ECONOMIC PAPER 47

Financing for Development

Perspectives and Issues

Percy Mistry

COMMONWEALTH SECRETARIAT

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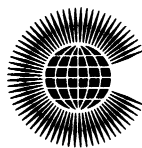

COMMONWEALTH SECRETARIAT

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Contents

Abbreviations		**vi**
Executive Summary		**ix**
1.	**Introduction and Background**	**1**
2.	**The Importance and Potential Value of UNCFD**	**3**
2.1.	An Eroding Public Mandate for Aid?	5
2.2.	A New Raison d'Etre for FfD?	7
3.	**Mobilising Domestic Financial Resources for Development**	**13**
3.1.	Findings and Recommendations of the Zedillo Panel Report	13
3.2.	Additional Issues for Commonwealth Finance Ministers	14
3.3.	Targets for Increasing Gross and Net Domestic Savings	19
4.	**Maximising Earnings from Trade for Financing Development**	**23**
4.1.	Findings and Recommendations of the Zedillo Panel Report	23
4.2.	Issues for Commonwealth Finance Ministers to Consider in Enhancing Trade Prospects	24
4.3.	The Special Role of the Commonwealth Secretariat	29
5.	**Mobilising External Private Capital for Financing Development**	**33**
5.1.	Observations and Recommendations of the Zedillo Panel	33
5.2.	Issues for Commonwealth Finance Ministers to Consider in Mobilising Private Capital	34
	Backdrop and Analysis	34
	Private Capital Flows and Development	35
	The Distinction between Foreign Direct Investment and Foreign Portfolio Investment	36
	Foreign Direct Investment	36
	Actions to Encourage Foreign Direct Investment Flows	38
	Implications for Commonwealth Countries – Foreign Direct Investment	41
	Foreign Portfolio Investment	43
	Implications for Commonwealth Countries – Foreign Portfolio Investment	48
	Private Voluntary Flows	49

6.	**Mobilising Official Development Assistance for Financing Development**	**55**
6.1.	A Contextual Digression on Whether Aid Works	55
6.2.	Issues Raised by ZPR/SGR on Increasing Official Resource Flows	56
6.3.	Prospects for Increasing ODA and Other Official Resource Flows	59
6.4.	Global Taxation as a Means for Financing Development	63
7.	**Reducing External Debt Burdens to Revive Growth and Development**	**65**
7.1.	Issues Raised by ZPR on External Debt	67
7.2.	Issues for Consideration at UNCFD on Resolving External Debt Problems	67
8.	**Systemic Issues and Changes in the Global Institutional Architecture**	**73**
8.1.	Systemic Issues Raised by the Zedillo Panel Report	73
8.2.	An Agenda for the Commonwealth	74
	Reforming the WTO	74
	Labour Standards and the ILO	75
	Environmental Issues and the Global Environment Organisation	76
	The Official Financial System and the Bretton Woods Institutions	76
	Regional Monetary Fujnds	81
	The SDR-FfD Link	82
	Reforming the International Financial Institutions	82
	The Role of the Bretton Woods Institutions	84
	Regional Development Banks	87
	Unifying the MDB System	88
	Global Taxation and the International Tax Organisation	89
	Global Governance Summit and the Economic Security Council	91
	The Role of the UN in Development	93
	Bilateral Aid and OECD-DAC in the Global System	96
	Twisting the Development Agenda out of shape	96
	Good Governance of the International System	97
	A New Rationale for Government-to-Government Resource Transfers	98
	The War of Global Competitiveness	100
9.	**Conclusions and Synopsis of Findings and Recommendations**	**103**
9.1.	Domestic Resource Mobilisation (Section 3)	104
9.2.	Enhancing Earnings from Trade (Section 4)	104
9.3.	Private Capital Flows (Section 5)	105
9.4.	Official Aid and Capital Flows (Section 6)	108
9.5.	Reducing External Debt Burdens (Section 7)	109
9.6.	Systemic Issues and Global Institutional Architecture (Section 8)	111

Annex **119**
Achieving Convergence in Incomes and Living Standards between the Industrial and Developing Worlds – An Illustration

Bibliography **123**

Tables

1. Net Resource Flows and Net Transfers to All Developing Countries 1970–2000 4
2. Growth Rates of GDP and Population in the Industrial and Developing Worlds 7
3. GNP Per Capita and Growth in Private Consumption Per Capita 1980–98 8
4. Sources of Financing for Investment in Developing Countries 1999 16
5. Gross Domestic Investment, Savings and Resource Balances in the World 1999 17
6. Resource Gap in the Developing World in 1999 if GDI were 33 per cent of GDP 18
7. Net Resource Flows to All Developing Countries by Type 1970–2000 37
8. Private Flows, ODA Flows, External Debt and Debt Service 1998 38
9. Foreign Direct Investment in the Developing World 1970–2000 39
10. Portfolio Flows from Capital Markets to Developing Countries 1991–2000 43
11. Private Voluntary Flows to Developing Countries 1983–99 51
12. Official Financing Requirements for the Four Priority Areas of ZPR 57
13. Net Official Resource Flows to Developing Countries 1990–2000 61
14. External Debt and Debt Service Burdens of Developing Countries 1970–2000 66
15. The Relative Incomes of People in the OECD and Non-OECD Worlds 1950–2050 120

Box Different Perceptions of Priorities for Achieving Sustainable Development 99

Abbreviations

ACP	African, Caribbean, Pacific countries
AfDB	African Development Bank
AfDF	African Development Fund
ANZ	Australia New Zealand
ANZCERTA	Australia/New Zealand Closer Economic Relations Trade Agreement
AsDF	Asian Development Fund
ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
BWIs	Bretton Woods Institutions
CARICOM	Caribbean Community
CFMs	Commonwealth Finance Ministers
DAC	Development Assistance Committee
DAF	Development Assistance Framework
EBRD	European Bank for Reconstruction and Development
ECOSOC	Economic and Social Council
ECOWAS	Economic Community of West African States
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facilities
ESC	Economic Security Council
FfD	Financing for Development
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GAVI	Global Alliance for Vaccines Initiative
GDCF	Gross Domestic Capital Formation
GDI	Gross Domestic Investment
GDS	Gross Domestic Savings
GEF	Global Environmental Facility
GEO	Global Environmental Organisation
GPG	Global Public Goods
HIPCs	Heavily Indebted Poor Countries
HSHR	High-Skill Human Resources
IADB	Inter-American Development Bank
IC	International Corporation
ICSID	International Centre for the Settlement of Investment Disputes
IDA	International Development Association
IFC	International Finance Corporation

IFI	Integrated Framework Initiative
IFIs	International Financial Institutions
ILO	International Labour Organisation
IMF	International Monetary Fund
ITC	International Trade Centre
ITO	International Tax Organisation
MDB	Multilateral Development Bank
Mercosur	Common Market of the Southern Cone (Brazil, Argentina, Paraguay and Uruguay
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North American Free Trade Agreement
NGO	Non-Governmental Organisation
NTBs	Non-Tariff Barriers
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PCC	Private Consumption per Capita
PCF	Private Capital Flows
PPP	Purchasing Power Parity
PSE	Public Sector Enterprise
QRs	Quantitative Restrictions
RMF	Regional Monetary Fund
RDB	Regional Development Bank
SAARC	South Asian Association for Regional Cooperation
SADC	Southern African Development Community
SDIS	Small Developing Island States
SDRs	Special Drawing Rights
SDS	Small Developing States
SDT	Special and Differential Treatment
SGR	Secretary-General's Report
TCF	Total Capital Flows
TIAF	Trade and Investment Assistance Facility
TNC	Transnational Corporation
TRIPS	Trade-Related Intellectual Property Rights
UNAID	United Nations Agency for International Development
UNCFD	United Nations Conference on Financing for Development
UNCTAD	United Nations Conference on Trade and Development
UN-DFPs	United Nations Development Funds and Programmes
UNDP	United Nations Development Programme
UNEP	United Nations Environment Programme
UNICEF	United Nations Children's Fund
URAs	Uruguay Round Agreements
WTO	World Trade Organisation
ZPR	Zedillo Panel Report

Executive Summary

This report,[1] commissioned by the Commonwealth Secretariat, covers the six major substantive areas that comprise the core of the International UN Conference on Financing for Development (UNCFD) to be held in Monterrey, Mexico in March 2002. Using as its lodestones the findings of the High Level Panel chaired by former President Zedillo of Mexico (the Zedillo Panel Report or ZPR) and of the UN Secretary General (the Secretary General's Report or SGR), the report raises conceptual and practical issues involved in each of these areas and emerges with its own views. Based on reasoning elaborated at length, and comparing the conclusions it reaches vis-à-vis those of ZPR and SGR, the report makes a variety of observations, suggestions and recommendations for consideration by the Secretariat and by Commonwealth governments to help them refine and determine the positions they take at the conference. The report strives to provide the intellectual and practical underpinnings for the Secretariat's inputs into the preparatory process and for interventions by the Commonwealth Secretary-General at the Conference.

The six areas that constitute the substantive 'financing for development' (FfD) agenda are:

1. Domestic Resource Mobilisation;
2. Trade Earnings;
3. Private Capital Flows;
4. Official Flows and Official Development Assistance;
5. External Debt;
6. Systemic Issues concerning the architecture and functioning of the overall global institutional system (multilateral and bilateral) that influences financing for development, both official and private.

Beginning with two introductory chapters that provide the background and rationale for UNCFD, and underline its objectives and its importance as an overdue event in reviving a suspended dialogue on development finance, the following six chapters of the report deal with each of the areas outlined. The ninth chapter draws together the recommendations made in the report. This summary highlights the principal recommendations made in the six core areas, focusing on those that go beyond those of ZPR and SGR.

Domestic Resource Mobilisation

Going beyond the observations of ZPR and SGR, this report recommends that (with the exception of East Asia which has achieved high levels of growth) developing countries in other regions need to grow at 7–8 per cent annually if they are to have any prospect of reversing the divergence between their per capita incomes and those of developed countries. To achieve these growth rates they must increase gross domestic investment levels to 30–33 per cent of GDP and gross domestic savings to 28–30 per cent of GDP. East Asia has already accomplished that. But other developing countries lag

1 The report is based on foundations laid in preliminary work done by the author for the South Centre. That involved outlining a strategy for developing countries to pursue at UNCFD. The author is grateful to the South Centre and its Acting Executive Director, Branislav Gosovic, for agreement to make use of this preliminary work and build upon it in this report. In its comments on the UN's development funds and programmes the report incorporates the findings of work done by the author for the Swedish Ministry of Finance. The earlier work referred to, in these two contexts, includes: *The United Nations Conference on Financing for Development (UNCFD): A Strategic Opportunity for the South* (Preliminary Draft of a Discussion Note (mimeo), South Centre, Geneva March 2001); and *Mobilising Support and Resources for the UN Funds and Programmes*, Ministry for Foreign Affairs, Government of Sweden, Stockholm, 2000. The latter report (prepared jointly by Oxford International and COWI of Denmark) was part of a series of studies carried out as part of the Development Financing 2000 Project. Other studies in the series include papers on Financing Multilateral Development Banks and on Global Public Goods.

far behind, with average Gross Domestic Savings (GDS) of under 20 per cent of GDP and with Africa's average GDS being less than 17 per cent of GDP. Developing countries need to increase GDS by at least 1 per cent of GNP per annum between now and 2015.

That can only be done by: (a) enhancing voluntary financial savings through changes in domestic financial institutional systems, financial markets and tax regimes; and (b) reducing public sector dissaving through measures aimed at:

- Reducing wasteful public expenditure;
- Balancing recurrent revenue and expenditure by 2015;
- Progressively reducing fiscal support for public sector enterprises (PSEs) to zero by 2010;
- Increasing contributions of PSEs to fiscal revenues by 3 per cent per annum in real terms;
- Reducing equity exposure in PSEs to zero by 2015;
- Withdrawing completely from the ownership of banks and other financial institutions by 2015;
- Accelerating the development of their national and regional capital markets (with the help of International Financial Institutions (IFIs) and Multilateral Development Banks (MDBs).

Enhancing Earnings from Trade

Agreeing with ZPR and SGR on the importance of launching a new trade round (achieved at Doha in November 2001) this report stresses the equal importance of the full implementation by developed countries of the commitments they made in the Uruguay Round to liberalise and open their agricultural and textile markets. It stresses the importance of:

- Revisiting the Trade Related Intellectual Property Rights (TRIPS) agreement and General Agreement on Trade in Services (GATS) to remove anomalies that inhibit development;
- Assessing the net benefits that have been derived by different groups of developing countries from the Uruguay Round;
- Assisting low-income developing countries and small developing (and island) states to cover the significant incremental administrative costs they have had to incur in coping with the implementation of Uruguay Round Agreements (URAs);
- Accommodating interim regional trade and investment arrangements in developing regions under the emerging WTO regime;
- Averting back-door protectionism by developed countries through attempts at one-sided imposition of inappropriate environmental and labour standards on developing countries, multilateral investment rules and competition policies, and through insistence on opening up government procurement hastily in a way that damages the interests of firms in developing countries without providing them with an adequate transition period to adapt.

The report finds there is a powerful case, given its unique comparative advantage, for having the Commonwealth Secretariat play a special role in providing technical assistance and administrative support on trade matters to all SDS and SDIS. It should do so through a substantially enlarged trade assistance programme funded by the international community.

Private Capital Flows

Going beyond the general prescriptions offered by ZPR and SGR that require developing countries to continue opening and liberalising their investment regimes and creating environments conducive to foreign investment, this report recommends enhancing Private Capital Flows (PCF) and widening their distribution across

the developing world by: (a) accelerating privatisation especially in Africa and South Asia to attract foreign investment and capital inflows; (b) reducing – and eventually eliminating – government ownership of banks and financial institutions; (c) having OECD countries provide tax breaks at source on a sliding scale (favouring low-income and least developed countries most and advanced middle-income countries least) to their private investors who are investing in developing countries; and (d) reorienting the operations and activities of the MDBs, and in particular the World Bank, to support PCF.

MDBs can enhance PCF flows to a wider range of developing countries by providing:

- More support for capital market development through increased financial sector operations;
- A wider range of guarantees to cover risks other than political/country risk and policy risk;
- More support for PCF to the least developed countries and SDS/SDIS;
- Structured derivative instruments that help to mitigate or hedge risks for private investors as well as for central banks and treasuries of countries aiming to attract portfolio investment on a large scale;
- Comfort to foreign private operators (especially of infrastructure and utility services) through appropriately structured partnerships and capital structures for privatisation and for new projects that enable such operators to enter developing countries they might otherwise avoid if they had to take immediate equity risk;
- Guarantees for sovereign and sub-sovereign bond issues on international and regional bond markets.

MDBs could further support PCF by issuing their own bonds in emerging capital markets; improving their crisis management programmes and practices; and encouraging official debt-equity swaps in HIPCs. The report recommends restructuring and rationalising the World Bank's role so that it focuses almost exclusively on enhancing PCF to the developing world, while leaving it to the regional banks to take over its more traditional retail lending and development financing roles.

Official Flows and Development Assistance

Eschewing traditional genuflection to increased official development assistance (ODA) without any forethought, the report asks whether ODA has worked over the last 50 years and whether increasing ODA would necessarily result in faster or better development. It finds several perverse incentives operating in determining the provision and use of ODA that militate against development impact. Less than 80 per cent of ODA recorded by donors actually flows to recipient countries. Less than 35 per cent of ODA finances development investment. A rising proportion of ODA is being absorbed by administrative costs. And ODA is being diverted from development to other purposes regarded as more pressing by donors and NGOs. The report argues that suggestions for ODA to finance global public goods (GPG) would further complicate the picture and compromise development outcomes.

Against this background the 0.7 per cent ODA/GNP target has lost credibility and should be revised to a total capital flow (TCF/GNP) target of 2 per cent in which ODA represents at least 0.5 per cent; the grant element threshold should be raised from the present 25 per cent to at least 50 per cent. Tax breaks provided by donor countries to encourage PCF should be counted as a contribution to ODA (although the technical complexities involved would need to be ironed out to achieve equivalence). The report argues against suggestions made by ZPR and SGR for the establishment of an International Tax

Organisation (ITO) and the imposition of either the 'Tobin Tax' on financial transactions or a Global Carbon Tax, believing that these suggestions are unhelpful and premature. They would detract from raising additional resources for FfD and could result in diverting a portion of the existing public revenues of developing countries.

Instead, the report strongly supports augmenting ODA through annual emissions of SDRs by the IMF (aimed at matching increased need for global liquidity caused by economic expansion and expanding trade and cross-border investment) with the part of these SDR emissions accruing to OECD countries being voluntarily surrendered, and with interest on them being waived, thus enabling the SDRs to augment ODA through a revived SDR-Aid Link.

External Debt

Reviewing the experience of debt crisis management by the IFIs the report concludes that their performance over the last two decades leaves much to be desired. It reaches the same conclusion in respect of the successive HIPC debt relief initiatives of 1996 and 1999. Going beyond the hesitant suggestions of ZPR and SGR, the report finds that the principal stumbling block to extended debt relief for HIPCs lies in the reluctance of IFIs to accept the crucial necessity of writing-down their own claims (on both hard and soft window debt) on HIPCs on their balance sheets. The arguments put forward by the IFIs against this outcome are disingenuous and should not be accepted by the international community. Worse, their line of reasoning transfers undue pressure on donor aid budgets to finance HIPC debt relief and creates a moral hazard problem in exempting the management and staff of preferred creditor institutions from exercising prudence and incurring the costs of repeated false expectations, misjudgements and errors in adjustment programme design and implementation. Instead it permits IFIs to use their preferred creditor status as a cloak which covers their operating and management defaults. Contrary to assertions by the IFIs, such write-downs are manageable and affordable in the case of all IFIs other than the African Development Bank (AfDB).

This report recommends, therefore, that the international community requires at UNCFD that IFIs write down their claims on HIPCs and improve the terms of such relief over a shorter time period than is presently the case by front-loading, rather than back-loading, the trigger point for relief. It also recommends that swift action should be taken in applying similar measures to the debt burdens of developing countries that are not HIPCs but nevertheless have unsustainable debt repayments.

In addition, the report finds that making IFIs the ultimate arbiters of debt relief for HIPCs, or any other countries whose creditors they are, defies the rule of law. In deciding the quantum, terms and timing of debt relief the IFIs cannot play the roles of prosecution, judge and jury in relation to developing countries that cannot mount a credible defence of their case in a forum where they might get a fair hearing. There have been anomalous instances of some countries getting greater and quicker debt relief for reasons of political expediency than countries which had a stronger case for relief on economic grounds.

Applying the rule of law (and basing it on what happens in developed countries when debts of individual, corporate and public entities are reduced and reorganised) would require debt relief to be arbitrated by an Independent Commission on Developing Country Debt Restructuring. Such a body would need to include representatives of creditors (including the IFIs), competent and qualified senior financial statesmen from developing countries with experience of managing an economy under the pressure of unsustainable debt burdens, and independent financial and economic experts of proven merit and global standing. This report

argues that a major test of international credibility would be failed at UNCFD if agreement was not reached on:

- Establishing such a Commission;
- Creating within a year of the Conference – i.e. by March 2003 – an International Convention on Debt Relief for Developing Countries based on the principles and regulations exemplified in Chapters 9 to 11 of the US Bankruptcy Code.

In addition to these recommendations the report suggests that in restoring to sustainability the debt burdens of HIPCs and other developing countries whose prospects are compromised by debt overhangs, an aggressive programme of official debt-equity swaps involving multilateral and bilateral investment corporations should be launched to facilitate rapid privatisation. Furthermore, 'extendable mortgage' concepts and principles should be applied to levelling off debt service burdens and hard window borrowing and lending for social investment should be avoided.

Systemic Issues

On systemic issues this report agrees with bolstering the capacity of the WTO to cope with the substantially increased need for services to developing countries as the organisation attempts to complete its transformation from GATT (which was a rich countries' club) to a more genuinely multilateral trade organisation. In a similar vein, the report argues that there is a need to enhance the International Labour Organisation's capacity to deal with the issue of labour standards but suggests caution and further study before endorsing any attempt to fold all the existing international environmental organisations into a single Global Environmental Organisation (GEO). These are, however, side issues in terms of their systemic importance.

The core 'global systemic issue' in relation to financing for development concerns the roles that the IFIs – and particularly the two BWIs – play vis-à-vis each other, vis-à-vis other IFIs (principally the regional development banks), and vis-à-vis the UN's fragmented and disparate set of institutions and specialised agencies that claim to play significant roles in assisting development and financing its soft side. On this core issue, the report finds ZPR and SGR to be muted in making needed recommendations for the institutional architecture and system for financing development to be made more coherent, efficient, effective, as well as better co-ordinated and less dysfunctional. In addressing that deficiency, this report makes several recommendations in on how the roles of the IMF and World Bank should be reoriented, rationalised, and better focused in order to avoid the problem of 'mission creep' that has led to these institutions (especially the World Bank), becoming too all-embracing, unfocused, virtually unmanageable and immune to sensible external governance.

It would be redundant to summarise all these recommendations here. In essence they advocate:

- Focusing the IMF's role so that it concentrates on proactive macroeconomic surveillance and monitoring of the world's economies with a view to developing a more reliable early warning system for financial crises occurring and spilling over into regional or global contagion. The Fund should have the capacity to avert, contain and manage such crises more effectively through a wider array of prophylactic instruments and facilities;
- Reducing and rationalising the World Bank's role (as well as its budget and staff) so that it becomes a leaner, apex wholesale financing institution responsible for
  - providing guarantees (instead of making loans) to help developing countries become more creditworthy and 'marketworthy' (i.e. more attractive to private direct and portfolio investors domestically and globally);

- increasing the access of developing countries (and of their sub-sovereign entities) to regional and global capital markets for equity and debt;
- enhancing PCF to all developing countries, both directly and indirectly;
- strengthening the capacity, functioning and regulation of their financial systems; and accelerating processes of privatisation in all developing regions where it is lagging or faltering (particularly in South Asia and Africa);

◆ Leaving the wider gamut of retail development financing functions across different sectors to the RDBs, whose capacity has improved substantially and whose operating model should move away from attempting to become second-rate clones of the World Bank and instead become more like the European Investment Bank (EIB) in terms of regional presence, funding, governance, operating style and regional independence. To ensure that the MDBs operate as parts of a single coherent system for financing development investment, this report suggests cross-shareholdings by the World Bank in the RDBs through a swap of developed countries' shareholdings in the RDBs.

On other, more peripheral, systemic issues the Report concludes that:

◆ The notion of harmful tax competition is oxymoronic because it disregards the very different public finance aims, objectives and circumstances of developed vs. developing countries which require a measure of tax competition so that developing countries can attract the domestic and external savings they need to raise and improve the quality of their investment and growth;

◆ The arguments made by ZPR and SGR for establishing an ITO are premature and unconvincing;

◆ There is likely to be no significant value-addition in creating an Economic Security Council; instead there should be a focus on improving systemic institutional co-ordination at governance, management and operating levels between and across the IFIs, the UN system and the WTO.

The report argues for restoring the primacy of the UN's role in influencing the development agenda and reversing the process by which that role has been usurped by the BWIs since the debt crises of the 1980s. This is unlikely to occur if the UN's plethora of development agencies, funds and programmes remain disparate and fragmented instead of coalescing under a streamlined UN Agency for International Development. Such a step would enable scarce core resources to be released from useless expenditures on duplicating internal administration in each agency; instead they could be deployed to increase the volume and improve the quality of soft development assistance services for developing countries. Coupled with such a measure, the report believes that the international system should rely more on institutions like the Commonwealth Secretariat that have a unique comparative advantage in playing a far more cost-effective and efficient technical assistance service delivery role in SDS and SDIS than either the UN or the IFIs.

