in a tax design: efficiency, equity, adequacy and flexibility, and achieving this is not a trivial matter.[6] There is often a dilemma between efficiency and equity and their relationship with the principle of neutrality (similar tax burdens on similar persons).[7]

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[4] See for example: Qué son los criterios ESG y para qué sirven (deloitte.com)
[5] S2100878_es.pdf (cepal.org)
[6] The author presented the same logic in Sistemas Tributarios post covid-19 (elobservador.com.uy), in that version the author received comments from Alberto Barreix, Leonardo Costa, Carlos Loaiza and Diego Vallarino, which are again gratefully acknowledged in this article.
[7] https://www.oecd-ilibrary.org/taxation/taxation-and-the-future-of-work_20f7164a-en

Defining the concept of "similarity" between individuals or legal entities is not trivial either: is a vulnerable person similar to a non-vulnerable one, is a company with high levels of environmental and social sustainability and good governance similar to one that pollutes and abuses its dominant position vis-à-vis workers and consumers?

Imposing tax burdens that respect equity and neutrality in an efficient way is a second question, considering how costly and cumbersome it can be to have as many tax burdens as dissimilar persons (individuals and legal entities). Customized tax design can respect the principle of equity and neutrality if the tax burden takes into account similarities and differences, but it must face the principle of efficiency. The system cannot be cumbersome to reduce the risks of avoidance and evasion.

Barreix, Bes and Roca[8] make a proposal for a customized VAT by integrating the "traditional" VAT with the conditional income transfer instruments that have been successfully applied in the last 20 years in Latin America. It is worth noting that the proposal implicitly recommends combining information on individuals with their **vulnerability** characteristics and their expected responses to the transfer. The consideration of the concept of **vulnerabilities in reference to populations exposed to the perverse effects of climate change and environmental degradation could be made compatible with the concept of personalized VAT.**

More generally, the **technology of data analysis[9]** and the **theory of mechanism design[10]** can help in the design of tax systems with **sustainability criteria** such as **ESG** that consider the two issues mentioned above.

Firstly, tax microdata can provide personalized information and thus provide elements that allow flexibility of the instruments according to the life cycle of each taxpayer and at the same time can help targeting according to vulnerability and sustainability criteria.

Secondly, the application of mechanism design theory to tax design makes it possible to relate incentives to the expected desirable results while respecting the private information and personal interests of taxpayers. In other words, it allows for the alignment of private objectives and interests with public policy objectives.

By combining data analysis technology with the design of mechanisms, it is possible to design, for example, income taxes (for individuals and legal entities) with personalized effective rates associated with a scoring system that ranks taxpayers according to their vulnerability to specific situations and according to the expected outcome in terms of sustainable development according to well-defined **sustainability criteria**.

The design can contemplate negative rates (equivalent to subsidies) that ensure a minimum income for those who, for reasons of vulnerability to a contingency such as

[8] https://repositorio.cepal.org/handle/11362/1456
[9] https://www.oecd-ilibrary.org/taxation/the-potential-of-tax-microdata-for-tax-policy_d2283b8e-en
[10] http://transicionsocioeconomica.blogspot.com/2015/09/la-teoria-del-diseno-de-mecanismos.html

natural disasters, for example, or the capacity to accelerate the transition to sustainable development.

The scoring system according to vulnerability criteria and sustainability criteria allows the flexibility of the regime with respect to different contingencies, with respect to the economic cycle of each contributor and with respect to the public objectives in each circumstance.

The transparency of a proposal such as the above resides in the ability of the System to process the fiscal microdata that allow for the verification that everyone contributes according to their characteristics (contributive justice) so that after taxation everyone assumes similar burdens if they are similar persons (neutrality principle) and receives net income according to their characteristics and the relationship between their performance and the desirable expected results (distributive justice).

If the objective is that the incentives accelerate the changes related to the transition towards sustainable development, the ESG **sustainability criteria** for the design of the scoring system can promote in the companies what in the literature is called self-discovery.[11] Each company has the incentive to seek its path towards sustainable development knowing that the associated additional costs will be compensated by the tax benefits. The possibility of recategorization by change in the score according to the expected desirable result also makes companies "seek" the new process, the new technology, linked in this case to the transition towards sustainable development, which generate more impact on the variables to access a lower effective tax rate.

For its part, the government, in successive evaluations, will discover the "types" of companies in each sector and in each region that have the greatest potential to contribute to the objectives of sustainable development. This phenomenon could be called joint-discovery. In successive evaluations, the public and private sectors will be able to "discover" the "type" of reactivation in each sector and in each region of the country that, while providing more benefits to society, will also provide more benefits to the entrepreneur.

The same could be reasoned for the behavior of individuals, those in informal activities and self-employment.

In other words, the proposal promotes the alignment of viable objectives between the government and the private sector to aspire to the best transition in accordance with **sustainability criteria and in particular the ESG are proposed**.

In short, the transition to sustainable development is costly, to finance it:

- The international community must consider the differences between countries in terms of vulnerabilities and must prioritize, through preferential conditions, the countries most exposed to climate change, natural disasters and the

[11] https://www.nber.org/papers/w8952

vulnerabilities and response capacity of these countries to these risks. Specifically, in our region, the countries of the Caribbean and Central America should have access to non-reimbursable funds and preferential financial conditions in international credit organizations and in the cooperation policies of developed countries, which should definitively abandon the GDP criterion.

- At the national level, countries should incorporate sustainability criteria such as ESG in regulations, in public investment through private companies and in tax systems. In particular, it is suggested that progress be made towards personalized tax systems that incorporate the concepts of vulnerabilities and sustainability criteria to ensure contributive justice and distributive justice.