The report expresses concern about the real development agenda and priorities of developing countries being twisted out of shape by different and ever changing multilateral and bilateral donor preferences (as well as continual ad hoc interference) in the management of the development process at country level. It believes that for genuine 'ownership' of development effort by developing countries themselves, donors should move toward accepting the annual budget document (within a three or five year rolling framework) as the core of any government's development policy, as is the case in every developed country. They should not

require extraneous documents, such as poverty reduction strategy papers and country assistance strategy frameworks, which detract from, rather than contribute to, the capacity of developing country governments to articulate and pursue their own paths which donors can, of course, choose whether or not to support.

Finally, the report proposes that UNCFD should provide an appropriate occasion for the international community to adopt and embrace a new rationale for official government-to-government resource transfers. That involves abandoning a tired, dysfunctional and unworkable 'aid' or 'development assistance' paradigm that has characterised government-to-government resource transfers over the second half of the twentieth century. That rationale has failed, by and large, to accomplish what it was supposed to over the last 50 years.

The report suggests adopting instead a rationale that is more suited and relevant to development based largely on deploying market-based globalisation as its driving force. In keeping with that shift, the proper underlying basis for government-to-government official transfers should be 'compensatory offsets for restriction of, or denial to, market access', involving all markets for goods, services and factors, especially labour. Such a rationale makes far more sense in the twenty-first century than a concept based on misguided neocolonial notions of official altruism that more often than not have degenerated into the exercise of overt and covert political influence through 'financing for development'.

1

Introduction and Background

In preparing for the UN Conference on Financing for Development to be held in Monterrey, Nuevo Leon, Mexico, March 18–22, 2002 it may be opportune for officials and ministers from Commonwealth countries to recall its history. Developing countries have pressed to have such a conference for over two decades. Members of the Development Assistance Committee (DAC) of the OECD – i.e. the major providers (or donors) of official development assistance – have been sceptical about what it would achieve other than: (a) highlighting failure to meet the ODA/GNP target of 0.7 per cent; and (b) creating pressure for new targets aimed at increasing ODA and other capital flows that finance development.

In 1997 the donor group finally relented. But its continued reluctance to engage in a meaningful exchange was reflected in its view that such a meeting should not be a fully-fledged *conference* but a 'high-level international intergovernmental *event*'. That issue was finally resolved in November 2000 (after years of negotiations) in favour of a conference, with agreement on the venue being reached only in early 2001. Differences of view about UNCFD were not confined to its status. They were replayed in determining its agenda and content. Donors insisted that the Bretton Woods Institutions should be given a major say in laying the groundwork for the conference. It is unnecessary to go into a detailed account of the preparatory process and of successive Preparatory Committee (Prepcom) meetings and draft reports. Suffice it to say that the agenda for the Conference now embraces six key areas of discussion affecting 'financing for development':

- Mobilising ***domestic resources***;
- Enhancing earnings from ***trade***;
- Mobilising ***external private resources***, in particular
  - Private commercial capital flows, including
    Foreign Direct Investment (FDI)
    Foreign Portfolio Equity Investment
    Commercial bank lending
    Bond-market flows (or foreign portfolio debt investment)
  - Private Voluntary Flows (i.e. from private voluntary and non-governmental organisations);
- Increasing international financial co-operation for development, which is code for increasing ***Official Development Assistance*** or aid;
- Managing ***external debt*** to facilitate rather than inhibit development;
- Addressing ***systemic issues***, i.e. enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development (or, in other words, making the international financial architecture work).

Starting with a brief section setting out the context of UNCFD and underlining its potential value and importance, the following six sections of this paper deal with each of the agenda items identified above, in the order in which they have been listed. In dealing with each topic the paper refers to other official reports that have been prepared for the conference in setting the stage for its analysis and discussion.

2

The Importance and Potential Value of UNCFD

Its inauspicious genesis notwithstanding, UNCFD provides an overdue occasion for the international community, and for the Commonwealth as an influential part of it, to revisit the conceptual and practical foundations that have supported financing for development between 1950–2000. It provides an occasion to renew and reinforce these foundations to meet the different needs created by the pressures and promise of globalisation in the twenty-first century. It presents an opportunity that the global community cannot afford to miss.

Differences between developed and developing countries (and their concerns about the other's motives and objectives) notwithstanding, UNCFD provides an occasion for common understandings to be reached through persuasive diplomacy in the months ahead. Such understandings should aim at creating and bolstering more relevant foundations for financing development over the next 20–25 years. With the Commonwealth accounting for nearly a third of all developing countries, and half the population of the developing world, its key policy makers (in particular its Ministers of Finance and Development Co-operation) have a crucial role to play in influencing the deliberations that take place prior to and at UNCFD, as well as its eventual outcomes.

As preparations are made for UNCFD, officials of all governments should recall that the present development assistance framework (DAF) was originally shaped in the 1950s and 1960s. It is becoming dysfunctional in the twenty-first century and is assailed by controversies over: (a) the continued validity of the original raison d'être underlying the case for aid; (b) the effectiveness of government-to-government aid transfers; (c) the continued relevance of earlier conceptual constructs on which the DAF was built; (d) its elaborate and unwieldy multilateral and bilateral institutional architecture, with functions and mandates being duplicated, unhealthy institutional competition and lack of co-ordination; and (e) the impact (particularly on the poor) of the strategies, policies, conditionalities and agendas applied in the dispensation of aid – multilaterally and bilaterally.

These concerns have not been confined to academe or the media. They have been discussed frequently in official forums within and outside the UN system. For example, failure to meet the ODA/GNP target of 0.7 per cent – except by the Nordic countries and the Netherlands – has evoked consternation ever since the target was proposed by the Pearson Commission in 1969.[2] Yet attention has continually been drawn to aid performance relative to that target since the 1970s. Even so, ODA has kept falling: from a peak of 0.41 per cent of donor GNP in 1980 to 0.33 per cent in 1992 and 0.24 per cent in 1999. The stagnation of ODA flows in *nominal* dollars through the 1990s, reflecting a large *relative* and *real* decline, has been highlighted annually in the reports of the OECD's

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2 Some donors, for example the USA, have never agreed to this target, although others, such as Germany, Japan and the UK, indicated officially during the 1970s that they would attempt to meet it. Those commitments, however, appear to have fallen by the wayside. Smaller, new donors, however, such as Ireland, have adopted the 0.7 per cent target as a goal to be reached within a few years as part of official aid policy.

Development Assistance Committee, several UN development funds and programmes, and of the multilateral development banks. But indignant repetition has not brought about significant improvement in the average ODA/GNP ratio.

Meanwhile a sea change has occurred in the importance of private capital flows since 1990. These have multiplied, reducing official flows to insignificance, except in the poorest developing countries that have limited appeal to foreign direct investors (other than for mineral extraction) and no appeal to portfolio capital. The relative concentration of, and limited access to, flows of foreign direct investment pose challenging questions for the international community (official and private) and, in particular, for the governments of FDI source and destination countries. Table 1 shows how much the pattern of resource flows to developing countries has changed.

Equally, the volatility and short-term nature of foreign portfolio investment in emerging markets, leading to complexity in the management of their capital accounts, has been a perennial concern since 1990, generating research (and burgeoning literature) in academic and official circles.

Concerns about poor developing countries continuing to mortgage their future with high-cost debt-creating flows, while debt reduction is not taking place at the rate anticipated in the poorest and most debt-disabled of them, have been vexing and prominent in public debate. And, with the advent of a more open trading regime under the aegis of the WTO in the early 1990s, there has been a shift of emphasis, in donor and developing countries alike, to expanded earnings from trade which, it is argued, are preferable to transfers of aid. Cross-cutting these developments have been systemic concerns about the imperfect (and, from the viewpoint of developing countries, unsatisfactory) functioning of the international financial institutions in recent decades. These have resulted in repeated calls for revising the architecture of the official international financial system. That is becoming urgent with reverse gross flows from developing to industrial coun-

Table 1. Net Resource Flows and Net Transfers to All Developing Countries 1970–2000
(Amounts in US$ billion)

	1970	1980	1991	1995	1996	1997	1998	1999	2000
Total Net Resource Flows	**11.3**	**82.8**	**119.7**	**231.7**	**274.3**	**334.6**	**327.9**	**250.7**	**280.9**
of which									
Official	5.6	34.9	60.9	55.1	31.9	42.8	54.6	45.3	47.1
Private	5.7	47.9	58.8	176.6	242.4	291.8	273.3	205.4	233.8
Interest payments	−4.1	−48.9	−72.3	−98.6	−104.5	−109.1	−122.6	−135.3	−153.1
Remittances on FDI	−6.5	−23.7	−18.3	−26.5	−30.4	−31.4	−35.2	−41.6	−48.5
Net Transfers	**0.7**	**10.2**	**29.1**	**106.6**	**139.4**	**194.1**	**170.1**	**73.8**	**79.3**
Official	4.7	28.8	41.1	22.8	1.2	10.3	19.2	−10.2	−24.0
Private	−4.0	−18.6	−12.0	83.8	138.2	183.8	150.9	84.0	103.3

Source: Global Development Finance (GDF) 2001. World Bank, Washington DC
Note: The numbers appear different from Table 2.2 in GDF-2001 because of an error that appears to have been made on net and gross equity flows in Tables 2.2 and 2.6 of that report. The net equity flows reported in Table 2.2 are actually gross flows, while the gross equity flows in Table 2.6 are net flows. All the tables in this report have been corrected for this error.

tries now approaching $400 billion annually. Although global attention is invariably focused on *net resource flows*, what is important to developing countries is the *net transfer* of finance that takes place (i.e. after interest has been paid and profits and dividends have been repatriated). The net transfer is much less impressive than the resource flow numbers suggest.

Clearly, if developing countries are to have access to official and private capital, they need to pay interest and dividends, and permit profit repatriation. But while they are still developing, it is important that the resource flows (i.e. on the capital account) are of a magnitude that compensate for the reverse flows that have to take place. As Table 1 shows, thanks mainly to private capital, the average level of net transfers increased from around $15 billion in the 1980s, to about $80 billion between 1990–94, increasing sharply to an average of $150 billion between 1995–98 before falling back sharply to an average of $75 billion in 1999–2000. Most disconcertingly, net transfers on the official account have fallen particularly sharply from their peak in 1991 to negative levels at the close of the decade.

2.1. An Eroding Public Mandate for Aid?

In the context of these concerns, an overarching problem has been the gradual but discernible erosion in global public support for increasing aid. Such support has weakened with time and a mixed record of development performance. The general public in industrial countries has grown weary of media exposure that shows the developing world continuing to exhibit an undiminished propensity for conflict, continued vulnerability to natural disasters and exogenous influences, and serious shortcomings of governance (whether public, regulatory or private/corporate). The impression has taken hold, rightly or wrongly, that despite substantial aid flows to many developing countries (for example in Africa) development gains remain elusive. Countries that receive the most aid per capita appear to be stagnating and becoming more aid-dependent. In contrast, in countries where development is occurring (for example in East Asia and, more recently, India), improved performance is attributed not to aid (which has diminished in these countries, in both relative as well as absolute terms) but to domestic economic reform, increased domestic saving, liberalisation of global trade, expansion of the role of the private sector and reduction of the public sector.

A related phenomenon has been a preference for voluntary giving through NGOs rather than increasing government-to-government transfers funded by increased taxes. In part that has been because of resistance to increasing taxation in OECD countries and to calls for tax revenues to be spent on improving public services within these countries. In greater part, it is due to growing perceptions that government-to-government transfers are, by their very nature (because of the perverse incentives created at each end), subject to misapplication and leakage. Aid is now widely perceived as contributing less to genuine development than financial flows of other kinds. Arguments that, despite its shortcomings, aid is critical for the majority of developing countries (especially the poorest), cut little ice with the public in developed countries. After 50 years of post-war development experience, that argument does more to diminish public support for continued aid than to bolster it.

As the FfD model that applied between 1950–90 has evolved, neither private capital markets (domestic, or international), nor the private voluntary sector (NGOs) – 'civil society' in the new vernacular – were as important as they are now. Their significance since 1990 has contributed to a different FfD structure taking shape over the last decade. Implicitly rather than explicitly a new pattern is emerging *ad hoc*, without sufficient prior involvement on

the part of all the stakeholders concerned, particularly developing countries. That process is being spurred on by impulses beyond the control of sovereign governments, resulting in an element of confusion (and frustration) about what strategic and tactical responses on the part of developing countries would be appropriate to ensure that they do not lose out from the profound changes that are taking place.

Alterations in the FfD paradigm are also being impelled by: (a) transformation of the global trading regime, with the opportunities it is supposed to be creating for increased earnings; and (b) the demise of alternatives to the market-model for sustainable development. These developments are expected to enhance trade-related earnings while reducing reliance on aid, private investment and voluntary flows. Axiomatically, it is anticipated that universal adoption of the market model will make FfD less dependent on official aid, and more reliant on private finance from capital markets. That expectation is naïve. In the short run, it may even be dangerous. But, in the long run, it has a compelling logic. The challenge for UNCFD is to chart a transition from the short-term reality to the long-term goal that enables the world to progress and its disparate standards of living to converge.

The FfD framework that evolved between 1950–90 was influenced by the unattractiveness of *laissez-faire* market doctrines at the time. Drawing on the experience of the former Eastern bloc, and the post-war socialist models emerging in Western Europe, many developing countries rejected the market-model upon achieving independence. They did so partly because it was associated with colonialism, but mainly because other economic models appeared to hold greater promise for achieving rapid development with better distribution of income and wealth. FfD (especially aid) between 1950–90 was also influenced by competition between two opposed doctrines seeking to establish primacy in the developing world, as well as by competition among former colonial powers to retain influence over their former colonies. The result was that too large a proportion of ODA flows were driven by non-developmental motives. Under such circumstances it was remarkable that even a fraction of the aid provided had a productive outcome. In retrospect, that unfortunate feature of the FfD framework of 1950–90 legitimised the subordination of 'development' to other imperatives, particularly those of making recipient countries lean in a particular political direction, or to orient their trade toward particular partners.

The diminution (though not elimination as yet) of counterproductive competition in providing aid since 1990 has introduced new elements in the emerging FfD paradigm for the twenty-first century. One consequence has been to deprive developing countries of a clumsy, blunt bargaining chip. Another has been to reinforce an unfortunately myopic, unhealthy donor/IFI monopoly over development goals, priorities and strategies. Contemporary discussion of the philosophical, economic, political, social (and moral) case for FfD has thus drifted far from the intellectual underpinnings established for it in an earlier era.

Those foundations need to be redesigned and reinforced to cope with globalisation and with the following new developments: (a) multiple FfD channels reflecting the increased importance of markets, civil society and the correspondingly diminished role of governments; (b) a new, different global trading regime emerging under a near-universally accepted market-model for development; (c) newer and different stresses emerging in the global economy with rapid financial globalisation that has heightened capital and current account risks in the balance of payments; and (d) an inexorable process of integration (however imperfect and intermittent) of the world's financial and real

economies, with attendant dislocations and consequences for countries, societies, families and individuals.

2.2. A New Raison d'Etre for FfD?

At the threshold of a new century it would be remiss of the international community if it failed to undertake an overdue review, and construct a more robust framework, to serve the reciprocal needs of the developing and industrialised worlds over the next half-century. Yet, the conceptual case for financing development now is not fundamentally different from what it was before. It is still based on the desirability (from economic, political, social, moral and sustainability viewpoints) of progressing towards *convergence* of living standards across the planet). The case for convergence is compelling because it is illogical, if not unimaginable, to argue that continued *divergence* of living standards across the world is socially or economically desirable and/or politically sustainable, especially with the expectations that globalisation is now generating.

Yet, as Tables 2 and 3 show, incomes and living standards between (and within) industrial and developing countries have been *diverging* rapidly since 1982. That is neither accidental nor inadvertent. Growing *divergence* between the industrial and developing worlds has resulted from inadequate, uneven rates of development, with many setbacks and reversals. That outcome is not simply being tolerated. It is being proactively reinforced through policies and actions that obstruct development and inhibit financing for it.

Divergence is occurring because: (a) develop ing countries have, in the past, pursued economic policies that have exacerbated and accentuated their disadvantages; (b) a dysfunctional FfD paradigm has resulted in heightening the vulnerability of developing countries to financial crises; and (c) developed countries have been protecting their interests, delaying adjustment and retarding market-access in areas

Table 2. Growth Rates of GDP and Population in the Industrial and Developing Worlds[3]

	GDP Growth (%)		Population (mn)		Population Growth (%)	
	1980–89	1990–99	1980	1999	1980–99	2000–2015
High-income Countries	**3.1**	**2.4**	**827**	**891**	**0.7**	**0.3**
Developing Countries	**3.4**	**3.3**	**3602**	**5084**	**1.8**	**1.3**
of which						
Low-income Countries	4.4	2.4	1386	2417	2.3	1.7
Middle-income Countries	3.2	3.5	2217	2667	1.5	0.9
East Asia and Pacific	8.0	7.4	1359	1837	1.5	0.9
South Asia	5.7	5.7	903	1329	2.1	1.4
Europe and Central Asia	2.4	– 2.7	426	475	0.6	0.2
Middle East and North Africa	2.0	3.0	174	291	2.7	1.7
Sub-Saharan Africa	1.7	2.4	381	642	2.8	2.3
Latin America and Caribbean.	1.7	3.4	360	509	1.9	1.3

Source: World Development Indicators 2000. World Bank, Washington DC

3 These figures do not include the GDP or population figures for 72 out of 206 economies. The 72 economies (including some non-reporting counties, for example Cuba and many of the small island countries in the Caribbean, Indian Ocean and Pacific) had a total population of 184 million in 1999 and a total GDP of about US$90 billion.

Table 3. GNP Per Capita and Growth in Private Consumption Per Capita 1980–98

	GNP per capita (current US$)		Per capita GNP (current US$)	PCC Growth (%)
	1980	1998	1998 (PPP)	1980–98
High-income Countries	**9,660**	**25,730**	**21,763**	**2.2**
Developing Countries	**850**	**1,240**	**3,410**	**1.9**
of which				
Low-income Countries	380	410	1,790	1.4
Middle-income Countries	1,140	2,000	4,880	2.2
East Asia and Pacific	330	1,000	3,500	5.6
South Asia	170	440	2,030	2.6
Europe and Central Asia	3,200	2,150	5,580	– 3.0
Middle East and North Africa	2,250	2,060	4,600	– 1.5
Sub-Saharan Africa	710	550	1,450	– 1.2
Latin America and Caribbean	2,170	3,840	6,280	0.6

Source: World Development Indicators (WDI) 2000 and *World Development Report (WDR) 2000/2001.* World Bank, Washington DC

where they are losing competitiveness. Through the 1990s, OECD countries have pursued economic, financial, trade, labour market, knowledge transfer and social policies aimed at enhancing their own competitiveness. They have attempted to maintain standards of living of their populations by resorting to subterranean protectionism and keeping their labour markets closed selectively. The reality of increasing *divergence* resulting from such policies contrasts with the public posture of OECD members on the desirability of *convergence*; a contradiction between intent and action that UNCFD must strive to resolve.

With the demise of the Cold War, two other forces have emerged to bolster the case for a renewed effort to reverse divergence, and restore a trend toward convergence, through accelerated development of the world's poorer countries. The first is the *economic* shift towards near-universal (if still reluctant in some countries) acceptance of a market-model of growth and development. The second is a near-universal *political* shift toward genuinely plural, representative, and democratic models of governance; allowing, of course, for variance in form and institutional characteristics. Such models demand greater transparency, accountability, responsibility and performance on the part of legitimately elected governments than has been the case over most of the previous half-century.

These two forces are interacting to rebalance the relative power and role of government vis-à-vis individuals, civil society and markets (creating room for private players and constructive competition) in the development process. Taking that into account, it is imperative that the international community succeeds, at the threshold of the twenty-first century, in formulating a rationale for FfD that accommodates and encourages these tendencies.

UNCFD provides the first opportunity in over three decades to reconsider the basic precepts and raison d'être for FfD in a globalising world. It permits overdue discussions to take place between the industrial and developing countries in the broader context of the UN instead of the narrower confines of the Bretton Woods Institutions. It elicits participation at the highest political levels, i.e. by heads of government

with wider remits and mandates than finance ministers, aid ministers and central bankers. It presents an opportunity for industrial and developing countries to address a number of concerns that influence the ability of developing countries to mobilise the resources (domestic and external) needed to:

- Finance the core prerequisites for development, i.e. adequate infrastructure for power, communications, transport, water and sewerage, and adequate capacity to cope with the consequences of burgeoning urbanisation;
- Integrate domestic financial systems and capital markets seamlessly into a single global financial system and capital market;
- Integrate their national economies into the emerging global economy non-disruptively, with as few domestic and/or global dislocations as possible;
- Become more socially cohesive and institutionally capable in order to accommodate the centrifugal political pressures of regionalisation and globalisation, on one hand, and the opposing centripetal tendencies of resurgent ethnicity, devolution, decentralisation and localisation on the other;
- Attain national development goals, such as: higher than previously targeted (i.e. 7–8 per cent rather than 4–5 per cent) rates of growth; accelerated poverty reduction to meet IDG-2015 targets; increased employment to meet demographic challenges and avert social catastrophes; increased rates of per capita income growth across all income groups; and increased ratios of domestic investment to GDP to levels (i.e. >30 per cent) that can sustain annual growth rates of 7–8 per cent.

The key question is whether developing countries can realistically achieve these multiple goals while adjusting simultaneously to a process of globalisation of which they have highly imperfect understanding and over which they have no control. The answer will be decisively negative if UNCFD fails to make progress on FfD. If it is to succeed, participants must escape from the past pattern of exchanges between developed and developing countries that has characterised international discourse. UNCFD should aim at worthwhile outcomes by launching a new phase in development co-operation and aligning multilateral discourse in keeping with the changes that are occurring in the tone and tenor of *bilateral* relations between key industrial and developing countries.

In a globalising world, developed and developing countries are bound more by what unites them – in terms of their joint global interests and the need for convergence – than by what divides them. Clearly, *developing* countries have an interest in seeing tangible outcomes materialise from the conference in increasing FfD of all types. *Developed* countries have an interest in the more rapid development of the global economy as a means of stimulating demand, keeping their production engines going and averting the threat of a prolonged global slowdown. Investment in development, along with modest consumption-support for the poorest and the weakest segments of the world community, are pro-cyclical as well as counter-cyclical means of managing global demand. If these traditional tools of demand management are regarded as indispensable in developed countries, it is difficult to see why the same concepts cannot be applied in the same way at the global level.

From that perspective, the interests of the developed and developing countries do not collide; they coincide. Both groups have an interest in ensuring that: (a) policy errors or resource inadequacies do not trigger frequent financial crises in the developing world; and (b) such crises do not threaten, through contagion, regional and global financial markets. They have a joint interest in preventing such crises and containing their impact when they occur.

Both have an interest in changing the rules of the game, along with making attendant changes in the functioning of the international financial system (and in its architecture), to ensure that the costs of adjustment and remedial action do not always fall disproportionately on the poorest people in developing countries. Both have an interest in ensuring that insufficiently rapid development in four-fifths of the world does not trigger potentially explosive social problems in the privileged one-fifth through mass migration. Both have an interest in protecting global commons and the global environment. And both have a common interest in avoiding the cross-border spread of debilitating infectious diseases and preventing mass ignorance from compromising prospects for the future. More positively, both should have an interest in ensuring that the standards of living enjoyed by one-fifth of the world are gradually spread (through sustained differential growth rates that eventually converge rather than through ham-handed redistribution) to the remaining four-fifths in order to avoid conflict and to increase, rather than diminish, global welfare.

At UNCFD, governments of industrial countries will underline the real-world restraints that prevent them from committing to measures requiring larger budgetary efforts for financing development. Their preference will be for achieving desirable FfD outcomes with less public money. Developing countries, on the other hand, and the 'aid industry' that intermediates public funds to them, will want the opposite outcome. UNCFD will need to reconcile these conflicting interests and strike a balance that both sides can accept.

Many specific facets of FfD are better tackled in forums such as the WTO (for example trade), the IMF (contingent financing), the World Bank (infrastructure) or the regional development banks. Of course, UNCFD must underline the inter-relationships across these different components for the sake of coherence, recognising that failure in one compartment will have knock-on effects in others. But in doing so, a balance will need to be struck by industrial and developing countries alike in respecting institutional mandates and boundaries for settling specifics. UNCFD cannot be used by *developing countries* as a platform to pass resolutions on how the WTO, IMF, World Bank or regional banks should function. Nor should *industrial countries* undermine UNCFD by insisting that key FfD issues can be settled only in the governing councils of the IFIs they control. Such attempts would be equally counterproductive. Both should be eschewed up-front.

For the same reason, all countries (developed and developing) need to temper their expectations with realism. Clearly, both camps will press for their respective preferences to be accommodated in full. But there are limits to how far certain issues can be taken in an international conference without running the risk of reversal. While pushing the edge of the FfD envelope as far as it can go to achieve a mutually acceptable outcome, what needs to be avoided is a stalemate of irreconcilable differences. Industrial countries need to eschew the temptation to pre-emptively head off demands for more FfD by repeating tired nostrums about good governance, capacity-building, institution-building, financial-sector and market liberalisation, privatisation, increased domestic resource mobilisation and greater efforts to attract foreign capital. The presumption that developing countries are not sufficiently interested in these measures, and need to be continuously reminded of them through pious, patronising preaching (to the converted), is erroneous.

It is undeniable that developing countries should be making more rapid progress in these areas than they are. But the reason progress has been insufficient is not a lack of interest or political will, but the paucity of knowledge and capacity and the fact that the essential 'initial

conditions' have not been in place to make sufficiently rapid progress on all these fronts simultaneously. The other obstacle lies in the need to achieve the domestic social and political consensus necessary for change in all these desirable directions in tandem, and for it to be sustained and embedded.

2.2.14. By the same token, developing countries must acknowledge that their record leaves much to be desired when it comes to core issues that affect development and FfD adversely: i.e. governance, corruption, inefficiency, lack of transparency and accountability, the subversion and manipulation of democracy and judicial processes, the running down of standards of public and political behaviour and of public institutions, and changing the established culture of public officials seeking office to pursue private agendas. They need to acknowledge responsibility for their problems rather than use UNCFD as a pulpit for blaming their situation on their colonial past, the unfairness of others, the fundamental injustice of embedded power asymmetries in the functioning of the global system and the perennial unfavourability of external circumstances. After 50 years of development experience with far too many failures, these litanies have worn thin.

Since the 1980s considerable knowledge has been gained about: (a) the development process; (b) its vulnerability to external shocks, even in robust middle-income countries; (c) the nature and causes of recurring financial crises; and (d) the implications and consequences of their mismanagement. But the more we learn, the less we seem to know or be sure of. Every answer begs a more complex series of questions.

Even so, it is clear that what has been learnt over the last two decades suggests that present arrangements for FfD – and especially *external* FfD – do not support the goals of either: (a) achieving convergence of incomes and living standards over a sustained period of 50–100 years; or (b) meeting the ambitious IDG-2015 targets in developing countries. That alone is a good reason for holding UNCFD and making it a success.

Hopefully UNCFD will not be simply a one-off event but will signal a new beginning in a continuing dialogue aimed at improving the speed and quality of development around the world. That is vital for greater global stability and security. UNCFD should catalyse resumption of an ongoing, productive dialogue between developed and developing worlds that has been interrupted for two decades. Such an exchange should not be framed in the context of a 'zero-sum game' (i.e. one side's gains automatically resulting in losses for the other side) but of a positive sum game (where both sides win) in a globalising world.

The Commonwealth, in many ways a smaller version of the UN, provides an ideal forum in which new ideas can be tested and discussed between its developed and developing country members dispassionately and constructively. It is a unique club which, if it chooses, can help to facilitate discussions at UNCFD by using the influence that its members have over their own respective camps. In order to do this, Commonwealth member countries need to discuss and come to some form of agreement among themselves on the key substantive issues that UNCFD will address. It is to these issues that this paper turns in the sections that follow.

The six agenda items for UNCFD outlined in the first section of this paper are discussed in the UN Secretary-General's Report (SGR) on UNCFD (January 2001); the successive reports of the Preparatory Committee for the Conference (Prepcom); and the Report of the Panel of Experts appointed by the UN Secretary-General and chaired by former President Zedillo of Mexico. The last is referred to throughout this paper as the Zedillo Panel Report (ZPR). In approaching its task, this paper introduces these six items with a brief reprise of how ZPR treats each and of ZPR's

emphasis and recommendations. The paper then goes on to develop its own analysis and views in each of the six areas.[4]

The main reason for not using the SGR as a compass for this paper is that its commentary on the six agenda items is insufficiently substantive. Essentially, SGR comprises a long list of suggestions linked by nostrums on which broad agreement already exists, and to which little value can be added at UNCFD. They dwell, unsurprisingly, on the need for *developing* country governments to pursue sound macroeconomic policies in a medium-term framework, strengthen institutions, build administrative capacity, ensure good governance, and achieve more efficiency, greater effectiveness, transparency, accountability and responsibility in anything that has a bearing on development. All of that is, of course, true and unarguable. But none of it is useful in moving the argument forward.

Of the 87 recommendations contained in the SGR, 75 are exhortations to the obvious. The remaining 12 contain kernels of substance whose value is diluted by the proposals in which they are wrapped. Most of these call for setting up international forums for discussions, replete with panels of experts, and studies focused on exploring ideas that are in some instances fanciful, in others dubious and in some cases discredited. It is clear from its substance, and the way in which it has been written, that ZPR has used SGR as the basis for extruding its own analysis and recommendations. Unsurprisingly, it discounts or ignores most of what SGR has to say; focusing selectively on a few of the key points that SGR makes that are not all-encompassing generalities.

4 This paper uses ZPR as its lodestone because that Panel was appointed by the Secretary-General to draw the sting from criticisms by developing countries that SGR was compromised. The involvement of the Bretton Woods Institutions in the preparatory process resulted in vetoes on analysis and recommendations that did not accord with their own views and preferences. ZPR supposedly, therefore, embodies a view from the developing world that SGR dilutes, thus diminishing the latter's value as a point of reference.

3

Mobilising Domestic Financial Resources for Development

From its agenda, it is apparent that as much attention will be focused at UNCFD on: (a) what governments of developing countries need to do to increase domestic resource mobilisation (for financing their own development) as on (b) what governments of developed (donor) countries might do to provide greater amounts of external and particularly official concessional financing (ODA) from their budgets. If more rapid development and growth is to occur, it is unarguable that the bulk of the additional resources required will need to be generated locally in developing countries themselves.

3.1 Findings and Recommendations of the Zedillo Panel Report

In dealing with this issue, the Zedillo Panel Report articulates many obvious, uncontestable views on the importance of domestic resource mobilisation in financing development and the responsibility that developing country governments have in maximising the availability of such resources. It highlights the importance of:

- Good governance, property rights and the rule of law;
- Sound domestic macroeconomic policies consistent with sustained growth;
- Fiscal discipline, tax reform and sufficient revenue to finance an acceptable level of social public expenditure sufficient to meet IDG-2015 targets;
- Institutional infrastructure and appropriate standards (for labour safety, the environment, etc.), for regulating and supporting productive market behaviour, rather than encouraging market failure;
- A financial system that intermediates domestic resources efficiently and effectively.

In contrast to ZPR's selective approach, SGR makes 23 broad suggestions in this area, some of which focus on enhancing tax revenues through revision and greater progressiveness of tax systems, coupled with more aggressive collection efforts. If followed, some of these suggestions risk reversing the progress that has been made over the last two decades because they would slow down growth and discourage greater private sector participation. Of the ideas expressed by SGR, the only specific recommendation that ZPR takes up to enhance domestic savings is compulsory provision of pensions through a two-part scheme:

(a) A fully-vested, defined contribution scheme – requiring compulsory contributions by all individuals – that could be state-run, or privately run and regulated by the state, with mandatory individual contributions as a proportion of income; together with

(b) A tax-financed scheme with a progressive redistributional impact to ensure a minimum pension for all.

ZPR qualifies its recommendation with the caveat that the importance of each element (i.e. contributions v. tax) is likely to vary by country, depending on the solvency of the extant pension system and the weight a society places on social cohesion.

In dealing with the complexities of mobilising

domestic resources and maximising domestic savings for financing development, SGR's and ZPR's analyses (and their recommendations) are inadequate. A pension scheme of the type proposed might make sense for many middle-income developing countries in enhancing the contribution of involuntary savings to resources available for development investment. But it ignores fiscal and financial realities in low-income countries with large populations, unpropitious demographics, and very large rates of open unemployment and underemployment. With such a recommendation, the devil lies in the detail that applies at the country level. It is not amenable to sweeping generalisation of the type resorted to.

Regrettably, ZPR is silent on domestic resource mobilisation potential that could be realised by reducing and reversing the current misallocation of public resources in most developing countries. These include, *inter alia*, wasteful expenditures on defence and internal security; an unaffordable 'overhead cost' of government in most countries with too many ministries, too many unproductive (or counterproductive) public employees and indulgence in frivolous expenditure on ministerial travel and bloated security entourages; producer and consumer subsidies that do not target the poorest; insufficiently prioritised capital investment; pork-barrel politics, etc. It is surprising that ZPR does not estimate the potential (globally and regionally) for releasing a significant incremental proportion of GDP (varying roughly between 8–15 per cent across the developing world) for essential social expenditures in most developing countries, if existing levels of public dissaving could be curtailed with public expenditures rationalised and re-prioritised to targeted social needs and meeting the International Development Goals for 2015 (IDG-2015).

Nor does ZPR deal adequately with the several extant impediments to galvanising private savings in developing countries; not least the fact that individuals and corporations are unlikely to increase financial savings in currencies that cannot be relied on to maintain their value with the storage of wealth. Both these weaknesses mean that ZPR's analysis and recommendations must be treated with caution. To attempt to redress these weaknesses in ZPR, this paper attempts to extend the analysis illustratively and make recommendations of its own. These are presented below.

3.2 Additional Issues for Commonwealth Finance Ministers

What does financing for development include?
Before delving deeper into the importance of domestic resource mobilisation, a small digression is justified to ask: 'What does "financing for development" imply?' The answer is not immediately or intuitively obvious. ZPR implicitly assumes that FfD is needed to: (a) finance an adequate rate of growth, without illustrating what that growth might need to be; (b) meet IDG-2015 requirements; (c) cope with humanitarian crises; and (d) finance global public goods.

Taking these four 'uses' of FfD as lodestones for quantifying FfD needs (whether for a country, a sub-group like the Commonwealth, a region or the developing world as a whole) leads to a near-impossible task. It is not easy to estimate the total, domestic or external financing needed for 'development' from the traditional data series that are invariably referred to. FfD needs are not captured (entirely or adequately) in the *hard investment* data series (for example, in data on gross or net investment) published by governments and IFIs. Moreover, FfD implies financial requirements that go beyond resources for physical investment. It embraces funding for *consumption support* (for example in connection with poverty-alleviation) and for *soft investment* (for example in human, social and institutional capital) that appear on national government accounts as public expenditure.

In addition, FfD includes requirements for *technical assistance*, *institution and capacity-building*, and knowledge-transfer; *payments for intellectual property rights* (for example in areas such as pharmaceuticals for immunisations, vaccines and drugs needed to combat endemic diseases as well as HIV/AIDS). It covers *exigent resource requirements* and *transition or contingency financing* for rectifying external and internal account imbalances via stabilisation or structural/sector adjustment programmes, as well as other variants of crisis management and post-crisis rehabilitation (such as debt restructuring and reconstruction finance) that may not involve any specifically identifiable investments as such. It also covers, as ZPR acknowledges, *global public goods* and the costs of *humanitarian relief*.

Development assistance (often, but wrongly, regarded as being synonymous with development financing) shown in the ODA data series of OECD covers funding for food aid, humanitarian relief, refugee assistance in the midst of conflict and natural disaster management, for example droughts, floods, earthquakes, tidal waves, mudslides, etc.

These different needs, financed by a variety of sources in an even wider variety of ways, add up to a mixed bag whose contents are difficult to identify specifically or trace easily.[5] There are large reconciliation problems not just with errors and omissions on the balance-of-payment accounts but also between the accounts of donors and recipients on aid flows. These rarely reconcile because payments made for technical experts in donor countries show up on donor accounts as ODA expended but not on recipient country accounts as ODA received, while local expenses for experts (such as housing, transport and subsistence) show up on developing country accounts but not on donor accounts.

For the developing world as a whole, an average of about 95 per cent of resources for financing all aspects of development are domestically mobilised resources.[6] Yet it is the 5 per cent tail that wags the 95 per cent dog when it comes to setting priorities for the global development agenda. A major goal for UNCFD should be to restore a sense of balance and perspective, on the part of both donors and IFIs, by allowing countries that finance 95 per cent of total development investment to have a say proportionate to their financing in determining what their global development priorities and strategies should be, instead of continuing to allow external interlocutors who finance less than 5 per cent of the total to have the overwhelmingly dominant voice.

To put arguments about domestic resource mobilisation and external financing requirements in an understandable context, three tables are presented below for illustrative purposes. Table 4 shows the financial resources expended on *physical* investment as captured in the gross domestic capital formation (GDCF) data for 1999. It indicates that 13 per cent of such resources were externally sourced (some

5 These technical and data difficulties notwithstanding, it may nevertheless be possible to obtain a sense (in order of magnitude terms) of what the FfD needs of the developing world might be, what proportion might reasonably be expected to originate locally and the residual amount that needs to be financed externally. A simple, and much criticised, exercise of this nature was undertaken for UNCTAD-I in 1964 when the trade gap was estimated, starting from the UN Development Decade target for minimum annual growth rate of 5 per cent in the income of the developing countries.

6 This average obscures a wider range of proportions of domestic resources in the total FfD mix (between 60–98 per cent) when a country-specific or regional picture is developed. At present, a regional picture shows that sub-Saharan Africa is most dependent on external financing while East Asia is least. Some individual sub-Saharan African countries are excessively dependent on external resources. In extreme cases in some of the poorest African countries, this is reflected in ratios that indicate external resources (mostly ODA) accounting for over 50 per cent of the annual public budget, over 65 per cent of gross domestic investment and over 50 per cent of the gross current account deficit.

Table 4. Sources of Financing for Investment in Developing Countries 1999
(Amounts in $ billions; figures in parenthesis are as a percentage of GDI)

	All developing countries	Low-income countries	Middle-income countries
A. Gross Domestic Investment	1530	213	1317
B. Total External Flows	261	38	223
C. Investment Related External Flows	201 (13%)	18 (8%)	183 (14.0%)
D. o/w Official Flows	13 (1%)	7 (3%)	6 (0.5%)
E. Private Flows	188 (12%)	11 (5%)	177 (13.5%)
F. o/w FDI	171	11	160

Source: Global Development Finance (1999), World Bank, Washington DC

from other developing countries), while 87 per cent originated from purely domestic sources.

The differences across developing regions are highlighted in Table 5. Several key features become immediately apparent:

- The developing world as a whole (including the transition economies) did not have a resource imbalance; domestic savings were sufficient to cover the investment that took place. But such investment supported an average growth rate of about 3–4 per cent, instead of the 7–8 per cent that needs to be achieved;
- Excluding the transition economies[7] the rest of the developing world would have had a resource imbalance of –3 per cent of its collective GDP;
- Excluding Eastern Europe, the developing world's output is dominated by East Asia and Latin America, with these two regions accounting for nearly 75 per cent of output. There is a combined resource surplus of +4 per cent of GDP for these two regions;
- The South's two poorest regions, South Asia and sub-Saharan Africa, have the largest resource imbalances. They cannot finance their investment from domestic savings. They also have the South's lowest levels of investment and savings.
- If the East Asia/Pacific region is excluded from the picture, the average investment ratio for the South drops to 20 per cent of GDP. The resource imbalance for the rest of the South actually becomes –5.5 per cent of GDP, translating into a shortfall of about $260 billion between actual investment and the domestic savings available. That shortfall was financed largely by external resources, especially by private flows;
- Excluding East Asia, the resource shortfall in the rest of the developing world would be much larger if developing regions were to increase their investment/GDP ratios to the East Asian level (33 per cent of GDP).

Based on what is known about development, and what has been achieved in East Asia (and countries such as Botswana in Africa), a GDI/GDP ratio of 30–33 per cent is necessary for the developing world to increase its GDP

7 The economies of Central Asia are very poor developing economies comparable to the poor countries of South Asia and sub-Saharan Africa in most respects. The so-called transition economies of Eastern Europe are structurally and income-wise in the same position, or worse off than, most of East Asia and Latin America. Hence the distinction between these transition economies and the developing world is artificial. It is based on a legacy notion of the 'second world' that featured as a distinct geo-political entity in the Cold War era. It is a distinction that should now be dropped with these countries being included within the ambit of the more all-embracing term 'developing countries'. That is what they are.

Table 5. Gross Domestic Investment, Savings and Resource Balances in the World 1999[8]
(US dollars are in billions; percentages are % of GDP)

	GDI	GDS	XGS	RSB	GDP	GNP	@PPP
High-income Countries	**21%**	**22%**	**22%**	**+1%**	**$23,663**	**$22,921**	**$21,763**
Developing Countries	**23%**	**23%**	**26%**	**0%**	**$6,558**	**$6,311**	**$17,324**
of which							
Low-income Countries	19%	16%	27%	–3%	$1,068	$988	$4,315
Middle-income Countries	24%	27%	28%	+3%	$5,490	$5,323	$13,022
East Asia and Pacific	33%	38%	39%	+5%	$1,890	$1,833	$6,424
South Asia	21%	17%	12%	–4%	$596	$581	$2,695
Europe and Central Asia	20%	23%	38%	+3%	$1,094	$1,022	$2,654
Middle East and North Africa	22%	19%	25%	–3%	$590	$599	$1,338
Sub-Sarahan Africa	17%	14%	27%	–3%	$333	$321	$929
Latin America and Caribbean	21%	20%	16%	–1%	$2,055	$1,955	$3,197

Notes: GDI = Gross Domestic Investment; GDS = Gross Domestic Savings; XGS= Exports of Goods/Services; RSB = Resource Balance; GDP = Gross Domestic Product; GNP = Gross National Product; @PPP= Converted at Estimated Purchasing Power Parity Exchange Rates
Source: World Development Indicators, 2000. World Bank, Washington DC and WDR 2000/2001

growth rate to the East Asian level of about 7–8 per cent. Had investment averaged 33 per cent of GDP for the developing world as a whole, the resource gap for hard investment would have been over $630 billion in 1999 (in Table 6 dollar figures for GDI and GDS have been extrapolated from Table 5).

If other FfD needs were added to this figure of financing requirements for hard investment, the total FfD gap would be between $750–800 billion. Clearly, a gap of this size could not be bridged by increasing savings efforts in developing countries themselves at their current levels of per capita income and with their large amount of public sector dissaving; this, of course, must be reduced.

Table 6 illustrates a hypothetical situation. Except for East Asia, the amount of investment as a proportion of GDP in other developing regions is inadequate to generate the sustainable growth rates that developing countries, as a whole, need to aim for. It is unlikely that GDI can be increased to 33 per cent of GDP quickly across the developing world. For that to happen, domestic savings would need to rise to 28 per cent of GDP in the next year or two, and to 30–35 per cent thereafter. That would leave a short-term resource imbalance of 5 per cent of GDP to be financed externally. If savings could be increased throughout the developing world from an average of 23 per cent to 28 per cent of GDP (a proportion that could be realised in most regions other than Africa if public sector dissaving was reduced to zero), then the resource imbalance that would have needed to be financed in 1999 would have been about $330 billion.

If 85–90 per cent of the resources for *hard investment* in developing countries are of domestic origin, and investment has to be lifted from an average of 23 per cent of GDP in the developing world to between 30–33 per cent,

8 Unfortunately the WDI data series reports on 132 economies out of 206 (WDR for 2000/2001). Thus it is incomplete, although it probably captures about 95 per cent of the world's output, population and trade. Figures for this table have been rounded out to add up.

Table 6. Resource Gap in the Developing World in 1999 if GDI were 33 per cent of GDP
(Amounts in US$ billion)

	Actual dollars 1999		GDI/GDP = 33%		
	GDI	GDS	GDI in $	Resource Imbalances	
	(A)	(B)	(C)	C – A	C – B
High-income Countries	**4,969**	**5,205**	**n.a**	**n.a**	**n.a.**
Developing Countries	**1,530**	**1,540**	**2,164**	**634**	**624**
of which					
Low-income Countries	213	202	352	139	150
Middle-income Countries	1,317	1,338	1,812	495	474
East Asia and Pacific	610	685	612	2	–73
South Asia	122	95	199	77	104
Europe and Central Asia	207	226	363	156	137
Middle East and North Africa	118	102	197	79	95
Sub-Saharan Africa	54	42	112	58	70
Latin America and Caribbean	419	390	681	262	291

Source: Derived from Table 4; based on WDI-2000 and WDR 2000/2001. World Bank, Washington DC

then domestic savings have to increase in response, i.e. from an average of 23 per cent to at least 28 per cent before rising to 30–33 per cent, to avoid incurring too large a resource imbalance, the financing of which from external sources might not be sustainable. Domestic savings in East Asia are already at 36–38 per cent of GDP. Its resource surplus of savings over domestic investment enables East Asia to finance investment in the rest of the developing world, as well as financing resource flows to the developed world. (Korea, for example, invested large amounts in the USA and UK in the 1990s.) But as Table 5 shows, in the rest of the developing world the domestic savings rate varies from 23 per cent in Eastern Europe and Central Asia to a low of 14 per cent in sub-Saharan Africa. These savings rates are far too low, even as a starting point, for achieving the upward boost of investment that is needed to propel growth to an annual rate of 8 per cent or more annually.[9]

Clearly, before asking governments in industrial countries to do more in providing ODA and non-concessional FfD, governments of developing countries need to show resolve and good faith in putting their own houses in order. At UNCFD, developing countries should pledge to adopt strong measures (policy, institutional and implementation) to lift domestic savings rate in their own countries in a steady and sustainable fashion and adopt firm annual targets against which their performance can be measured.

The argument made by African countries, for example, that per capita incomes in their countries are too low to permit higher levels of

9 In its abbreviated compendium of global development indicators, *The Little Green Data Book 2001*, the World Bank shows net domestic savings (i.e. gross savings minus consumption of fixed capital) and 'Genuine Domestic Savings' (defined as net domestic savings + education expenditures, – (energy depletion, mineral depletion, net forest depletion and carbon dioxide damage)). These savings ratios (cf. GDS in Table 4) for developing regions in 1999 were:

	World	EAP	South Asia	ECA	MENA	SSA	LAC
Net Domestic Savings as % of GDP	12.3	27.1	9.5	15.6	15.0	6.0	9.1
Genuine Domestic Savings	15.0	25.0	8.0	11.9	–1.3	3.8	9.7

domestic savings needs to be examined carefully. In most African countries, the salary cost of government machinery amounts to between 8–10 per cent of GDP in the smaller economies; it averages about 5–6 per cent of GDP for sub-Saharan Africa as a whole. That frictional loss imposes too heavy a burden on the fragile GDP of most African countries. It is a disproportionate cost that Africa cannot afford to keep incurring if it is to develop and catch up with the rest of the world.

In South Asia, where per capita income levels are even lower than Africa, and the number (and proportion) of people living in absolute poverty is higher, domestic savings rates are, nevertheless, significantly higher than in Africa. They would be higher still if public sector dissaving could be reduced. In India, for example, private savings are about 27 per cent of GDP, but government dissaving amounts to –4 per cent of GDP, resulting in an overall GDS ratio of 23 per cent. Thus low incomes are not a plausible reason for low savings. By the same token, in Latin America and the Caribbean, where per capita incomes are 7–8 times higher than in South Asia, and three times higher than the average for East Asia (which is heavily affected by the weight of China), the ratio of savings is a desultory 20 per cent of GDP.

To address this inadequacy in mobilising domestic resources for development to the greatest extent possible, developing countries (except those in East Asia that are over the limit) need to take resolute action to increase private savings and reduce public dissaving. Such actions should be taken regardless of what developed countries are prepared to do to enhance FfD. What the developing world is prepared to do should *not* be presented at UNCFD as a bargaining chip. That stance would be self-defeating. Developing countries need to do whatever they can to help themselves before they can legitimately criticise donors for not doing enough. Governments of developing countries should, therefore, resolve to take measures and establish targets that can be monitored by the international community.

3.3. Targets for Increasing Gross and Net Domestic Savings

Governments of developing countries should aim at increasing GDS in their economies by 1 per cent of GDP each year until 2015. This would permit all developing regions except Africa to achieve a GDS ratio of 28 per cent of GDP between 2007–10 and for Africa to achieve that target by 2015. It would also permit developing countries (except in Africa) to reach an investment target of 33 per cent of GDP by 2015 and for Africa to reach that target by 2020. To achieve such targets further public policy measures may need to be taken, for example:

- Reduction of wasteful public expenditures by central, provincial, local and municipal governments. Governments should ensure sustainable, balanced recurrent revenues and expenditures, compatible with provision of a minimum acceptable level of essential government services.
- Balanced recurrent revenue/expenditure accounts by 2015. Development investment (for example infrastructure that cannot be financed by the private sector, such as rural roads and railways) should be financed from domestic bond issues and targeted ODA or official finance.
- Reduced fiscal support for public sector enterprises (PSEs) with a rigorous programme of corporatisation and commercialisation that enables PSEs to be run on independent, professional business lines without political interference. Fiscal support for PSEs should be reduced to zero within five years, i.e. by 2007. PSEs should be required to enhance profitability and contributions to government revenues (taxes and dividend

payments) by 3 per cent per annum in real local currency terms.

- Commitment to privatisation and divestiture where this is justified by social and political conditions and experience (as it would be in most, but not all, developing countries). It is not possible to apply a common template for all situations.[10]

- In most countries it is difficult for governments to avoid political intrusion in PSEs resulting in non-commercial objectives overwhelming commercial objectives. In such countries, governments should commit themselves to a divestiture rate of *at least* 10 per cent each year of their total shareholding in revenue-generating PSEs that are attractive to private investors, i.e. in the infrastructure, industrial and energy sectors, and in agricultural production, marketing and distribution. The target should be to have government holdings in commercial PSEs across the developing world reduced to zero by 2015.

- Disengagement from pre-emption of domestic private household and corporate savings through direct or indirect ownership of the financial, and especially the banking, system. The role of government should be confined to guiding the financial system and capital markets through regulation, supervision and monitoring of financial institutions and markets. It should withdraw from ownership of all financial institutions, i.e. public commercial banks and finance companies, development finance institutions, mortgage and leasing institutions, life and general insurance companies, unit trusts, mutual funds, pension and provident funds, and other types of asset management companies. Withdrawal should occur in an orderly fashion through a divestiture programme designed and carried out in conjunction with the IFIs and regional banks whose funding might be needed. It should be completed by 2010 in all countries other than Africa and by 2015 in Africa. The aim should be to create in every developing country a competitive, vibrant financial system that offers a range of financial services and savings instruments, and is capable of integrating with the emerging global financial system.

- Creation of a policy framework to encourage growth of long-term voluntary and involuntary savings (for example for compulsory contributions to private pension funds) through appropriately structured direct and indirect taxation policies and incentives to stimulate long-term private saving and financial asset accumulation on the part of private corporations and households.

- Encouraging the growth of wide and deep capital markets for debt, equity and derivatives with institutional and instrumentation diversity. In regions where countries may be too small for viable national markets to develop efficiently, taking into account economies of scale, governments should participate in the creation, regulation and development of *regional* capital markets (for example in the sub-regions of Africa).

These measures indicate the actions governments of developing countries could take to demonstrate their resolve to their own public, and to the international community at large, to increase *domestic* savings to the levels needed to generate sufficient domestic resources to finance development in their countries and regions. In addition to these specific actions to stimulate domestic savings, the governments of developing countries would, as ZPR stresses, need to assure stable and secure macroeconomic environments in which the value of

10 It would be strange, for example, to suggest that governments like those of Botswana and Singapore, that have large majority holdings in commercial entities should divest such holdings. These governments require standards of performance from their PSEs that private companies anywhere would find hard to match. But governments such as these are the exception rather than the rule.

currency would remain sound. They would also need to have stable, rule-of-law-based, representative, socio-political regimes that accorded popular legitimacy to governments and their actions, and permitted the removal and election of governments through non-violent means.

4

Maximising Earnings from Trade for Financing Development

Next to relying on their internal resources, developing countries will have an unprecedented opportunity in the coming decades to switch from previously entrenched dependencies on aid and external (official or commercial) borrowing, to relying more on earnings from trade and remittances to finance their development. That shift in options reinforces the case for creating and reinforcing a different FfD framework. Priorities for UNCFD should be to:

- Consolidate and deliver the gains that developing countries were intended to derive from completion of the Uruguay Round;
- Eliminate the remaining asymmetries that still impede market access in key areas, for example agriculture and textiles;
- Widen the agenda and scope of the next round of negotiations to increase access to markets (in services and labour markets) in which developing countries can increase their trade earnings by asserting the competitive advantages they have in a globalising world.

4.1. Findings and Recommendations of the Zedillo Panel Report

ZPR makes a strong case for enhancing earnings from trade, with several recommendations that developing countries should embrace and support collectively. Observing that 'every country that has pulled its people out of poverty has made a significant opening to trade a central feature of its economic strategy', ZPR argues for:

- Cessation of foot-dragging and full implementation by developed countries of their commitments under the Uruguay Round to liberalise trade in areas of significance to developing countries, especially in agriculture and textiles;
- Removal of the other substantial barriers to trade in manufacturing which two recent studies indicate are costing developing countries: (a) potential gains of about $130 billion annually on visible trade;[11] and (b) between $90–155 billion per year on total trade[12] which could be realised if developed countries reduced existing import tariff levels by 50 per cent;
- Initiating a new development round of multilateral trade negotiations at the ministerial meeting of WTO in November 2001 in Doha, Qatar. This round should focus on negotiations that are of concern to developing countries and should aim to make trade as free between OECD and developing countries as it already is between industrial countries within OECD. ZPR outlines a

11 Anderson, K. et al. 'Potential Gains from Trade Reform in the New Millenium' (Table 4), in Hoekman, B. and Martin, W. (eds). *Developing Countries and the WTO: A Pro-active Agenda*. Oxford: Blackwells, 2001. See also the comment on this in ZPR (p. 10, footnote 4).

12 Joseph, F. 'The Economic Impact of New Multilateral Trade Negotiations: Final Report'. Report for DG2 (the Trade Directorate) of the European Commission, 2000.

seven-point agenda for such a round;[13]

- Reaching agreement on a new round by excluding negotiations on labour and environmental standards and relegating these issues for discussion and negotiation in the decision-making bodies of international institutions already established to deal with these particular issues, i.e. the ILO and UNEP;
- Strengthening the 'Integrated Framework Initiative' launched jointly by several international organisations[14] to strengthen capacity-building for trade negotiations and export diversification in the least developed countries. The Trust Fund set up for this Initiative should be supported by donors and developing countries alike;
- Removing all restrictions on market access for the least developed countries[15] and implementing immediately all Uruguay Round concessions which affect them;
- Restoring and improving the IMF's Compensatory Financing Facility that was scaled back in the 1980s;
- Supporting (on a trial basis) the new market-based insurance scheme for commodity risk management being promoted by the World Bank in developing countries;[16]
- Opening discussions on liberalising migration by removing restrictions on the movement of people across borders in a phased manner.

4.2 Issues for Commonwealth Finance Ministers to Consider in Enhancing Trade Prospects

The ZPR's 9-point agenda on trade is fairly comprehensive and does not need to be added to. It is based on eight similar recommendations and the logic of arguments made by SGR. But in both instances these recommendations need careful scrutiny. It would be obtuse to argue, in principle, with the desirability of: (a) completing the unfinished business of the Uruguay Round by having developed countries accelerate market opening in key areas; (b) improving on the existing trade regime to permit developing countries to realise significant gains that are being artificially blocked; and (c) gearing up to launch a new Development Round of trade liberalisation in a few months.

But, as the Ministerial Meeting in Doha suggested, unless (a) and (b) are done quickly, there may be more complications involved in launching negotiations for a new Development Round than could reasonably be handled by most developing countries, and especially the

13 The agenda outlined by ZPR includes seven points that are not exhaustive: (1) Finishing uncompleted business from the Uruguay Round; (2) Strengthening the rules of the WTO System; (3) Liberalising trade in agriculture; (4) Reducing tariff peaks and tariff escalation; (5) Re-examining and reforming the regime of Trade-Related Intellectual Property Rights agreed under the Uruguay Round; (6) Legitimising limited, time-bound infant industry protection by countries in very early stages of industrialisation; (7) Examining the prospects of liberalising migration. The Doha meeting appeared to reach tentative agreement on many of these issues. But it remains to be seen whether such 'in principle' agreement is eventually translated into practice as negotiations take place and the next phase in global trade liberalisation unfolds.

14 They include the WTO, World Bank, IMF, UNCTAD, UNDP and the ITC (International Trade Centre).

15 As ZPR notes (p. 12), New Zealand and Norway have already opened their markets completely to LLDCs. The USA has developed special market access programmes for African and Caribbean countries through special initiatives but with limitations that curtail their value. The EU is considering phasing out (between 2002–2004) all quota and tariff restrictions on LLDCs for the import of everything other than arms and (regrettably) bananas, rice and sugar (on which liberalisation will be stretched out much further).

16 The proposed scheme: (a) makes no attempt to stabilise or guarantee commodity prices but focuses on securing in advance the floor price received by individual farmer producers; and (b) envisages operating through an intermediary – situated in an appropriate international organisation like the World Bank – that would reinsure its contracts with private sector insurersand reflect their terms. The intermediary would essentially facilitate the availability of such terms (with, of course, a spread to cover its own costs) to poor farmers throughout the developing world who lack access to private insurance markets. Under the scheme as proposed, the intermediary would sell incurance to farmer-producers on the prices of at least the 12 principal commodities exported by developing countries. Aid resources would subsidise part of the premiums paid by small farmers below a certain income threshold.

least developed given their limited institutional, legal and negotiating capacities. With a few notable exceptions, developing countries as a whole remain to be convinced that the expectations and promise generated by the Uruguay Round Agreements are being realised to the extent anticipated. They have not become more closely integrated into the global economic system in the way they had been led to expect; nor have they become equal members of it. They have not been able to generate export-induced growth of a kind that has enabled them to balance their current and fiscal accounts in order to sustain high growth rates without risking imbalances that could eventually lead to financial crises. In that connection, ZPR's and SGR's recommendation (advocated by the IMF) to restore the IMF's Compensatory Financing Facility to a stature that is more credible deserves support.

There is no single unambiguous study from an authoritative source that indicates what the net impact of UR/WTO trade liberalisation on developing (or Commonwealth) countries has been in terms of whether they have lost or gained. Such studies are complex and demanding. But the need for them is clear, especially if developing countries are to overcome their suspicion that so far, at least, they have lost rather than gained from UR and for that reason must remain wary about engaging in a new WTO round. There can be little doubt that developing countries have incurred major costs (in terms of undertaking the necessary adjustments and in coping administratively with the demands made on their fragile legal systems) in transforming their domestic regimes to accommodate the obligations they have undertaken under the Uruguay Round. Most such countries, especially small developing (and island) states, i.e. SDS and SDIS that are the most human-resource and financially constrained, have been unable to cope with the administrative and legislative workload imposed by URAs. These require domestic legislation and institutional frameworks to be put in place quickly, so that the complex substantive and procedural rules required can be implemented within the time frame committed to. In certain instances (for example with TRIPS), it is clear that developing countries were not fully aware of the consequences and implications of what was agreed. The costs for such countries in reforming domestic legislation and increasing their capacity to protect legitimate interests through litigation have been much larger than anticipated.

In that connection, ZPR/SGR recommendations for strengthening the Integrated Framework Initiative and supporting the Trust Fund set up to finance it are on target and worthy of support by the Commonwealth. The role that the Commonwealth should play in this initiative, through the Secretariat, has been considered in another report[17] and is taken up later in this section. The Secretariat has a particularly useful role to play in SDS where it has a clear comparative advantage over any other international organisation.

While they are all too clear about the costs, most developing country policy-makers feel that the benefits of the Uruguay Round have been elusive and that the costs of UR may outweigh the visible benefits. In contrast, all developing countries believe that the benefits of UR for OECD members outweigh their costs.[18] OECD countries have been slow to

17 Mistry, P. S. and Saptagiri, L. *An Evaluation of Commonwealth Secretariat Assistance to Member Countries with International Negotiations*. Evaluation Study No. 65. London: Commonwealth Secretariat, 2000.

18 Though that feeling of asymmetrically accruing costs and benefits runs strong, the evidence to support it is unclear. There can be no question that between 1993–99 world trade has increased substantially. The share of developing countries in such trade has increased as well. How much of that increase has been due to the Uruguay Round, and what the costs associated with that increase have been, is impossible to quantify on the basis of the evidence available.

deliver on UR commitments to liberalise trade in agriculture and textiles, both crucial to developing countries. Provisions relating to special and differential treatment (SDT) for least developed countries have not as yet been fully accommodated by all developed countries in their domestic legislation. There has been increasing, and often unfair, resort to contingency protection, for example anti-dumping measures against developing country imports. This has been accompanied by resort to litigation of a kind that violates the spirit of URAs. As a result, developing countries have become ultra-cautious about the wording of any future trade legislation.

To be fair, OECD countries have opened many markets in keeping with UR commitments. But these have not been markets that matter to the developing world. The USA is perhaps the most open market to developing countries for goods, services and labour exports. It is also the most open market for access to capital. But the benefits of that openness are not shared symmetrically by all developing countries.[19] Japan remains a relatively closed market because of non-tariff barriers (NTBs) and traditional trading practices, rather than because of tariffs and quantitative restrictions (QRs). The EU has been slow to adapt because domestic political regimes in its member countries (especially in labour, industrial and agricultural markets) have proved resistant to change. Obviously such changes have attendant social and political costs that these economies have not been willing to incur.

When it comes to trade liberalisation, developing countries remain at a disadvantage. Most of them, especially the smaller countries that are not major players in trade in manufactured goods, believe they have lost from the UR in net terms. They do not have the negotiating capacity (at WTO or in their home capitals) to protect their own interests. They are oppressed by the TRIPS and GATS regimes that have been agreed, and suspect that further trade liberalisation – before the asymmetries and implementation problems of URAs are sorted out – may result in welfare losses rather than gains. They are handicapped by structural and other competitive disadvantages that inhibit their prospects. Without access on equal terms to the same human, capital, institutional and knowledge resources that other countries possess, they would prefer continued resort to special and differential treatment over a sufficiently long transition period to enable them to become more competitive.

For the next round of trade negotiations to be conducted successfully, compromises will need to be made by the developed and developing worlds on overall trade principles and policies, on rates of further tariff reductions and removal of QRs and NTBs, on transition periods, on other troublesome technicalities and on contentious issues such as revisiting the TRIPS agreement. There will need to be hemispheric and region-to-region dimensions to future global dialogue on the continued liberalisation of world trade. More preparatory work will need to be done to proceed with smoother URA implementation and scale back the ambitious agenda for the next round of WTO negotiations embracing several new areas, i.e. environmental standards, multilateral rules on investment, competition policy, trade facilitation, transparency in government procurement; and electronic commerce. In addition, the spectre of *labour standards* being raised through the back door (despite the clear signal from developing countries at the Singapore Ministerial Meeting that these should be left off the agenda) remains ever-present. For all these rea-

19 The main beneficiaries of US market openness are in the Western Hemisphere and East Asia. The EU remains a relatively open market to the ACP countries, to the economies of North Africa that lie on the southern shores of the Mediterranean and, increasingly, to the transition economies of Eastern and Central Europe.

sons, caution is justified on the part of developing countries in responding to ZPR's enthusiasm for a Development Round to be launched quickly.

That note of caution applies even more pointedly to the commodity-risk management scheme that the World Bank has succeeded in getting SGR/ZPR to endorse. The scheme is a distinct conceptual improvement on previous grand designs for global commodity price stabilisation that were unworkable. It is innovative in relying on a market-based solution and using the risk management capacity of the global private insurance industry to address a price-risk problem concerning small farmers in developing countries. But credible analysts[20] have raised doubts about its details, practicality and workability. Is an institutional sledgehammer being created to crack a walnut? Why does such an intermediary need to reside within an international institution?[21]

The estimated set-up, capital and operating costs of such an intermediary need to be brought into the open. They are likely to be substantial if it is to have the reach and the network to deal with tens of millions of individual small farmers throughout the developing world in environments where basic physical, institutional, legal and communications infrastructure is missing. More needs to be known about the logistical *modus operandi* of such an intermediary before the concept is endorsed or taken up. Options such as training and developing networks of existing local insurance agents, working with private agents who provide credit and other inputs to small farmers in the poorest countries, may make more sense. A greater level of confidence could be placed in service delivery and contract underwriting being managed at the apex by a group of private insurance firms with expertise in such a business, instead of a well-intended but inexperienced bureaucracy that has no knowledge of how to deal with small farmers.

4.2.12. Finally, ZPR puts on the UNCFD agenda the issue of opening discussions on more open *labour migration* across borders. Whether or not UNCFD is the right forum for introducing such a major question is a matter of opinion. It is difficult to see how it can be credibly argued that labour standards should be left to the ILO, the vexing question of child labour to UNICEF and environmental standards to international environmental organisations, while putting the issue of labour migration on the agenda of UNCFD. Doing that opens the door to other issues that developing countries might prefer to avoid.

That asymmetry aside, it is obvious that opening up global labour markets less selectively (and self-servingly) is a question that has to be confronted, sooner rather than later, by the international community. Labour-market liberalisation is simply the reverse side of the coin of trade and financial liberalisation. Clearly, remittances are a growing and, in some instances, critical source of export earnings for developing countries. Thus they are a crucial element in FfD. Opportunities for expanding such earnings cannot be artificially inhibited in perpetuity for nationalistic (protectionist) reasons that are becoming increasingly irrelevant in a globalising world.

If globalisation is to have meaning, then borders cannot become pervious only for goods, services, money and the flow of everything other than people. If development is for people, then so is globalisation. That has implications

20 For a reasoned analysis of the issues involved, see Chapters 8 and 9 in Page, S. and Hewitt, A., *World Commodity Prices; Still a Problem for Developing Countries?*, special report. London: Overseas Development Institute, 2001.

21 That option might imbue and perhaps impede it with stifling bureaucracy and ponderous operating practices when it needs to be nimble and agile. It might make more sense for the proposed intermediary to be a self-standing public-private partnership between private insurers and donor governments allowing room for some of its premium income to be partially funded or subsidised by donor governments.

for accommodating and encouraging the unimpeded voluntary movement of people across borders. How can labour mobility and labour market flexibility be a virtue at the national level and a cardinal vice at the international or global level? Closed labour markets in industrial countries can only add to inefficiencies in the global economic system because the global labour market is not being permitted, as a result of the policies of industrial countries, to clear as it should.

Certain segments of the global labour market (especially for high-skill human resources or HSHR) are already quite open – for example for top executives in transnational corporations, star talent in the media, entertainment and sporting fields, and top academics, scientists and researchers. There are no substantive restrictions preventing such individuals from crossing the borders that they want to cross. Moreover, borders for legal human migration *among* OECD countries are already more open than borders between the OECD and developing countries. There is no economically justifiable reason for such a dichotomy.

Developed countries have, of course, been swift to open, temporarily, access to labour markets for intermediate and low-skill human resources in which they suffer acute shortages. This was recently witnessed with middle and relatively low-skill IT talent from India, and with the aggressive (even shameless) recruitment of professionals from developing countries in the primary and secondary education and health sectors of OECD countries, particularly the UK, at the present time. Some of these temporary, self-serving market-openings have secondary and tertiary backwash effects. For example, the exodus of teachers, nurses and doctors from South Africa into OECD countries is resulting in South Africa draining its neighbours in Africa of such professionals. Temporary, segmented labour market opening can have significant human costs, as was evident with the collapse of the 'dot-coms' in early 2000 which resulted in many newly arrived immigrants from Bangalore to Silicon Valley having to return within a few months.

Conceptually, selective opening of labour markets is just as undesirable, pernicious and harmful as selective opening of markets for goods, services and capital. That truism holds irrespective of the political, social and racial sensitivities of protected labour in the developed world. Selective, self-serving opening of labour markets (which, unfortunately, is the only type of opening that political and social circumstances in OECD countries permit at the present time) puts developing countries in triple jeopardy. It denudes them of the HSHR that they desperately need, for example, to bridge the digital divide and to meet the ambitious targets of IDG-2015. It deprives them of expected benefits from the long-term investments they have made in developing such high-skill human resources. And it leaves them with a huge labour surplus at the low-skill end of a size that they cannot absorb or provide an adequate social safety net for in their own economies.

At present there are no arrangements or protocols to compensate developing countries for an artificially induced loss of investment in HSHR arising from the failure of specific segments of the labour market in developed countries. These failures are attributable to myopic policies that trigger egregious supply-demand imbalances in industrial countries at awkward political moments in time. The costs of adjusting to such sudden labour-market failures are casually, and thoughtlessly, passed on to developing countries, which are effectively treated as a reservoir or sump to be drained when such circumstances arise.

To be sure, developing countries derive benefits from opportunistic labour market opening in OECD countries through remittances. Such flows, however, are not a characteristic of HSHR exports as much as they are of low-skill

human resources exports, for example to labour-short Gulf countries. There is anecdotal evidence of other benefits associated with countries that have a large diaspora, for example the sustained growth of FDI in China driven by overseas Chinese, and the large short-term bank deposits of non-resident South Asians which effectively help to swell the international reserves of their countries of origin.

In addition to the asymmetry of industrial countries arguing self-servingly for the opening of all markets (goods, services and capital) except labour on a non-selective basis, the changing demographics of developed countries[22] raises compelling arguments for more open, liberal immigration policies that accommodate labour inflows at all skill levels with fewer restrictions. Such changes will require significant and painful adjustment in the political and social markets of OECD countries. But their current policies require even larger adjustments to be made, and significant opportunity as well as real costs to be absorbed, by developing countries in their own labour, goods and services markets.

The case for opening up the question of liberalising labour migration is irrefutable. But the question is 'How strongly will Commonwealth Ministers wish to support such a recommendation by ZPR?' The answer is fraught with the diplomatic sensitivities that surround this issue, and the inconsistency of doing so while insisting that similar issues only be raised in the decision-making bodies of the specialised institutions concerned. This paper argues that developing countries should place a marker at UNCFD that the liberalisation of labour migration is an issue that has to be confronted sooner or later. But the temptation should be eschewed to push the issue too far, especially if it threatens to derail UNCFD and prevent it reaching productive outcomes.

4.3. The Special Role of the Commonwealth Secretariat

A brief digression is needed on the special role that the Commonwealth Secretariat might play in connection with the position that Commonwealth Ministers of Finance might take in UNCFD on another round of trade liberalisation. This detour is necessary because of the implications that the next trade round will have on FfD over the next 20–25 years, and the institutional implications it has for the Secretariat in helping member countries (especially the least developed, SDS and SDIS members) to cope.[23]

With the shadows of Seattle (as well as Prague, Washington, London, Gothenburg and Genoa) continuing to cast a shadow over a new trade round, the Secretariat has a crucial role to play in shaping the attitudes and policies of an influential group of developing countries. Such a role would add value to the new round by helping to achieve positive outcomes. Developed Commonwealth members (Australia, Britain, Canada, New Zealand and Singapore) can influence policies and attitudes in OECD countries. Similarly, countries such as India, Malaysia, Nigeria and South Africa have a growing influence on opinions and attitudes in the developing world. If existing URAs are to be implemented smoothly, and negotiations in a new Development Round conducted satisfactorily, it is crucial to have these opinion-makers on board. The trial balloons released by ZPR may be more usefully explored within the Commonwealth family before attempts are made to agree on them at UNCFD or WTO.

In facilitating global, hemispheric and region-

22 This is true of almost all the major OECD countries except the USA whose immigration policies, despite restrictions, are more liberal than those of the EU or Japan and whose periodic amnesties for illegal immigration allow in large numbers of low-skilled immigrants.

23 In making this detour, attention is called to a recent evaluation of the Commonwealth Secretariat's assistance to member countries with international negotiations; and especially with trade negotiations concerning WTO and ACP-EU, i.e. Evaluation Study No. 65, op cit.

to-region trade dialogue,[24] and ensuring its compatibility with the emerging WTO regime, experience with assistance on trade-related negotiations suggests that the Commonwealth provides unusually flexible scaffolding. Sensibly used, it could make a contribution to the eventual construction of a more durable, robust WTO edifice that is less vulnerable to Seattle-type disruptions and discontinuities.

Commonwealth developing countries are all having difficulties (of varying degrees of severity) with putting in place revised domestic trade *legislation* to conform to their undertakings and obligations under URAs. With a new trade round, that problem will be compounded. Developing member countries need legal assistance from the Secretariat to help them cope. The Secretariat could design model legislation, consistent with a common law heritage, that would be applicable across Commonwealth countries with modifications. Assistance is needed immediately in coping with the revision of TRIPS and copyright law (under which special provisions need to be designed for protection against predatory bio-prospecting by foreign companies of unique plant and marine life varieties) and GATS.

In addition, developing country members require assistance with framing domestic trade and investment legislation that is flexible and adaptable. Such legislation must accommodate a new global trading regime that requires continual reduction of tariffs, as well as removal of non-tariff barriers, administrative barriers, and changes in customs and excise rules and procedures along with the necessary enforcement provisions. Help is needed in devising appropriate legislative and regulatory regimes for government procurement, Internet service provision and the conduct of e-commerce. Existing laws governing the provision and regulation of telecommunications and broadcasting services need to be revamped to accommodate private and foreign participation in these areas.

Assistance is also required for revising legislation governing the regulation and control of cross-border financial transactions with special provisions for those conducted over the Internet. Dedicated Secretariat websites on trade issues need to be established urgently with up-to-date information accessible to all members. These websites should be updated weekly and contain access to all background papers and studies prepared, the latest information on the status of negotiations in key areas and the positions of key countries. They should also include a Secretariat news bulletin informing trade officials in governments of the issues they should be tracking. To some extent, the new series of WTO Policy Briefs launched by the Secretariat fills this need, but it needs electronic dissemination.

The above suggestions constitute a rich agenda for the Commonwealth Secretariat to contemplate in designing an appropriately balanced programme for its own special assistance for member countries. But the Secretariat needs also to play a front-line role under the proposed Integrated Framework Initiative supported by ZPR. Its particular comparative advantage over any other multilateral or bilateral institution lies in dealing sympathetically and cost-effectively with SDS. It is regarded by most, if not all, SDS members' governments as an extension of their own capability. The Secretariat should, therefore, be delegated specific responsibility under the Integrated Framework Initiative (IFI) for delivering an integrated package

24 For example, the Commonwealth Secretariat is already playing a role in assisting its Caribbean members with the on-going trade dialogue between NAFTA and CARICOM. That will eventually spill over into the WTO arena. Similarly the Cotonou Agreement has set the stage for trade-relations between the EU and various REPAs in the four or five African sub-regions; between the EU-Caricom; and EU and the Pacific. The Commonwealth Secretariat could play a role in cementing trade ties between ANZ and the Pacific, and, assuming political factors eventually permit, within SAARC and between SAARC and ASEAN.

of technical assistance on trade negotiations to all SDS with in-country assistance being focused on Africa, the Caribbean and the Pacific.

The capacity-building assistance required by SDS for trade should be funded by the IFI Trust Fund, not by the Commonwealth Secretariat's meagre budgetary resources. In that connection, developed Commonwealth countries should give serious consideration to expanding the extant Trade and Investment Assistance Facility (TIAF) in a manner that enables the Secretariat to contribute to the Trust Fund some of the resources required for assisting SDS and SDIS. The Secretariat must pay attention to the training, knowledge and support needs of trade officials not just at the negotiating table, but including officials participating in inter-ministerial committees on trade in the capitals of Commonwealth member countries. It needs to achieve a better balance between: (a) assistance delivered to member country delegations in Brussels (for ACP-EU negotiations) and Geneva (for WTO); and (b) assistance delivered to their trade officials and ministries in home capitals. That may involve communicating more effectively the policy work that the Secretariat has done and improving on its follow-up efforts to make sure that such work is translated into sound policy-making at country level.

In providing such assistance, the Secretariat must avoid duplication and overlap with other international institutions operating under the IFI. But although that caveat is fine in theory, it is often difficult to apply in practice. It is not always possible for the Secretariat to know what other institutions are doing. The priorities of other institutions (especially the Bretton Woods Institutions) often shift in mid-stream. With ODA diminishing, every international institution is now gravitating toward assisting with the new Round. Trade liberalisation has become a new growth industry for multilateral agencies (whether multilateral or bilateral). The World Bank and the IMF have large, established work programmes on assisting developing countries with trade liberalisation because it features as a central pillar in adjustment programmes. But assistance from these sources carries ideological baggage (not always temporally consistent) that diminishes its value. Small Commonwealth members in need of assistance prefer the Commonwealth Secretariat or UNCTAD as a source of such assistance (although with UNCTAD they often have to wait for unduly long periods because of the acute constraints on UNCTAD's own resources which lead it to ration its services).

SDS are concerned that the advice they receive from the IFIs on the positions they should take in the next WTO round will be of a kind that will make it easier for *developed* countries to achieve their objectives in the negotiations. Such advice does not necessarily cater to the interests of the developing world. Many member countries believe that this is what happened in the context of UR negotiations. They succumbed to IFI pressure to reach agreement, only to find that they are now having considerable difficulty in implementing URAs and living with their consequences.

The Commonwealth Secretariat's role in assisting the SDS with trade negotiations should avoid placing too heavy an emphasis on arguing for SDT under WTO rules. Its continued reliance on the SDT argument may be justified in the short to medium term. But after that it reaches a dead-end. What is needed to make the argument for SDT over a transition period credible is a vision for the structure and competitiveness of SDS when that transition period has ended. Without a strategy for making SDS economies viable in the long-run, the argument for a transition to something that is not even a vague idea, holds little intellectual water. Structural constraints on SDS economies lead to the logical conclusion that if

SDT is to be argued for, then the case has to be made that such treatment is needed in perpetuity and not just for a transitional period. Such a stance is untenable under the emerging WTO regime, which cannot accommodate SDT for more than a limited period. If experience over the last three decades is a guide, it is not clear exactly what buying more time for SDS to become competitive is likely to achieve and by when. The problem that must be confronted by the Secretariat and its SDS members is to seek a long-term approach to competitive viability under which the 'wherewithal deficit' of SDS is resolved, rather than perpetuated.

The long-run solution may be for SDS to associate with larger regional groupings in their neighbourhoods on a basis that enables them to maintain some control over their destinies. As a strategy, the Secretariat should argue the SDT case for SDS only as a one-off, time-bound, expedient. It should focus more on encouraging forms of regional integration that facilitate transitions under which, for example, CARICOM associates with NAFTA and/or Mercosur as quickly as possible, and deals with WTO as part of NAFTA or Mercosur or both.

In the same vein, the Secretariat should assist African economic groupings with SDS members to integrate faster and enter into better arrangements with the EU under the evolving Cotonou framework. African sub-regional groups, such as ECOWAS and SADC, should be encouraged to enter into closer trading and monetary arrangements with the EU that can be refined over time. Similarly, the Secretariat should facilitate a process whereby Pacific SDIS become members of ANZCERTA and ASEAN under appropriate arrangements. They should cope with future WTO rounds through regional arrangements. Whatever SDT they need should be negotiated within these arrangements, compatible with WTO rules. The key objective that SDIS should achieve under associated membership arrangements with larger trade blocs in their respective regions is not the perpetuation of SDT, but open access to the labour markets of the region in order to increase their remittance earnings opportunities as a first step toward achieving durable self-reliance. The *quid pro quo* is opening their economies to non-indigenous investors from the region in every sector, including land. They will need to embrace more enthusiastically than they have been willing to do so far, the entry of know-how, investment capital, entrepreneurial talent, and human/social capital of the kind that they urgently need.

SDS members can no longer keep themselves closed to these influences, and earn a living *on their own terms* through SDT in a world that no longer recognises the right to special exemptions. Harsh as that sounds, it is a reality that the Commonwealth needs to confront sooner rather than later. Obviously, the Secretariat cannot be naïve about the difficulties that SDS will face in integrating with neighbouring regional blocs on appropriate terms. Nor can it be sanguine that this can be achieved quickly or painlessly. That problem notwithstanding, these suggestions illustrate where a viable future for SDS may lie.

5

Mobilising External Private Capital for Financing Development

5.1. Observations and Recommendations of the Zedillo Panel Report

Observing that: 'Private capital cannot be expected to finance poverty reduction or human development ... [but it] ... can be an important factor in promoting growth – or in precipitating crises ...' and 'The extent to which FDI bypasses smaller and poorer countries is often exaggerated ...', ZPR makes the following points in considering the role of FDI and FPI in financing development:

- Developing countries need to continue improving their attractiveness to FDI through *positive* actions (i.e. by upgrading standards of accounting and auditing, transparency, corporate governance and public administration, along with improved infrastructure and application of the 'equal treatment with domestic firms' principle), rather than through tax concessions and lower social or environmental standards. Competitive tax concessions should be regulated and discouraged by an International Tax Organisation;
- Foreign investors in developing countries should subscribe to the UN's Global Compact which highlights nine principles for good corporate citizenship, dealing with human rights, and labour and environmental standards;
- The catalytic role of the MDBs in directing FDI to developing countries should be increased (Volcker Commission) through the provision of partial risk guarantees;
- FPI should be encouraged to diversify the number of options available to countries for financing development. However, such flows need to be properly regulated to avert the risk of macroeconomic destabilisation and financial crisis. To that end the international financial architecture needs to be strengthened to reduce vulnerability, and domestic financial systems need to be strengthened through stronger prudential norms and practices and better standards and codes in a number of areas;
- Developing countries need to be more proactively involved in the design and formulation of prudential norms and improved standards/codes because their implementation can be difficult and costly. Capacity-building assistance is required to implement improved codes;
- Private capital needs to be 'bailed-in' for the management of financial crises by making collective action clauses a standard feature of sovereign bond issues and a queuing process that prevents or slows down flight exit;
- Artificial restriction by industrial countries on institutional investment in emerging markets needs to be removed;
- The prospect of the new Basle proposals for determining the minimum capital requirements of banks making commercial bank loans prohibitively expensive for all but the most creditworthy developing countries should be averted .

ZPR's treatment of the importance of external private capital in financing development (based on treatment by SGR) is regrettably insipid, if not trivial. Its analysis reiterates the obvious while its recommendations do not go

far in providing a road-map for reducing the dependence of developing countries on official flows (which are waning) while increasing their reliance on private flows (which are increasing). Even for the poorest developing countries, private capital is likely to continue to increase in importance despite occasional interruptions caused by episodic (but inevitable) financial turbulence.

Except for creating an ITO (an issue dealt with later in this paper), none of ZPR's observations and recommendations pertaining to private capital flows is contestable. For that reason, they can be endorsed and supported by the Commonwealth Finance Ministers. But they are unlikely to be very helpful. The recommendations do not advance any arguments. Nor do they create new pathways and breakthroughs for increasing the scope and reach of private capital in financing development in more countries for more purposes. In a substantive sense (and despite SGR's list of 14 suggestions for enhancing such flows) ZPR/SGR are almost dismissive in their treatment of private flows while over-emphasising the importance of reversing declines in official flows. The subsections that follow attempt to redress these weaknesses in offering a wider and more balanced perspective.

5.2 Issues for Commonwealth Finance Ministers to Consider in Mobilising Private Capital

Backdrop and Analysis

The 1990s were a shock in exemplifying the suddenness with which *private capital flows* (PCF) assumed primacy in external resources flows to developing countries. Their impetus led to the total amount of external financing for developing countries increasing substantially. As a consequence, *official finance* became relatively less significant as a flow of resources to the developing world in a shorter time-span than was earlier imagined. In the mid-1990s official flows, especially ODA, fell in absolute terms as well.[25] There was a reversal in PCF between 1998–99 following the Asian crisis (Tables 9 and 10) but they have begun to recover in 2000. Some industrial countries, for example the USA, now see private flows as a substitute for ODA in meeting future FfD needs. That expectation is overplayed and unrealistic. Private capital can play an important role in emerging markets where physical and institutional infrastructure, markets and opportunities exist to attract and absorb such flows productively without running the risk of bidding up asset prices and creating valuation bubbles. These conditions, which influence their value, necessarily limit their role in the developing world.

Private flows are not intrinsically flawed because their nature constrains their reach. On a per capita, rather than per country, basis, private capital is better distributed across the developing world than usually acknowledged. For example, it is often observed that 80–90 per cent of private capital flows are directed to only 10–25 developing countries. That statistic, exhausted from misuse, disparages private flows as being too unfairly concentrated to matter to most developing countries. The implication is

25 That change was even more marked from the 1980s when ODA increased rapidly as a response to the collapse of private finance (in the form of commercial bank loans rather than FDI or FPI) with the onset of the debt crisis in 1982. Rapid increases in ODA between 1982–90 were necessary to finance the burgeoning growth of fast-disbursing structural adjustment and crisis-management programmes in Latin America and Africa. Most of the ODA provided in the 1980s was used to finance external debt service to private creditors (mainly banks in the developed world) in order to prevent failure of the global financial system. It was aimed at short- and medium-term stabilisation and not at long-term development investment. For that rather obvious reason – which unfortunately added to the perception of aid failure – increased ODA in the 1980s went hand in hand with increasing poverty and dispossession in the debt-distressed parts of the developing world. That outcome resulted from the debt-management and structural adjustment policies applied by the Bretton Woods Institutions. When the worst effects of the debt crisis passed, the same quantum of ODA was not required to keep funding external debt service. Hence some decline in ODA was to have been expected.

misleading. The 25 developing countries that absorb 90 per cent of private inflows to the developing world account for over 75 per cent of its population, 70 per cent of its output, 80 per cent of its trade and 80 per cent of its international reserves. Measured thus, the concentration of private flows reflects the distribution of the developing world's 'market capacity'.

It would be odd to expect a different outcome. Eighty per cent of private capital cannot possibly flow to 80 per cent of the number of developing countries. A small island country with a population of less than a million people, and no market to speak of, cannot possibly absorb the same amount of private capital as India or China. There is a case for arguing that the distribution of private capital is skewed when Chile and Malaysia attract larger flows than India or Nigeria, or when India attracts less than 10 per cent of the FDI that China does. But the reasons for these 'distortions' are not difficult to discern. They have little to do with the faults of private capital. They have more to do with flaws in the behaviour of countries that are destinations for investment. ZPR indicates what might be done for such distortions to iron themselves out. But it is not obvious, as ZPR and other proponents imply, that policy choices which deter private capital from entering many developing countries should result automatically in the consequent FfD gap being filled by equivalent amounts of ODA.

Private capital plays a major role in the lives of most people in the developing world. It may not play as significant a role in the least developed economies, although the potential for it to do so (for example in the case of Bangladesh) is greater than generally acknowledged or realised. Least developed countries will depend on ODA flows for some time to come. Their financial systems are too nascent to attract private capital. In some, their debt overhang deters private flows as does their level of development, the structure of their economies, the absence of opportunities and essential infrastructure, and lack of natural resources. In short, their financing needs do not match the investment preferences of private capital. For these reasons, ODA and private flows are not perfect substitutes. But the experience of the 1990s suggests strongly that private capital can replace ODA more widely, deeply and to better effect than was once firmly believed, and is still frequently alleged, in a number of areas.

Private Capital Flows and Development

Experience between 1980–2000 has been instructive about the implications of private capital flows for development. The dangers of commercial bank lending, especially short-term lending, as a source of FfD became clear in the debt crisis of 1982–90. But lessons from that period seemed to have been forgotten when similar dangers materialised in 1994–95 and 1997–98. In contrast, *FDI* has obvious and significant benefits in terms of its contribution to increasing the level and quality of investment, of productivity and associated know-how transfer of both hard and soft technology.[26] FDI is not, however, without costs. It creates long-term liabilities when dividends are remitted and/or interest is repaid to parent companies, and when invested capital (or capital borrowed from the parent) is eventually repatriated.

FPI has the benefit of boosting reserves and money supply in the short-run, and diminishing reliance on commercial bank borrowings and on official finance for managing the external account. But it has *costs* in terms of volatility. In the absence of astute management to control or dampen the impact of inward surges of portfolio capital by monetary and fiscal authorities, such surges can lead to financial system destabilisation and trigger eventual equally swift outflows, with knock-on effects on the real economy.

26 See Chapter 2 of *Global Development Finance 2001*, op cit.

5.2.3. *The Distinction between Foreign Direct Investment and Foreign Portfolio Investment*

These truisms often lead analysts to overplay the real dangers of FPI while being over-sanguine about FDI. It is often the case that risk-management inclines treasurers of TNC affiliates in developing countries to maximise local borrowings against fixed and working capital assets. The surplus liquidity maintained can be quickly shifted abroad in a time of crisis. Risk-management instruments (especially derivatives for hedging against interest rate, currency and price risk) in sophisticated financial markets now permit corporate treasurers of TNC subsidiaries in developing countries, representing the largest amount of FDI, to undertake off-balance sheet transactions that can have the same effect as FPI in financial crises when it rushes in a panic to exit. By the same token, transactions recorded as FPI (for example share-purchases by institutional investors in green-field investments) can actually be a substitute for FDI and be just as stable.

Thus, while the conceptual differences in cost-benefit profiles and volatility-risk between FDI and FPI remain important in theory, their actual costs and dangers in practice can be, and frequently are, misconstrued and misrepresented. For that reason, it is as important for central banks and regulatory authorities in developing countries to monitor the off-balance sheet risk management positions of major foreign direct investors (especially commercial and investment banks) in their countries as it is to monitor flows of FPI and capital flight.[27] In that connection, it should also be noted that domestic corporations and domestic portfolio capital also behave in ways that exacerbate financial crises in the same way as FPI; this is true whether capital accounts are officially controlled or not.

Foreign Direct Investment

Since 1994, FDI has become the single largest source of external financing for the developing world (Table 7). Accompanied by the right macroeconomic policies, FDI has 'crowded-in' other ancillary investments and increased growth rates through the associated transmission of technology, human skills, increased domestic competition and increased exports. Inflows of FDI have grown from 0.14 per cent of the developing world's GDP in 1980 to 0.78 per cent in 1991, rising to 3 per cent in 1998 before dropping back to 2.63 per cent in 2000. In dollar terms FDI inflows have grown from $4.4 billion in 1980 to $36 billion in 1991 and $185 billion in 1999,[28] a remarkable increase by any measure.

The developing world accounted for just a quarter of global cross-border FDI in 1999, although that share peaked at 36 per cent in 1997 before the Asian crisis.[29] It has since fallen back to less than 16 per cent of global FDI in 2000. Against that proportion, the developing world now accounts for 22 per cent of world production measured at nominal exchange rates and for 45 per cent measured at purchasing power parity (PPP) exchange rates (Table 4). Given a presumed differential of about 4–5 per cent in sustainable long-term growth potential between the industrial and

27 The World Bank's Global Development Finance Report for 2000 (GDF-2000) observes: 'FDI flows are also subject to slowdown or reversal in the event of economic difficulties ... increased uncertainty with economic crisesmay cause investors to reduce new commitments, accelerate repayment of affiliates' debts to home office, or take off-setting positions through derivatives. In the latter case, the decline in investors' exposure to the country is not even recorded in the data on FDI. In a limited number of countries, direct investment financed by joint-ventures' external borrowing may be incorrectly classified as FDI, and thus may tend to behave similarly to capital market flows.'

28 *Source: Global Development Finance* (GDF-2000 and 2001-draft), World Bank, Washington DC.

29 The decline from 36 per cent in 1997 to 25 per cent in 1999 was also partly because of unprecedented merger and acquisition activity in the industrial countries in 1999 (UNCTAD, *World Investment Report*, 1999).

Table 7. Net Resource Flows to All Developing Countries 1970–2000

(Amounts in US$ billion)

	1970	1980	1991	1997	1999	2000
Total Net Resource Flows	**11.3**	**82.8**	**119.7**	**334.6**	**250.7**	**280.9**
of which						
Net Official Flows	**5.6**	**34.9**	**60.9**	**42.8**	**45.3**	**47.1**
o/w Grants (excludng. TC)	2.2	13.2	35.1	26.1	28.9	29.6
Memo: TA Grants	1.7	6.3	15.6	15.7	16.6	17.1
Net Private Flows	**5.7**	**47.9**	**58.8**	**291.8**	**205.4**	**233.8**
o/w FDI	2.2	4.4	35.5	172.6	185.1	176.2
FPI (Equity)	0.0	0.1	4.6	22.4	21.1	34.8
Bonds	0.2	1.1	10.9	49.0	25.4	31.1
Bank Debt	3.3	42.3	5.0	45.1	–24.6	–8.5
Other	0.0	0.0	2.8	2.7	–1.6	0.2
Memo:						
Interest Payments	–4.1	–48.9	–72.3	–109.1	–135.3	–153.1
Profit Remittances on FDI	–6.5	–23.7	–18.3	–31.4	–41.6	–48.5
Net Transfers	**0.7**	**10.2**	**29.1**	**194.1**	**73.8**	**79.3**
Official	4.7	28.8	41.1	10.3	–10.2	–24.0
Private	–4.0	–18.6	–14.8	184.5	85.2	103.1

Source: Global Development Finance Country Tables 1999 (for 1970 and 1980), World Bank; GDF 2000 and 2001 (draft mimeo for 1991–99); World Bank. Figures for 2000 on memo items are estimates from preliminary sources. The table takes into account short-term debt.

developing worlds over the next 20–25 years, it would be reasonable to suggest that the share of global FDI accounted for by developing countries should, *ceteris paribus*, stabilise at an average of about 40 per cent, representing the midpoint in a range of 35–45 per cent over that time-frame, allowing for annual fluctuations.

To some extent, the growth in FDI flows to developing countries was inflated between 1992–97 by one-off factors such as the privatisation of major infrastructure service companies in Latin America. The scope for similar waves of FDI motivated by privatisations in other regions, particularly in South Asia, remains. Even now, Latin America and East Asia account for 75–80 per cent of FDI to all developing countries (Table 8). Eastern and Central Europe and Central Asia account for another 15 per cent. With other regions receiving only 5–10 per cent of the total, there is obviously scope for attracting FDI to Africa and South Asia providing governments in these regions undertake the policy reforms and structural transformations to create more space for private participation in the economy that Latin America and East Asia have already undertaken (although those regions still have some distance to go).

The World Bank reports that developing countries have made progress in improving the climate for FDI between 1992–99.[30] They have eased/removed licensing requirements, opened

30 See GDF-2001 (draft mimeo) pp.10–11.

Table 8. Private Flows, ODA Flows and External Debt and Debt Service 1998

	PRF ($ billion)	FDI ($ billion)	XDT ($ billion)	XDS ($ billion)	Official Development Assistance Amount ($ billion)	($)	LGNP (%)	IODA/GDI (%)
All Developing Countries *of which*	267.7	170.9	2,536	296.1	38.4	(8)*	0.6%	0.83
Low-income Countries	12.2	10.7	419	26.5	18.5	(7)*	2.1	3.15
Middle-income Countries	255.5	160.3	1,957	269.6	19.9	(12)*	0.4	0.45
East Asia and Pacific	67.2	64.2	668	78.1	6.8	(4)*	0.4	0.37
South Asia	7.6	3.7	164	14.7	4.8	(4)*	0.8	1.31
Europe and Central Asia	53.3	24.3	481	45.6	6.4	(14)*	0.6	1.02
Middle East and North Africa	9.2	5.0	208	20.3	4.4	(18)*	0.7	1.25
Sub-Saharan Africa	3.5	4.3	230	14.5	12.4	(21)*	3.9	7.65
Latin America and Caribbean	126.8	69.3	786	123.0	3.5	(9)*	0.2	0.28

Note: PRF = Net Private Resource Flows; FDI = Net Foreign Direct Investment; XDT = Total External Debt Outstanding; XDS = External Debt Service for that Year; IODA = Investment-related ODA; LGNP = GNP of Developing Countries
*Dollar figure in brackets shows ODA per capita.
Source: GDF-2000. World Bank, Washington DC

up sectors previously closed to foreign investment, eased up on restrictions limiting the share of foreign investment in domestic firms, liberalised current and capital account regimes for foreign investors, strengthened laws on the protection of intellectual property rights, improved the regulation of domestic financial markets and made tax systems more neutral between domestic and foreign investors; indeed they have extended the 'equal treatment' principle across-the-board. Most developing countries no longer have severe regulatory impediments for foreign investment. Many have regimes that are more liberal than those of several OECD countries. The regional variations in how far developing countries have gone in these directions remain quite large with the regions receiving the largest FDI flows having made the most progress. Yet FDI flows have not responded to these reforms with as much alacrity as might have been anticipated. Why is this?

A low level of development, insufficient physical and social infrastructure and the lack of market opportunity and natural resources in many countries provides part of the answer. But another part appears to lie in the continued prevalence of corruption, failure to remove unnecessary regulatory requirements, complicated and non-transparent administrative procedures and insufficient protection of property (and collateral recovery) rights because of malfunctioning legal systems that do not provide civil redress in real time. Corruption has a greater effect on FDI than on FPI (thus discouraging the wrong flow) with recent studies[31] indicating significant correlations between corruption and lack of transparency, on the one hand, and FDI flows on the other.

Actions to Encourage Foreign Direct Investment Flows

What might be done to encourage FDI inflows

31 See, for example, Hoekman, B. and Saggi, K. 'Multilateral disciplines for investment related policies' in Guerrieri, P. and Sharer, H. E. (eds). *Global Regionalism and Economic Convergence in Europe and East Asia: The Need for Global Governance Regimes*. Rome: Institute for International Affairs, 1999; Drabek, Z. and Payne, W. 'The Impact of Transparency on Foreign Direct Investment' (mimeo) 2000.

Table 9. Foreign Direct Investment in the Developing World 1970–2000
(Amounts in US$ billion)

	1970	1980	1991	1997	1998	1999	2000
FDI to All Countries	60	93	160	473	683	982	1,118
FDI to Developing Countries	2	4	36	173	177	185	176
Developing Countries' FDI Share	2.9%	4.3%	22.1%	36.5%	25.9%	18.8%	15.8%
FDI as Percentage of GDP For All Developing Countries	0.25%	0.14%	0.78%	2.67%	2.95%	2.93%	2.63%
East Asia and Pacific	0.20%	0.30%	1.43%	3.32%	3.84%	3.02%	2.86%
South Asia	0.08%	0.08%	0.10%	0.91%	0.64%	0.53%	0.51%
East Europe and Central Asia	0.01%	0.01%	0.31%	2.12%	2.52%	2.51%	2.76%
Middle East and North Africa	0.71%	−0.86%	0.38%	0.87%	1.14%	0.24%	0.69%
Sub-Saharan Africa	0.16%	0.02%	0.33%	2.54%	2.05%	2.59%	2.36%
Latin America and Caribbean	0.68%	0.82%	0.68%	3.35%	3.710%	4.64%	3.62%

Source: GDF-2000 and 2001(draft) (World Bank)

to developing countries other than regime changes that will only take effect in the medium or long term? The obvious impediments notwithstanding, there is much that can be done about encouraging greater flows of FDI to developing countries, and especially the low-income and least developed groups, despite their obvious disadvantages as destination countries. It simply requires more imaginative thinking than has been done by SGR or ZPR. The central problem pivots around risks in these groups of countries exceeding (or being perceived as exceeding) those that private investors are prepared to take because of starting conditions prevailing in these countries. That problem begs the question: is there not a considerable amount of unexplored space for imaginative combinations of risk-sharing between private and public capital in these countries to overcome the reluctance of private investors? With the intellectual capacity that exists in the private sector, and similar capacity alleged to exist in the MDBs (and their affiliated investment corporations such as IFC), it should be possible to design project-specific, as well as generic, schemes for risk-sharing that pave the way for private capital to enter countries where it otherwise might not be prepared to take full exposure risk on its own.

In that connection, the World Bank has already opened the door to partial policy risk guarantees. But neither private investors nor developing countries are rushing through it. Also, although the ostensible value of the Multilateral Investment Guarantee Agency (MIGA) and the International Centre for the Settlement of Investment Disputes (ICSID) has been advertised, these agencies have not really added much value in encouraging incremental flows of private investment. Their impact has been minuscule. That suggests difficulties with the way in which these agencies work and the way in which the policy-risk cover concept has been applied in practice, rather than with the concept itself.

All the MDBs (and their investment affiliates) need to be encouraged to develop bolder schemes for encouraging and supporting private capital flows – through appropriately tailored guarantees as well as equity-risk sharing by their investment affiliates – to low-income and least developed countries. Such activity should be

given equal priority to direct loans by MDBs, for which their preference remains undiminished. At least 65 per cent of the number of operations of MDB-related investment corporations, such as the IFC, should be concentrated in low-income and least developed countries, instead of 75 per cent of them being in middle-income or industrialised low-income countries, such as India, in which FDI is prepared to flow of its own accord without any help from the MDBs. Such corporations, for example the IFC, often take the easy way out by preferring transactions in countries that do not need them (and often annoy the private institutional investors they displace by doing so) on the grounds that these are necessary to retain the quality of their portfolios. That argument has some merit, but it is grossly overused.

There is a powerful case for MDBs and their investment affiliates being more proactively involved in encouraging FDI inflows to low-income and least-developed countries by acting as spearheads on the unfinished business of privatisation, especially in South Asia, Central Asia and Africa, as well as in the SDIS of the Caribbean, Indian and Pacific Oceans. As Latin America and East Asia have already demonstrated, considerable opportunities exist in these regions to expand FDI inflows by a multiple of their present values by assisting countries with privatisations in which MDBs/ICs can start the ball rolling. These multilateral agencies should assume the perceived high initial risks (on equity and debt) accompanying such privatisations. They can do so by structuring transactions, i.e. financial engineering, and creating instruments, for example convertibles and call options on shares, during the phases of corporatisation and restoration of public sector enterprises to profitability before their eventual floatation.

Such transactions are unlikely to succeed unless MDBs/ICs bring in private operating partners (as well as private investment banks) who have a global market stake in particular areas of infrastructure, for example electricity, telecommunications, broadcasting and media, water supply, sewerage and waste disposal, and all types of transport services – air, waterborne and land – as well as infrastructure provision such as toll roads, bridges, tunnels, ports and airports. The same applies in privatising industrial units that are usually found in the public sector, for example in food and beverages, heavy industries such as cement, steel, metals refining and beneficiation, oil/gas, coal, chemicals and petrochemicals, and in textiles. The overall design under which private operators are brought in to revamp and manage these services, while MDBs/ICs take the initial capital risks, should eventually result in the private partners exercising options to assume equity control when the risks have been reduced to levels that private investors feel comfortable with.

These types of operations are likely to have associated spin-offs by encouraging collateral private investment, domestic and foreign, in supplier and ancillary industries that feed off large public units that are being privatised. They can also result in profitable spin-offs as large public enterprises are unbundled to focus on core competencies and as a climate is created to crowd-in private investment generally. None of this is fanciful generalisation. It has already been done in middle-income countries where initial political and public resistance was even stronger, as was scepticism about whether such radical solutions would work. It has been proved beyond any doubt that they can work. Such transactions, repeated in HIPCs, can help to reduce debt overhangs through swaps of official debt (held by bilateral and official multilateral agencies) for equity in public enterprises that can be prepared for privatisation. But if the generalisation is to become a reality, there must be political will on the part of the developing countries concerned and more imaginative management and vision in the MDBs/ICs than has been displayed so far.

5.2.5.7 Such involvement in promoting FDI inflows more proactively will open up opportunities for MDBs/ICs to expand FPI flows through such avenues as: (a) guarantees for bond issues by sovereigns and sub-sovereigns in the developing world; and (b) bond issues as well as regional/global equity placements by their instrumentalities that are being first corporatised and then privatised. Going further, MDBs can encourage FPI by floating their own bonds in the domestic capital markets of countries where confidence is lacking in the sovereign issuer as a benchmark. The proceeds from such issues can be earmarked for spending in the same countries for both physical and social infrastructure. The example of the European Bank for Reconstruction and Development (EBRD) floating bonds in borrowing member countries, for example Hungary, for financing local infrastructure is salutary. It needs further examination and selective emulation by other MDBs.

In middle-income developing countries, as well as some low-income countries like India, MDBs/ICs can go further by creating and making markets in derivative instruments that can be specifically tailored or traded over the counter. Such instruments would allow private investors to hedge risks on either a long-term or rolling basis in developing country currencies and interest rate movements. In particular, they can help to design and (together with global investment banks) make markets in instruments that might prevent private institutional portfolio investors from exacerbating financial crises through their own exaggerated involvement in inward and outward surges of short-term capital.

These types of arrangements might, for example, require foreign institutional investors to purchase options contracts at the time of entry that would result in large financial losses if the same investors indulged in double-plays or in putting undue speculative pressures on currencies and interest rates during times of financial crisis. Again, these are not fanciful suggestions. They are based on what has been tried in the crises that occurred in 1994–95 and 1997–98. The lessons learnt from these crises on the kinds of instruments that might be developed should not be lost. MDBs/ICs have a public interest role to play in helping to create and trade instruments that will encourage FDI flows and stabilise FPI flows.

Implications for Commonwealth Countries – Foreign Direct Investment

The regional variations in FDI (indicated in the tables above) are reflected across the Commonwealth. Its developing members can learn much from its developed members, and particularly from their provincial development and investment promotion agencies, about how to attract FDI and use it as a powerful weapon to assure sustainable development accommodating diversification and growth. The use of FDI by Singapore to promote growth and development is legendary in the annals of economics. Other developed Commonwealth countries have been among the most successful OECD countries in attracting FDI, not least the UK, which is regarded as the most competitive and attractive destination for FDI in Europe although stealth taxation, some recent policy measures and meddlesome administrative actions appear to be eroding its competitiveness.

Among Commonwealth developing member countries, Malaysia and Mauritius have developed FDI regimes that have proved successful, although these need to adapt and evolve to keep pace with ongoing changes. Mauritius needs to go several steps further toward fusing its domestic and offshore investment regimes and opening the whole island to unrestricted FDI in a fashion similar to Singapore for the next phase of its development. The Commonwealth's South Asian members lag far behind (as the tables above show) in the FDI stakes. Their investment regimes are being opened too slowly and reluctantly. This is due to inertia in

public administration as well as political reluctance to forego rent-extraction opportunities. The factors mentioned above (corruption, lack of transparency and malfunctioning legal systems that do not settle commercial disputes and enforce property rights expeditiously) play a large role in inhibiting FDI flows to the Indian sub-continent. Private flows could be much larger, approaching the FDI flows being attracted by China which are ten times as large, if the constraints that presently operate in South Asia were overcome.

This observation also applies to most of the Commonwealth's African members. In these countries much progress has been made with improving regimes and policies but without much effect as yet on improving FDI inflows. In Anglophone Africa (with the exception of South Africa) FDI inflows are still geared to the hydrocarbon, mining, plantation and services (tourism, finance and transport) sectors, with little FDI gravitating toward manufacturing. Although the traffic lights for FDI are being fixed in Africa under the pressure of adjustment programmes, there is less FDI traffic than there might be. Foreign investors are deterred by internecine conflict, political instability, absence of communications infrastructure and exceptionally low standards of public administration. FDI in Africa is also inhibited because many countries have national markets that are not viable in size. For FDI (or any private investment) to increase dramatically in that continent, sub-regional and regional market integration will need to accelerate.

The greatest challenges in attracting FDI for sustainable development (in areas other than tourism) are confronted by the island economies of the Caribbean, the Indian Ocean (although, as noted above, Mauritius is an interesting exception) and the Pacific. These economies have relied on SDT preferences for a long time but have not yet been able to attract the kind of FDI that has enabled them to diversify their production base. The limitations of micro-markets and of vast distances to be covered by sea and air lead to prohibitive transport costs deterring investment. At the same time, the recent threat posed by the OECD's harmful tax competition initiative, aimed at curbing the operation of offshore financial centres, on which many island economies of the Commonwealth are dependent, will affect FDI adversely in these economies. It is not clear what will take the place of the offshore finance industry if OECD countries succeed in achieving their misguided objectives at the expense of small defenceless countries with very few options.

Belief in the need to maintain SDT preferences for these SDIS remains unshakeable. But tenacious clinging to SDT may have retarded development and diversification in these economies instead of promoting it.[32] With the exception of Barbados, the Bahamas and Mauritius, there is no evidence to suggest that the time bought by SDT has been well used to secure the future by the other island economies. As noted above, the solution for SDIS probably lies in economic integration with neighbouring trade blocs, under arrangements that provide for free labour mobility as the *quid pro quo* for opening their investment regimes to investors within those blocs. To attract more foreign investment, SDIS members of the Commonwealth (especially in the Pacific) should reconsider their reluctance to permit foreign investment in land and remove restrictions that are presently imposed on FDI in order to protect indigenous ethnicity. These countries have to face the reality that a globalising world does not permit sovereign preferences to be exercised when sources of earnings are limited to very few opportunities (unlike the oil-rich countries of

32 See Page and Hewitt, 2001, op. cit.

Table 10. Portfolio Flows from Capital Markets to Developing Countries 1991–2000[33]
(Amounts in US$ billion)

		1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total	Gross	79.9	88.2	158.8	153.7	201.4	272.0	323.6	196.4	198.8	241.1
	Net	*23.3*	*44.1*	*57.3*	*67.5*	*71.0*	*112.3*	*119.2*	*96.5*	*20.3*	*66.9*
Bonds	Gross	11.0	20.1	50.1	45.7	52.6	97.6	114.3	73.0	70.3	77.2
	Net	*10.9*	*11.1*	*36.6*	*38.2*	*30.8*	*62.5*	*49.0*	*40.9*	*25.4*	*31.1*
Banks	Gross	61.3	54.0	57.5	72.8	112.7	125.2	179.1	107.8	94.0	115.9
	Net	*5.0*	*16.2*	*3.4*	*8.7*	*30.5*	*33.7*	*45.1*	*50.0*	*–24.6*	*0.7*
Equity	Gross	7.6	14.1	50.9	35.2	36.1	49.2	30.2	15.6	34.5	47.9
	Net	*4.6*	*6.0*	*8.1*	*17.0*	*8.0*	*13.7*	*22.4*	*8.6*	*21.1*	*34.8*
Other	*Net*	*2.8*	*10.8*	*9.2*	*3.6*	*1.7*	*2.4*	*2.7*	*–3.0*	*–1.6*	*0.3*

Source: GDF-2001, op. cit. Tables 2.2 and 2.6

the Gulf and Brunei) and depend entirely on tourism and attracting FDI.

Foreign Portfolio Investment

Gross foreign portfolio flows from capital markets to developing countries surged from $80 billion in 1991 to a peak of $324 billion in 1997 before falling to an average of $197 billion annually in 1998–99 (the aftermath of the Asian crises) and then recovering slightly in 2000 to $241 billion. The corresponding net flows were $23 billion in 1991, $119 billion in 1997 and $20 billion in 1999 recovering to $67 billion in 2000 (Table 10). Such flows include: (a) the proceeds of bond issues (sovereign and corporate) of developing countries, their instrumentalities and their private corporations on global bond markets; (b) commercial bank lending of both a medium-term nature (maturities of 3–5 years), as well as short-term bank lending (maturing in less than a year); (c) portfolio equity flows going to/from the securities markets of developing countries (or emerging markets); and (d) a balancing item to reconcile the inevitable discrepancies that arise with the recording of such flows.

Table 10 demonstrates how volatile gross and net FPI flows can be, a characteristic that applies to every component of such flows but mostly to commercial bank lending. As the table shows, net FPI (which is what counts in terms of financing for development in any particular year) rose from a low of $23 billion at the beginning of the decade of such flows, escalated to over five times that amount by 1997, fell back to below the 1991 level in 1999, and recovered sharply again in 2000 when it became clear that crisis-affected Asian economies had rebounded. The pattern demonstrates how sensitive such flows are to financial turbulence and how they may serve as a transmission channel for contagion.

For obvious reasons, such flows are concentrated in countries with well-developed capital markets of their own. It should come as no surprise that the share of middle-income countries in such flows is over 96 per cent or that 85 per cent of such flows are concentrated in 10 countries. The exception to this rule is China, which has been able to attract an enormous amount of portfolio equity investment, despite having capital markets that are not as well

33 Derived from Tables 2.2 and 2.6 in GDF-2001. These tables in the GDF were found to be wrong because the gross and net flow figures for portfolio equity investments had been confused and transposed i.e. the figures for gross equity in Table 2.6 should have been in the net figures shown in Table 2.2 and vice-versa. The totals in both these tables shown in GDF-2001 were therefore also wrong and have been amended above.

developed as, for example, India's and are far behind South Africa's.

Against these portfolio capital inflows, developing countries currently hold international reserves (mostly in US dollars with the balance in SDRs, gold, Japanese yen and a few European currencies) of over $850 billion. Such reserves represent *official* holdings on the portfolio capital account that run counter to portfolio inflows from capital markets to developing countries. The bulk of these reserves, however, are held by East Asian countries, with Greater China and Singapore estimated to hold over $500 billion.

The volatility of FPI affects only a handful of developing countries directly, although these account for the bulk of the developing world's population. It affects many more indirectly when financial crises are spread through contagion. In these instances, even countries that have been cautious about attracting FPI get caught in the backwash. All the financial crises triggered in the developing world in the 1990s have been linked to surges of FPI, first inward then outward. Such crises have been exacerbated by simultaneous over-indulgence in short-term foreign currency bank borrowing by domestic corporations. Inward FPI surges can, in the absence of sound reserves management and sterilisation strategies, have an impact on expanding local money supply and emit signals on exchange and interest rates that are contradictory. These do not correspond to signals in the real economy, such as prices and wages, and may exacerbate fuelling the growth phase of an economic cycle in an unsustainable fashion. This, in turn, can lead to generalised inflation or the rapid inflation of asset values, such as those of equities and property prices, fuelling the wrong kind of investment (in unproductive assets) and/or consumption booms triggered not by income growth but by asset price, exchange rate and interest rate signals that no longer reflect economic fundamentals.

Once triggered, these booms are difficult to rein in by orchestrating finely-tuned soft landings. Instead they usually result in economic dislocations, i.e. hard landings. When the effect of such dislocation begins to show, portfolio capital that seeks to maximise short-term returns and minimise short-term risk makes an equally dramatic exit. This has the inevitable effect of triggering a run on reserves, resulting in interest rates being dramatically raised, usually under IMF/World Bank pressure, to protect exchange rates and stem capital outflows. Asset values then collapse, leading to sudden distortions on corporate balance sheets that can trigger bankruptcy and unemployment. It also results in choking off investment, public and private, very sharply in the face of interest rate pressures that do not justify borrowing for investment. Together, these tendencies result in a collapse of demand and economic recession, putting pressure on an over-stretched fiscus (by reducing revenues and increasing expenditures simultaneously) that usually cannot take the strain. In such circumstances, everything gives. The bottom falls out of fiscal, monetary and exchange rate policy with the government losing control over the levers of macroeconomic policy and management. Resort to the IMF, resulting in the imposition of harsh stabilisation conditionalities, makes matters worse in the short term before the economy bottoms out and begins a long, slow painful recovery.

Many lessons were learned in the 1990s about the need to manage surges of private capital more intelligently in order to combat the temporary failure of markets as herd instincts are exercised both at times of inward and outward flows. It is odd, therefore, that there remains a marked reluctance on the part of *developed* country governments to consider ways of moderating hot FPI flows at source, especially during the inward surge (for the receiving country) part of the cycle, through a system of hoisting yellow and red flags. Such signals could be rein-

forced by publicising in advance changed rules of the game in the course of crisis management. Instead, OECD governments seem disinclined to discourage markets from failing through erroneous beliefs about the wisdom of relying entirely on *laissez-faire* in such instances.

The implicit position of developed country governments on FPI seems to be that: (a) private capital flows should be free from any kind of government or inter-governmental intervention; and (b) the world community should react only after a crisis. Extrapolating from repeated experience, another implicit position seems to be that the price of correcting market failure in the aftermath of a crisis should be paid entirely by the developing countries concerned, and usually by their poorest people. That presupposes that only they were at fault and that injudicious over-borrowing can occur without imprudent over-lending. If a moral hazard has been created with the way in which financial crises have been managed, it has not been in encouraging dissolute behaviour on the part of developing countries. It has instead been created by encouraging irresponsible behaviour and market-failure at the originating end through repeated IMF/World Bank organised and financed bail-outs of private portfolio investors and commercial banks, ostensibly to avert systemic risk.

Although the gravity of the problem should be recognised, together with the fact that something sensible should be done to ameliorate it, care has to be taken that neither developed nor developing countries act in ways that reduce or impair the flow of private capital. That would be in no one's interest. If emerging markets are to grow much faster than developed markets, global capital has to be permitted to flow to opportunities of high returns and to take the attendant risks. Obviously, such flows must be based on the explicit understanding by investors and developing countries that some risks will materialise and that many individual investments will fail. That is how markets work. The issue is not one of safeguarding against all investment failure but of averting situations where system risk is created that induces entire financial systems to fail because of herd instincts resulting in transient market failures.

Dealing with the issue, despite a decade of mixed experience, is not easy. Facile solutions are to be regarded with caution. In that context, the experience both of Malaysia Hong Kong (in intervening in the stock market to deter harmful speculation) provide case studies for public intervention that other Commonwealth countries need to understand and learn from. Malaysia's approach – derided by the international financial community at the time – eschewed traditional IMF prescriptions. It designed its own adjustment programme. An initial devaluation was followed by a fixed exchange rate regime with controlled domestic interest rates and the reimposition of temporary controls on movements of portfolio capital. Malaysia avoided an unnecessarily harsh fiscal and monetary squeeze of the kind that did so much damage to the rest of Asia. Its approach proved remarkably effective in bringing about necessary adjustment without unleashing the destructive forces that were experienced in Indonesia and Korea. Similarly, Hong Kong's monetary authorities broke with accepted tradition and intervened massively in the stock market to burn speculative investors indulging in pernicious double-plays (explained below) that may have led to a more serious financial collapse in Hong Kong than was, in the event, actually experienced.

It may be premature to reach immediate agreement on an internationally co-ordinated regime involving direct interaction among governments and financial market regulators (rather than the intrusive and heavy-handed intermediation of the Bretton Woods Institutions) to govern global private portfolio capital flows. Nevertheless, the world community would

be negligent if it did not flag this issue at UNCFD and embark on a programme that would result in better approaches by the IFIs with more acceptable outcomes. The aim should be to avoid tedious repetition of financial crises in the developing world. What should be agreed is that the standard template applied by the IMF to financial crisis management in all instances (hotly denied on every occasion, contrary to the evidence at hand) needs to be overhauled.

The aim of such a change should be to ensure that the eventual costs of dealing with any financial crisis are borne as much by portfolio investors, domestic and foreign, and by foreign and domestic banks, which are usually culpable of irresponsible lending, as by the country and entities which receive such investment or borrowing. The continuation of crisis management protocols that still provide preferential treatment for foreign investors and foreign banks during a crisis, and encourage the draining of a country's reserves, should be discouraged. Thought should be given to requiring investors and foreign banks interested in inward FPI to purchase appropriately designed prophylactic derivative contracts (for example buying options contracts on currencies and interest rate futures at the time of making inward investments) that would discourage the same foreign banks and portfolio investors from indulging in counterproductive currency speculation to drive the currency down or the interest rate up; or to indulge in *double or triple plays* in equity, debt and currency markets in the midst of a crisis, thus exacerbating it.[34]

For example, in some Asian countries in 1997–98 (Thailand, Malaysia, Hong Kong) foreign institutional investors and banks did simultaneous transactions in the derivatives and physical segments of the markets that drove interest rates up and currencies down, while short-selling equities and equity-indexes in those markets. The net result was that they made extraordinary profits when equity prices automatically fell, in the face of a draconian interest-rate squeeze and currency collapse. Apart from discouraging or banning those sorts of 'double-plays', the size and terms of the IMF rescue packages in a crisis should be sufficiently large and sensitively designed so as to minimise the damage inflicted on the economy in the stabilisation and adjustment phases that precede recovery. In particular, such rescue packages should be designed to avoid any risk of inflicting unnecessary and unjustified pain on the poorest segments of society in affected countries by ensuring sufficient funds and fiscal protection to erect safety nets.

Crisis management should avoid destabilising developing country governments that are in the midst of managing crises. They should not be used to pursue hidden agendas for using a financial crisis as a convenient opportunity to induce political regime changes (as seemed to be the agenda in Indonesia). Enough has been learnt to make this possible, providing sufficient political will exists to implement the measures needed, to design instruments appropriately and to ensure changes in the policies and *modus operandi* of the IFIs. These institutions should be prevented from inflicting unnecessary pain, which they often do in the false belief that it is essential for them to convince markets that they are being suitably harsh and disciplinarian, or simply because they have not thought things through carefully enough.

In addition to measures that can be taken by multilateral institutions and their affiliated investment corporations to encourage private capital flows, industrial and developing coun-

34 Some thoughtful ideas along these lines have been advanced by Avinash Persaud, a global currency expert, in two articles, 'The Disturbing Interaction between the Madness of Crowds and the Risk Management of Banks', paper commissioned for the Commonwealth Conference on Developing Countries and Global Financial Architecture, Commonwealth Secretariat, London , June 2000 and 'Sending the Herd off the Cliff Edge: The Disturbing Interaction between Herding and Market-sensitive Risk Management Practices'.The latter article won first prize in the Year 2000 Essay Competition held by the Institute of International Finance, Washington DC.

tries can both take actions to enhance the *push* effect (i.e. encouraging private capital to flow outwards from OECD countries) and the *pull* effect (providing an attractive environment for private capital in developing countries). Industrial countries can do more to encourage private flows to emerging markets through suitably designed tax credits, deductions and allowances for capital investment in the least developed countries (which could be treated on a par with either charitable deductions or incentive-driven investment). Special and differential tax treatment could also be applied to the receipt of profits and dividends by corporate, as well as individual, investors in emerging market funds (whether for a country, a region or the emerging market universe as a whole). In the latter case, tax benefits to mutual funds and asset management companies specialising in investing in emerging markets could be passed through to individual unit holders. Clearly, such tax measures would need to be calibrated to provide maximum tax benefits for investments flowing to the poorest (and the highest-risk) countries with a tiered reduction of the special treatment accorded to investment in more developed, middle-income emerging markets.

A caveat is however necessary when considering options through which industrial countries can induce private capital to flow to developing countries. The history of experience with using differential tax treatment, i.e. tax breaks, to achieve specifically targeted social, development or environmental objectives, domestically or internationally, has been mixed. It is not clear that the tax loss incurred, i.e. the cost of providing the impetus, is worth the benefit derived, or that tax incentive driven investment is necessarily the most efficient or productive. Moreover, in this instance, the cost of providing tax breaks would be socialised (by token of its being incurred by the fiscus of a particular OECD country), while the short-term gain accrues to another country and is privatised at both ends – i.e. the benefit accrues to a private investor in the industrial world and to private entities in the developing world. When these investments begin to yield returns, some gains will also be derived by the OECD country providing the tax break, by way of a reverse flow of repatriated capital, profits and dividends over the long term that would be subject to tax. Thus such tax breaks represent revenue deferral rather than revenue loss.

But despite this caveat there may be a case for providing special and differential tax treatment in OECD countries to encourage private flows to the developing world for a transitional period. There is another reason for doing so: most OECD governments have fallen far short of the ODA target of 0.7 per cent of GNP. Meeting such a target would mean raising tax resources or increasing domestic borrowing to finance ODA. If private capital outflows from a particular country can be considered, in a similar context, to contribute toward FfD (though obviously not substituting for ODA on a one-for-one basis) there is a justification for providing a tax break if it lessens the pressure on the source country to provide amounts of ODA that it cannot afford fiscally. Taxes collected to finance ODA or taxes foregone to encourage private flows are, in a limited conceptual sense, equivalent.

Asking OECD countries to make a major effort to encourage private capital outflows to developing countries is unlikely to be beneficial if the latter do not themselves create the right environment, not just for attracting private capital, but ensuring that it is effectively deployed. This no longer means providing tax holidays to compete for foreign investment. In fact, the value of tax breaks at the receiving end has virtually been played out as an attraction for FDI. Foreign investors are not looking for tax breaks in developing countries so much as a business environment in which they can do business without wasting time, effort and money. They are more interested in a long-term

entry that enables them to compete for domestic, as well as global, market share.

In particular, it requires developing countries to deliver on the wish-list elucidated in ZPR: (a) the elimination of corruption and rent-extraction; (b) putting in place effective and timely mechanisms for dispute resolution and global standards of judicial recourse, as well as for collateral recovery and closure; (c) changing laws, rules and regulations that constrain normal commercial market activity, such as the right to hire and fire workers based on market conditions and the profitability and economics of the firm and without excessive hindrance imposed by labour laws, or the right to purchase commercial and residential property, or the right to borrow and raise equity locally; and (d) increasing investment in basic infrastructure for power, telecommunications, water supply and transport at a more rapid pace than might have been necessary without the pressures of globalisation.

In the short term, accelerated private flows may pose as many, if not more, problems than they solve for many developing countries. Nonetheless, such flows are indispensable if the pace of development and growth is to take off and be sustained in a fashion that achieves convergence. In a globalising world, developing countries need foreign investors if they are to capture shares of global markets in emerging industries and products and gain access to essential technology and know-how.

Implications for Commonwealth Countries – Foreign Portfolio Investment

FPI flows pose a problem (and an opportunity) for a relatively small number of Commonwealth countries. In SDIS that operate offshore financial centres, their impact is exaggerated because they transit through these economies without affecting them in any significant way, except for the domestic income that their booking and handling generates. But every Commonwealth country appears anxious to attract FPI through accelerated development of its *national* capital market, and especially its equity market. In most of these countries, such markets operating at the national level are neither efficient nor effective. They are too small, likely to list only a few issues, and have very limited market-making capacity and very high overhead operating, administrative and regulatory costs. They suffer from a lack of economic size, depth, width and liquidity. Markets such as these are more likely to fail than to succeed and to generate, rather than solve, resource mobilisation problems.

If such markets do succeed in attracting FPI, it is likely to be harmful rather than productive. The urge to establish unviable capital markets individually in each Commonwealth country, and especially in the SDS and SDIS, should be resisted. With the advent of new communications and information technology in global financial markets, and with electronic exchanges replacing trading floors (thus making time, location and distance irrelevant in the processes of price discovery and matching trades), more thought needs to be given by smaller countries about how to associate with suitable financial centres in *regional* capital markets. That option is likely to take them further in the development of their financial systems, and provide greater protective bulwarks, than attempting to go it alone.

Private Voluntary Flows

PVF provided through non-governmental organisations[35] is usually associated with (and

35 NGOs such as, for example, CARE, Oxfam, Save the Children, Christian Aid, Bread for the World, CARITAS and their equivalents in continental Europe, the USA and Japan, as well as churches, mosques and religious organisations around the world. The NGO movement is characterised by an extraordinary mix of solid and temperate organisations with vast and long experience of development support for the poorest and humanitarian relief, alongside less benevolent NGOs focused on animal rights, environmental issues, labour rights, the pro-life and pro-choice movements and a host of similar clusters of concerns that occasionally coalesce (for example at Seattle) to develop an anti-capitalist, anti-market, anti-society, almost anarchist hue. 36 Development Initiatives 'White Paper on Globalisation: Background Note on Global Development Assistance: The Role of Non-Governmental Organisations and other Charity flows', UK Government, 2000, also referred to in GDF-2001 (draft mimeo).

also counted as) ODA rather than with private commercial capital. In large part this is because NGOs often obtain matching funds from their governments in OECD countries to complement the amounts they raise voluntarily. Agencies such as UNICEF and the Red Cross and Red Crescent, as well as the Rotary and Lions Clubs, raise much of their funding through National Committees that obtain voluntary donations in developed and developing countries. In recent years, very large private foundations, such as the Gates and the Turner Foundations, have also become significant sources of grant PVF and crucial co-financiers with UN agencies and governments in funding specific initiatives such as the Global Alliance for Vaccines Initiative (GAVI).

Although associated loosely with governments, funds mobilised by NGOs are, in large part, *private* and *voluntary*. They are not raised through taxation except for the proportion that governments choose to channel through NGOs to reach the poorest people in developing countries directly. Most importantly, they are not government-to-government transfers. For that reason, they are mentioned briefly in this section of the paper rather than the next.

According to a recent study,[36] PVF has become a large element in the FfD mix. Equally, its intermediaries, the NGOs, have become increasingly (and disproportionately) influential voices in determining global development preferences, policies and strategies. Their influence derives largely from the power they exercise over their own governments, and over inter-governmental institutions. Such power derives from their capacity to influence votes at times of elections through their powerful advocacy of single issues. For developing countries, NGOs represent: (a) an opportunity and a channel for humane people-to-people connections that sidestep bureaucracies and the procedural inhibitions of governments and private corporations; (b) an extra-governmental channel for recourse and redress; and (c) an element of potential intervention or interference in the domestic social and political affairs of developing countries that sometimes infringes their sovereignty and can violate the rights of legal corporate entities, if not of individuals, who disagree with their views.

Most vexing is the fact that NGOs appear to feel no obligation to exhibit the same standards of humility, transparency, accountability and responsibility that they militantly demand from governments and private corporations. Yet they are neither elected nor have the broad public mandate that they often claim. Instead they have the the dedicated support of single-issue lobbies that can be fanatical in expressing their beliefs and in pressing them aggressively on those who do not share them. The challenge for both industrial and developing countries lies in maximising the benefits from (a) and (b) above, while avoiding the pitfalls of (c), and at the same time retaining the value of PVF in the FfD mix. It is an unfortunate omission that neither SGR nor ZPR addresses this concern at all.

That is surprising because PVF is not insignificant in total financing for development. OECD-DAC statistics show PVF from NGOs averaging \$3.3 billion annually through the 1980s and \$6 billion annually through the 1990s (\$6.7 billion in 1999). These amounts were equivalent to about 7 per cent of ODA in the 1980s and 12 per cent in the 1990s. Other studies[37] suggest that total expenditures in developing countries by NGOs are higher – \$15.5 billion in 1998 vs. \$5.6 billion recorded by DAC, which would represent an amount

36 Development Initiatives 'White Paper on Globalisation: Background Note on Global Development Assistance: The Role of Non-Governmental Organisations and other Charity flows', UK Government, 2000, also referred to in GDF-2001 (draft mimeo).

37 Development Initiatives 2000, op. cit.

equivalent to over 31 per cent of total ODA provided in that year. The discrepancy is resolved if total expenditures by NGOs are seen to equal the amount they raise privately, plus the amount they get from matching grants provided by governments, which are already counted as official ODA. Thus, while not adding to ODA resource flows between 1997–2000, NGOs may have been responsible for spending between 40–45 per cent of what all OECD bilateral aid agencies together were responsible for disbursing, and for a larger *net transfer* of resources than the total *net transfer* intermediated by all the MDBs together.[38]

No reliable estimates are available of the amounts that NGOs in developing countries mobilise by way of private voluntary contributions in domestic resources. It would be surprising, however, if the aggregate amount they raised in all developing countries was less than the amount transferred by NGOs in OECD countries. In all likelihood it is significantly more. The picture is even more confused by the fact that many global NGOs (for example the Red Cross) raise funds in both the industrial and developing worlds. Thus, there is a significant domestic PVF component in financing development that is rarely acknowledged. It is usually ignored altogether although it may be as, if not more, significant than PVF through NGOs recorded by OECD-DAC. Equally there is no reliable estimate of PVF through NGOs flowing from one developing country to another.

Is there much scope for increasing PVF? Would developing countries wish to see even greater involvement by NGOs in intermediating funding (whether private or official) for development? These questions are difficult to answer. Although there has been a definite increase in the level of PVF between the 1980s and the 1990s, the level of such flows through the 1990s has been stagnant, reflecting the same inertia as ODA. This does not suggest that public resistance in industrial countries to increasing ODA via increased taxation is being offset by private voluntary giving for assistance to developing countries (which represents a fraction of less than 10 per cent of total PVF for all purposes). The figures in Table 11 establish this point.

Taking these tendencies into account, are resource flows from NGOs desirable from a developmental point of view? It is axiomatically assumed that they are. Most of these flows are aimed at the most difficult challenge of development – reaching the poorest people directly. Governments and multilateral institutions have concluded that their own bureaucratic *modus operandi* is unsuitable for tackling that interface:

NGOs' advantage lies in greater flexibility and use of specialised local knowledge to intermediate between official agencies and local communities. Often NGOs can deliver assistance that official donors are not equipped for. NGOs have gained prominence as aid has broadened its focus beyond strictly economic objectives to include goals of empowerment, social justice, sustainability, and accountability in governance. At the same time, because of their large numbers and the diverse religious, cultural, humanitarian and commercial interests they represent, NGOs amplify the difficulty of co-ordinating official aid.

(GDF-2001 draft mimeo, op. cit., World Bank, Chapter 4, pp. 16–17)

38 OECD statistics invariably refer to net resource flows and not net transfers. Net resource flows are the difference between gross flows from donor to developing countries minus the reverse flow of principal repayments. Net transfer also takes into effect reverse flow payments of interest and other charges on loans. Thus while the net resource flows (concessional and non-concessional) from all multilateral sources was $21.3 billion in 1998, the net transfer was only $7.4 billion. Indeed for 1994–96 the total net transfer from multilateral sources was –$7.3 billion, i.e. in those three years developing countries were actually transferring net resources to official multilateral agencies instead of receiving resources from them. The situation was even worse with bilateral net transfers on the debt account.

Table 11. Private Voluntary Flows to Developing Countries 1983–99
(Amounts in US$ billion)

	Annual Average									
	1983–84	1988–89	1992	1993	1994	1995	1996	1997	1998	1999
PVF/NGOs	**2.5**	**4.2**	**6.0**	**5.7**	**6.0**	**6.0**	**5.6**	**5.2**	**5.6**	**6.7**
Memo: Net Official Resource Flows										
Bilateral	14.1	25.3	41.4	39.4	41.3	40.6	39.1	32.4	35.2	37.9
Multilateral	11.2	15.7	12.0	14.9	10.0	10.9	13.0	21.1	21.3	20.0
Memo: Net Official Transfers on Debt										
Bilateral	10.6	18.8	1.6	–0.7	–9.1	–6.5	–27.0	–23.7	–11.1	–15.4
Multilateral	8.8	7.4	–0.4	1.9	–3.5	–3.0	–0.8	8.2	7.4	4.2

Source: OECD-DAC Annual Report 2000 Statistical Appendix. GDF 1999,2000,2001 World Bank (for figures on multilateral flows and net transfers)

What appears axiomatic cannot, however, be taken for granted despite popular perception – a perception created by NGOs themselves through astute management of positive media images. The perception belies the many problems that NGOs pose; not least, their lack of transparency, accountability and the proportion of funds absorbed by their own administrative costs. It is almost impossible to evaluate properly the overall developmental impact or the sustainability, over the long run, of NGO-provided assistance. They are too numerous, diverse, and employ entirely different standards of disclosure and accounting. The projects and activities they finance are small and often ephemeral.

Most evaluations of NGO-funded operations have been left to the NGOs themselves. It would be cost-ineffective to undertake independent external reviews of all their operations. The few studies carried out (in the Nordic countries, Australia, the USA and the UK) to evaluate the contribution NGOs have made to poverty reduction, humanitarian relief and the sustainability of what they started, have yielded mixed conclusions. Similarly, a review of NGO involvement in World Bank projects attributed unsatisfactory outcomes to unrealistic project design and weaknesses in NGO-partner capabilities. Thus the extent of NGO value-addition is unknown. It may be quite different from widespread public perception.

Without doubt, NGO activities have contributed much to relieving human distress and suffering in the short term, especially in handling refugees and relief in conflict zones. For that reason alone they may be worth supporting. But it is unclear exactly what (and how) NGOs have contributed to long-term, sustainable development. Many developing country governments, especially those of an authoritarian hue, have found NGO involvement in their countries uncomfortable to live with. But their discomfort has not been openly expressed for fear of further alienating the media and public in major industrial countries. Before categorical conclusions can be reached about value addition by NGOs to development, and to FfD, it is difficult to assert that PVF through NGOs is unquestionably good and needs to be significantly increased.

Similar to the increase in private capital flows to developing countries in the 1990s has been the upswing in contributions by private philanthropic foundations in industrial countries to programmes with cross-border benefits that

impinge on developing countries. These are now estimated to exceed $1 billion annually, having grown at about 8 per cent annually through the 1990s.[39] This amounts to about 2 per cent of annual ODA flows (up from about 1 per cent in the 1980s when flows from private foundations totalled between $300–400 million annually). Philanthropic foundations have played a special role in development since 1950 with the Ford, Rockefeller, and Carnegie Foundations making valuable contributions in encouraging the development and diffusion of untried technologies, for example pioneering the 'green revolution' in the developing world. The boost in philanthropic flows in the 1990s has come from new foundations set up by entrepreneurs in the 'new economy', for example Bill Gates of Microsoft and Ted Turner of CNN and Turner Communications. These have sponsored work on developing vaccines against infectious diseases, eradicating polio and vaccinating children worldwide, and financed computers in schools. Thus, private foundations have been especially valuable participants in financing international public goods in a pioneering way, breaking a path for official agencies and governments to follow.

Growth in philanthropic flows has been supported by tax laws in the USA that encourage charitable giving by permitting tax deductions that reduce taxable income. European countries have lagged behind, with a societal preference for public, rather than private, philanthropy. European tax laws provide little incentive for private charitable contributions on the American scale, though this is changing, for example in the UK. Annual contributions by members of the European Foundations Centre increased by 43 per cent to 4.8 billion Euros between 1998 and 1999.[40] The Japanese situation falls between these two with international giving by Japanese foundations rising in the 1990s despite a collapse in the Japanese stock market and in corporate earnings.

As with NGOs, there is little reliable information available on domestic resource contributions made by philanthropic foundations (private and corporate) in developing countries themselves. In India alone, where local private and corporate philanthropy has been established for over 150 years, crude estimates of resource flows (compiled from reports filed with the Charity Commissioners) from private philanthropic foundations suggest that they amount to $2–3 billion annually. This is characteristic of many developing countries where such foundations have compensated for the scarcity of public resources (and for the failure of governments) by creating townships and financing infrastructure, health-care, education, social services, pensions and welfare benefits on a sustainable long-term basis, albeit on a limited, and occasionally self-interested, scale.

It would not be surprising if a serious study, aimed at aggregating the resource flows that go toward financing development from private philanthropic foundations *within* the developing world, arrived at an estimate of more than $20 billion per year. It is essential for such a study to be undertaken in the context of an understanding that private philanthropic flows are not simply a feature of industrial world largesse, but a significant feature of *domestic* resource mobilisation for financing development.

In the FfD framework that emerges for the twenty-first century it may be worthwhile for all countries, industrial and developing, to reconsider refining their tax codes to enhance

39 The Foundation Center: *International Grantmaking: A Report on US Foundation Trends* (1997) and *International Grantmaking II: An Update on US Foundation Trends* (2001), sourced through http://www.fdncentre.org.

40 European Foundation Center: *Independent Funding: A Directory of Foundation and Corporate Members of the EFC* (2000), sourced through Orpheus Prgramme Publications (www.efc.be).

private voluntary flows aimed at financing social goods and services, particularly those aimed at the poorest. This would facilitate achieving IDG-2015 targets with more productive outcomes being achieved at the local level through community action on poverty reduction, especially as private social initiatives and philanthropic funding combine to augment and complement the efforts of governments and NGOs. Relying on government action alone is likely to continue to prove as disappointing as it has over the past half-century. That is because the incentive and decision-making structures that operate in large public bureaucracies are not conducive to addressing the problems of poverty alleviation with the speed, imagination, sympathy and flexibility that their solutions demand.

6

Mobilising Official Development Assistance for Financing Development

6.1 A Contextual Digression on Whether Aid Works

As far as developing countries and the agencies, bilateral and multilateral, that intermediate official aid flows are concerned, increasing official (tax-funded) resource transfers, and particularly concessional ODA resource transfers, from developed to developing countries is the raison d'être for holding UNCFD. Such agencies include the UN, the IMF and the World Bank, the three principal scriptwriters (as well as aspiring stars, directors and producers), of the UNCFD play. Their role as intermediaries inevitably creates a bias toward arguing for increased official flows as the most critical issue in FfD. That bias is reflected in the SGR and ZPR, despite attempts to obscure it by packaging this core issue inside five others.

At the risk of being accused of heresy, the experience of the last 50 years makes it reasonable to ask: Do official government-to-government resource transfers really promote development? Or do they hinder it by providing a soft option and delaying the economic, political and social adjustments that need to be made for sustainable development to occur? Would such adjustments occur automatically and swiftly (even if painfully) without, or with less, aid? Is official aid more a vehicle for conducting political relations – attempting to wield political influence on the part of the donor government and avoiding painful political decisions on the part of the recipient government – rather than a vehicle for attaining rapid development?

Despite the generally accepted official line that ODA is crucial in financing development, and must therefore be increased, the hard evidence that aid works is not clear-cut. Innumerable studies, at project, community, sector, country, regional and global levels, have been carried out between 1970–2000 to determine the outcomes and effectiveness of aid.[41] Their results are mixed and sometimes confused. Most such studies have been financed, if not conducted, by aid agencies or by academics and research institutions with a vested interest in an affirmative answer. Unsurprisingly, such studies have concluded that the bulk of ODA does work under the right conditions. But such circumstances do not apply at most times in most developing countries, although conditions are improving with the prolonged period of policy reform that began in the mid-1980s and is continuing.

What such studies do not address convincingly are the more difficult, embarrassing questions. If aid does work, why have so few developing countries actually developed over the last 50 years? Why have those countries that have developed between 1950–99 been less reliant on aid than on trade earnings, domestic savings

41 Concern about whether official aid worked has dated back almost to the beginnings of the modern 'aid-era' in 1950 with considerable theoretical debate about the merits of the two-gap theory. The landmark studies which have been done, and the literature on the subject, are too voluminous to mention or enumerate in a bibliography. This work has been done elsewhere. The classics on the subject apart from work done for the Pearson and Brandt Commissions in 1969 and 1980 are: Cassen, R. and Associates. *Does Aid Work?* Oxford University Press, 1986; and Riddell, R. *Foreign Aid Reconsidered*. London: James Currey, 1987. The World Bank has done and commissioned hundreds of such studies (with work done at the Bank by David Dollar and his associates being frequently quoted) as have the bilateral aid agencies of major donor countries.

and foreign private investment? Why have so few developing countries eliminated their reliance on aid flows that were supposed to be a temporary palliative? If aid works, why have so many low-income countries (especially in Africa) actually increased their reliance on aid between 1980–2000 with no exit from chronic, acute aid dependency in sight?

The few independent studies that have been carried out do not support the traditional consensus that aid, despite all its faults, has, by and large, worked.[42] They suggest that aid may provide a soft option that can retard rather than accelerate development. The problem seems to lie in the nature of the government-to-government transfer process. It appears to operate with incentives that militate against success. Official aid mixes uncomfortably with the privately motivated engine of development. At the same time, fungibility results in the dilution of its effects, when associated with a fiscal framework that does not prioritise public expenditures in a development-friendly direction. Such findings (and the protagonists of this heretical view) have been derided in an international development community that sees its vested interests threatened by such reasoning. But they appear to have won the argument effortlessly in the court of global public opinion.

The risk for UNCFD would be to ignore the perception of the global public that official aid by and large does *not* work; or, if it does, it must work badly for so much aid (estimated at $1.2 trillion provided between 1950–99 measured in 1999 dollars) to have achieved so little. Aid agencies are at pains (and on the defensive) in making the case that the glass that seems half-empty is actually two-thirds full. The arguments they use are seen as disingenuous; they do not resonate. Regrettably, the tax-paying public in industrial countries is less interested in the intricate hair-splitting that is conducted within the aid and academic communities about whether aid works. The overall picture they see (usually on their television screens) is neither convincing nor edifying in supporting the case that it does.

UNCFD would be taking a serious risk if the sceptical viewpoint were dismissed in an off-handed manner as being uninformed and ignorant. If ODA is to be increased in the coming decades, that will not happen simply by browbeating Finance and Aid Ministers in the industrial world to meet the official aid target or to accept conventional wisdom that is not strongly supported by evidence. It will only happen if the evidence results in global public conviction being reversed, and if public demand for renewed aid is expressed as a clear political preference that governments in the industrial world must accommodate. In the prevailing climate it is difficult (but not inconceivable) to see that happening. The arguments made below need to be viewed in that practical context.

6.2. Issues Raised by SGR/ZPR on Increasing Official Resource Flows

SGR makes 17 recommendations on improving international development co-operation; 5 of these are focused on increasing ODA. Most of the recommendations are general exhortations that are not very useful. ZPR (and SGR) argues that official resources to finance development are needed in four priority areas to: (a) initiate development in low-income countries and help them achieve IDG-2015 targets; (b) cope with humanitarian crises; (c) finance recovery from financial crises; and (d) provide global public goods. It emphasises that:

42 The names most associated with the sceptical genre are Peter Bauer and Deepak Lal whose work at the London School of Economics has taken a more jaundiced view of the merits of official aid. The number of sceptics has grown considerably since. The latest work by William Easterly (formerly of the World Bank), published under the title of *The Elusive Quest for Growth* (MIT Press, 2001), also raises serious questions about the effectiveness and impact of aid on development that the 'development community' finds difficult to answer.

Table 12. Official Financing Requirements for the Four Priority Areas of ZPR
(Incremental costs in $ billion)

Purpose	Item	Annual Cost
1. Meeting IDG-2015 Targets	Halving Extreme Poverty	20
	Universal Water Supply and Sanitation	00
	Universal Primary Education	9
	Reducing Infant Mortality by two-thirds	n.a.
	Reducing Maternal Mortality by three-quarters	n.a.
	Achieving Gender Equality	3
	Halting and Reversing HIV/AIDS	7–10
	Urban Slum Upgrading	4
	Meeting Human Development Goals	n.a.
	Total Order of Magnitude ZPR Estimate	**50**
2. Coping with Humanitarian Crises		3–4
3. Recovery from Financial Crises[43]		0
4. Providing Global Public Goods		15
Total Incremental Official Financing Requirements:		70
Existing Annual ODA Flows		55
Total Annual Official Financing Requirement:		**125**

Source: Technical Report of the High Level Panel on Financing for Development. UN, 2001

The world has a crucial interest in seeing these four roles funded on an adequate scale. A primary aim of [UNCFD] *should be to secure adequate mechanisms to achieve this. In particular, every country that seriously pursues the International Development Goals should be assured that their achievement will not be thwarted by a lack of external finance.* (Chapter 4)

In assessing the amounts needed for these four purposes, ZPR 'reviews the present state of evidence' (acknowledged to be incomplete) on the estimated costs of the four items listed above. It presents the breakdown shown in Table 12 for *incremental* costs over what is already being spent in the areas concerned. In offering these figures, ZPR recognises that for many items the assumptions used to derive estimates are untenable (for example estimating the cost of reducing infant and maternal mortality). In many instances, there is no valid basis for deriving global estimates in the absence of detailed studies in each developing country that determine itemised costs for meeting these targets. Nevertheless, its crude global estimate arrives at an incremental requirement of about $70 billion annually. Added to the average annual level of ODA in recent years (about $55 billion), that amounts to total official resource transfers of about $125 billion annually in nominal dollars.

ZPR calls attention to the fact that 10 per cent of the present ODA budget is absorbed by *humanitarian assistance and emergency relief*, although that proportion results in meeting only half of the amount actually needed. It does not mention that the *costs of administering aid*

43 The IMF considers that it has adequate resources at hand to meet these needs.

($3 billion in 1999) now absorb 6 per cent of the total ODA budget (compared to 3 per cent in the 1980s) or that the total administrative costs involved in running the UN system and its specialised agencies, the IMF and all the MDBs, amounts to a further $8 billion annually.[44]

Current spending on GPG already absorbs another 15 per cent of total ODA and technical assistance a further 24 per cent. Debt relief now absorbs a further 4 per cent of ODA. That leaves about 40 per cent of ODA available for financing development investment. Growing global awareness of the need for financing GPG to a larger extent might result in a further diversion of ODA funds from financing development investment unless ODA is increased.

Reflecting on the desultory ODA performance of donors in the 1990s,[45] ZPR hopes (over-optimistically) that endorsement of the IDG-2015 targets at the Millennium Summit will rekindle political momentum to increase aid. It notes that if the aid target of 0.7 per cent of GNP were to be met, an extra $100 billion in resources would materialise to cover more than the official financing needs that ZPR estimates. Its sanguine wistfulness overlooks the fact that neither the bilateral nor multilateral aid machinery that exists to channel current volumes of aid, nor the aid-receiving machinery in developing countries, have the capacity to handle such a large increase in official flows without incurring the risk of substantially increased waste, fraud, corruption and a large increase in administrative costs.

Conceding the reality that ODA is unlikely to increase significantly from present levels, ZPR looks to new sources of financing through various forms of global taxation. It reconsiders the 'Tobin Tax' on cross-border currency transactions, looking at both sides of the argument. Its treatment suggests that the demerits of such a tax outweigh its alleged advantages. Confusingly, ZPR recommends that further study be carried out on the feasibility of imposing such a tax, but with a hint of scepticism, asking 'whether a currency transactions tax is really the only option, or whether other potential tax bases exist that might be harnessed to raise revenue to pay for global public goods?' Such prevarication is odd. It reflects divided views in the Panel that could not be reconciled. ZPR answers its own question by recommending consideration of a Global Carbon Tax as an alternative.

The issue of global taxation as a means of financing development is dealt with later in this paper. But the paper suggests that Commonwealth Finance Ministers should be wary of endorsing either of these recommendations. Under present circumstances it would be difficult to reach a global agreement on the nature, design, level, collection machinery and eventual use of the proceeds from either of these taxes. Global public opinion would, with rare exceptions, be opposed to taxation levied at a supranational level for use by international institutions that do not have mechanisms for transparency and democratic accountability in place.

A more practical suggestion is ZPR's revival of the idea behind a new issue of IMF Special Drawing Rights (SDRs). This proposal is likely to be opposed by Germany and Japan for the same ideological reasons that they have repeated on every occasion this idea has been

44 In the case of the IMF and MDBs, part of that amount is paid for out of the gross incomes of these multilateral financial institutions, although the cost related to the concessional resources provided by the MDBs is a charge to ODA. That income is derived from interest payments and financial charges paid by developing countries and by earnings generated from investment of liquid funds.

45 ODA stagnated a time when the GNP of industrial countries as a whole was increasing at an average of 2.5 per cent annually (growth in the USA averaged an unparalleled 4.5 per cent annually over the decade, in Europe it averaged 2 per cent but Japan registered no growth) and when their fiscal budgets were coming into balance.

mooted. But it is an idea that may go part of the way toward increasing resources available for development in a manner that is unlikely to arouse global public opposition. ZPR's argument for a new SDR issue is persuasive and compelling. It deserves the support of Commonwealth Finance Ministers.

ZPR also draws attention to various problems relating to aid expenditures:

- Political or trade-related motives resulting in a distribution of ODA across countries that compromises its impact on both reducing poverty and promoting growth;
- Conditionality being applied to aid unrelated to the specific purposes for which it is being provided and imposing a crippling and counter-productive administrative burden on recipient governments and agencies;
- Increased donor propensity to micro-manage aid programmes and projects in ways that inhibit skill transfer, result in priority needs not being met and in a high proportion of ODA being absorbed by administrative costs;
- Initiatives for greater 'ownership and participation' by recipients not going far enough to result in meaningful improvements. To overcome this problem, and that of donors becoming over-involved with micro-management, ZPR supports the 'common-pool' approach[46] for all aid other than that intended for financing global public goods;
- For global public goods, ZPR suggests providing funds to developing countries in exchange for contractual commitments to provide the goods in question with all developing countries (middle- and low-income) being eligible to bid on an equal basis;
- Developing countries should not be required to borrow funds (official or private) for the production of GPG.

Finally, ZPR argues that: (a) the concessionality of ODA and of multilateral concessional funds (for example IDA, AsDF and AfDF) should be increased significantly; and (b) UNCFD should reaffirm the 0.7 per cent ODA/GNP target supported by a public campaign in donor countries to revive broad-based public support for aid. On the concessionality issue, this paper would go further than ZPR in suggesting that Commonwealth Finance Ministers press for the threshold of concessionality for funds classified as ODA to be increased from a grant element of 25 per cent to a grant element of at least 50 per cent. For comment on reaffirming the 0.7 per cent ODA/GNP target see below.

6.3. Prospects for Increasing ODA and Other Official Resource Flows

At the beginning of the twenty-first century the situation surrounding ODA is quite different from that in the three decades 1960–90. In real terms, aid increased by over 30 per cent between 1960–70. It increased again by 53 per cent between 1970–80 and by 32 per cent between 1980–90. Between 1990–2000, aid fell by 25 per cent in real terms while private flows increased fourfold. Net transfers from official sources have fallen even more precipitately. After a decade of dominance by private flows, the decline in ODA has become a permanent feature of the development-financing scene, not just a temporary inversion. Notwithstand-

46 This approach was suggested in Kanbur, R. and Sandler, T. *The Future of Development Assistance: Common Pools and International Public Goods*, Washington DC, ODC, 1999. Essentially it involves recipient countries elaborating their own development strategy, programmes and projects in consultation with their own populations and in a dialogue with donors. It would present its final plans to donors as a group. If they approved and supported these plans, donors would put their individual contributions into a common pool of financing that would not be restricted by further conditionality. Together with domestic resources mobilised by the government through taxation, the common pool would finance the overall development strategy. Though presented as an entirely new approach, this proposal is simply a recycled version of what has been attempted before in the 1960s and 1970s as budget-support programme aid.

ing the unmet aid needs of low-income developing countries, there has been a structural change on the supply-side. After 50 years of development assistance, support for ODA in supplying countries is on the wane despite hopeful but marginal reversals in countries such as the UK.

The reasons for this have been mentioned earlier. They include: (a) the collapse of the Eastern bloc in 1990 reducing pressure on major donor countries to continue using aid as a strategic tool to influence governments in the developing world and achieve geopolitical advantage; (b) cessation of ODA from the Eastern bloc to developing countries; (c) 'aid fatigue', giving way to a perception of 'aid failure', in policy-making circles and in traditional constituencies for providing aid in the industrial countries; (d) growing resistance to increased tax burdens in OECD countries with public pressure for revenues to absorb a lower proportion of GDP; (e) the outbreak of civil strife in the Balkans and in all the sub-regions of Africa, together with the continued waste of resources on futile confrontations over 53 years in the Middle East and South Asia; and (f) visible development failure between 1950–90 on the part of too many developing countries, particularly in Africa, but also in South Asia and many island economies.

Under these circumstances, developing countries, the UN system, and the Bretton Woods Institutions, as well as aid ministries in donor countries, face an uphill battle in making a forceful renewed case for the continuing and critical importance of official finance and especially of concessional ODA flows. To the *cognoscenti* in the aid community it is axiomatic that increased ODA is needed for a large number of poor developing countries that are being by-passed by private capital flows. These countries are not in a position to attract FfD from the global capital market. But what is also obvious is that many poor developing countries are in this situation not just because they lack finance. They also lack the capacity (and sometimes the intent) to use it to good effect.

Thus the case for increasing ODA results in a Catch-22 argument: desperately poor countries need more aid because of their poverty, but aid is insufficient and has not lifted them out of poverty. Without the capacity to use aid properly it will continue to be wasted, with the poorest countries remaining poor. So why provide more ODA? This circular argument also presents the dilemma of whether ODA allocations should be based on needs or on performance, i.e. should more ODA go to countries that perform well so as to encourage them to perform better, or should performing countries get less ODA because their needs are not as urgent as those of non-performing countries? These circularities have been debated *ad nauseam* but clear solutions remain elusive. Fashions shift by decade from addressing urgent needs to rewarding good performance and back again.

The ODA volume implications that arise make it necessary to reconsider the 0.7 per cent of GNP target for ODA at UNCFD rather than automatically reaffirm it as ZPR and SGR suggest. Developing countries should not perceive a review of this target as a threat to rigid development ideology and dogma that is sacred and inviolable. The target needs to be reconsidered on pragmatic grounds. There is no possibility that the large donor countries (in particular the USA) will ever legitimise this target by accepting it consensually at UNCFD or at any other time. If the target is 'reaffirmed' by a majority vote of the developing countries it will remain meaningless in a substantive sense. Continual reference to it will not result in the desired effect. No large donor country will be embarrassed into meeting it. If that were likely, it would have happened by now.

When an international target is violated more than it is honoured over a prolonged period (in

Table 13. Net Official Resource Flows to Developing Countries 1990–2000[47]

(Amounts in US$ billion)

	1990	1992	1994	1995	1996	1997	1998	1999	2000
Official Financial Flows	**55.2**	**56.5**	**48.0**	**55.1**	**31.9**	**42.8**	**54.6**	**45.3**	**47.1**
of which									
Non-Concessional Loans	12.0	10.1	–0.1	8.9	–7.8	7.2	16.2	5.0	5.5
Bilateral	2.9	4.5	–2.6	5.2	–12.4	–6.5	–4.4	–7.1	–5.5
Multilateral	9.1	5.6	2.5	3.7	4.6	13.7	20.6	12.1	11.0
Financial ODA Flows	**43.2**	**46.4**	**48.1**	**46.2**	**39.7**	**35.6**	**38.4**	**40.3**	**41.6**
of which									
Financial Grants:	28.2	30.5	32.7	32.7	28.1	26.1	27.3	28.9	29.6
Bilateral	24.6	23.9	24.6	26.1	21.8	19.8	20.5	22.0	22.6
Multilateral	3.6	6.6	7.9	6.6	6.3	6.3	6.8	6.9	7.0
Concessional Loans	15.0	15.9	15.4	13.5	11.6	9.5	11.1	11.4	11.7
Bilateral	8.3	8.5	6.5	4.9	3.0	1.5	3.1	4.3	5.1
Multilateral	6.7	7.4	8.9	8.6	8.6	8.0	8.2	7.1	6.6
Technical Assistance (TA)	14.1	17.7	16.9	20.0	18.7	15.7	16.2	16.6	17.1
Memo Items:									
Financial ODA + TA =	57.3	64.1	65.0	66.2	58.4	51.3	54.6	56.9	58.7
ODA as reported by DAC	n.a	58.3	59.6	59.1	55.8	47.7	49.7	51.3	n.a
IMF Flows	0.1	1.1	1.6	16.8	1.2	14.7	19.3	–12.6	n.a
Debt Service Payments*	164.2	167.2	199.2	241.9	279.4	305.2	316.1	349.4	n.a
Profit Remittances on FDI	17.6	20.9	24.9	26.5	30.4	31.4	35.2	41.6	n.a

Source: From GDF-2001 (draft mimeo) World Bank (Table 4.1) and also GDF 1999 and 2000 for annual figures

Note: These figures have been prepared by the World Bank based on OECD data and adjustments made by its own staff on debt data. They show some discrepancies with OECD data and exclude export credits and grants by NGOs.

* Debt service payments include principal and interest paid by all developing countries in those years.

this case over three decades) it loses relevance and credibility. Simply chanting it as a mantra annually and using it as a benchmark for gauging ODA performance does nothing to resuscitate its significance. Although some small donors (three Nordic countries and the Netherlands) are committed to meeting the target, several donors who once aimed to achieve it no longer even refer to it, for example Canada, Japan and the UK.

For the three years 1997–99 the aid efforts of all ODA donors together amounted to 0.24 per cent of their GNP, having fallen from 0.27 per

47 The ODA efforts of donors, as reported by OECD-DAC, do not translate directly into aid received by developing countries. The aid efforts of donors include the costs of administering aid (over $3 billion in 1999) and of technical assistance ($13 billion). Over two-thirds of these amounts are spent in donor countries ($11 billion) with only a third being expended in developing countries ($5 billion). Thus the direct economic benefits from these expenditures are derived in large part by the donor countries themselves although developing countries do receive indirect benefits (if aid were not administered there might be no aid). What developing countries receive to finance development is the transfer of ODA directly from donors, through their bilateral aid agencies, and the ODA transfer intermediated by multilateral agencies. Thus while the OECD DAC reported total ODA of $51.3 billion in 1999, the World Bank recorded a financial transfer of ODA to developing countries in that year of $40.3 billion or $11 billion less than the aid effort.

cent in the previous three-year period and from 0.33 per cent in the three years before that. The average has kept declining in a secular fashion from 0.41 per cent in the mid-1980s when ODA reached its peak. If ODA were to reach the 0.7 per cent target, in dollar terms it would translate into a total of over $160 billion instead of the $55 billion that was actually provided.

Whatever developing countries may think about the desirability of tripling ODA by donors meeting the ODA/GNP target, it would not be feasible in practical terms. As indicated earlier, the institutional machinery does not exist (bilaterally, multilaterally or in developing countries) to handle such a volume of funds productively. The risk is that tripling ODA could result in quintupling the waste factor inherent in its deployment. At most, the existing aid machinery would be able to handle between $70–80 billion without cracking at the seams.

In general, countries that provide high levels of ODA provide relatively low levels of private capital flow. Conversely, countries that provide a low level of ODA provide quite a high level of private flows. Some countries are exceptions to the general rule – the Netherlands, Sweden and Switzerland provide high levels of ODA and of private flows. For that practical reason it might make more sense to propose a *composite target of 2 per cent of GNP for total resource flows including private as well as ODA flows with the proviso that, within that overall 2 per cent target, ODA should be at least 0.50 per cent of GNP.* Such a target would be more realistic and achievable by the donor community. Donors that are below that composite target could pledge to meet it by 2010 at UNCFD.[48]

Concerns might arise that dropping the 0.7 per cent ODA/GNP target would provide a disincentive for the few donors that already meet the target or aim to do so (for example Ireland). It might dissuade them from doing more or, worse, encourage them to do less. That is unlikely. High-aid countries are unlikely to reduce their aid effort because of a change that requires them to give *at least* 0.5 per cent within an overall resource flow target of 2 per cent. It is of course the case that in these countries the ODA/GNP target provides a key benchmark when the government is persuading its legislature for aid appropriations in a given year's budget. What the composite target allows for is recognition that the ability of 'high-aid' governments to provide high levels of ODA lies in a social consensus and in factors that do not exist to the same extent in other donor countries. In the latter, the social and political preferences of the polity are quite different. A composite target caters to the circumstances of both types of donors in a way that the present ODA/GNP target does not.

High-aid countries are usually characterised by: (a) relatively small, homogeneous social market economies, with high levels of average adult education, that rely on co-operative principles, a sense of community and on socialism as a basic principle of cohesion; (b) an accompanying fundamental belief in the moral and social case for providing aid through taxation, thus applying accepted principles of domestic redistribution through taxes on an international scale, however small that scale may be;[49] (c) a disproportionately large government sector and a bilateral aid programme within

48 For the ODA/GNP ratio for all donors to increase from the present average level of 0.24 per cent to 0.50 per cent, the annual increment (for the donor community) would be 0.035 per cent annually between 2002–2010. That rate of increase is within fiscal reach for the donor community as a whole, taking into account the present fiscal situation and capacity of every donor. The composite target of 2 per cent of GNP for total flows, with at least 0.5 per cent being provided by way of ODA, would inject a note of welcome pragmatism into what developing countries should be seeking to achieve.

49 It has to be acknowledged, however, that even in the few high-aid countries, populations are becoming increasingly disenchanted with the non-performance of developing countries and of aid.

that sector compared to the size of their economies; (d) an acceptance in the population of relatively high levels of domestic taxation, as well as a belief in use of taxation for social engineering; (e) less belief in and reliance on private flows as a catalyst for development. The same attributes do not characterise other donor countries, for example the USA and UK, that evince large flows of private capital (some of it being round-tripped from developing countries through the financial centres of London, New York and Miami) but relatively low flows of ODA as a proportion of GNP. (In the UK this has been changing since 1997.)

A composite target would provide donor governments with greater flexibility in the arguments they might choose to make to their public and legislatures for enhancing resource flows to developing countries. It would give donors a choice between: (a) encouraging a larger quantum of outward *private* flows in keeping with their market ethos with their aid effort being made through tax-breaks for such flows (thus implying tax-revenue foregone); and (b) maintaining or increasing high ODA flows, with the aid effort being made through higher levels of direct public expenditure, in donor countries where belief remains in the value of governments as actors in development.

What would a composite target translate into in dollar terms? In 1999, the collective GNP of high-income countries was about $23 trillion. Assuming it had been met, the '2 per cent total flow' target would have implied a resource flow (private and official) of $460 billion. That figure compares with resource flows to developing countries in 1999 of about $250 billion, i.e. 55 per cent of the target amount. However, when total flows reached their peak just prior to being thrown off their rapidly rising (1991–97) trajectory by the Asian crisis in 1997, they amounted to $335 billion when the collective GNP of high-income countries was $20 trillion. That is a proportion of 1.67 per cent of collective GNP, i.e. within striking range of the 2 per cent target proposed. Assuming that the nominal GNP of the 'high-income world' grew by about 5 per cent per annum (2.5 per cent real and 2.5 per cent inflation), the restoration of the pre-1997 trajectory would result in the 2 per cent target being achieved by 2005. Achieving the 0.5 per cent ODA target within that composite target would take longer.

6.4. Global Taxation as a Means for Financing Development

Globalisation is contributing to the greater interconnectedness of countries and economies. Does it offer any potential for financing development in different ways through globally levied taxes? The idea of global taxation to raise resources for financing GPG was first mooted at the 1972 UN Conference on the Human Environment. It has been in cold storage since then. Is it now becoming a practical possibility? In theory, such taxation could be multifunctional. For example, James Tobin's proposal for a minuscule uniform tax on each transaction in the foreign-exchange markets, in the spot as well as the forward markets, including trade in derivatives, was endorsed by the Millennium Summit. It was intended as a way of dampening speculative flows while raising resources for general tax revenue and providing a new source of FfD. In the same way, global carbon taxes could discourage pollution and end energy profligacy in high-income lifestyles while adding to the resources available for financing development. International taxes could also tap new economic activities such as e-commerce transactions.

The financial resources generated from global taxation might create additional, and potentially significant, sources of funds for development, and for meeting other specific targets and programmes identified and agreed to by the international community. Global taxation, even on a microscopic scale, would contribute

to greater balance in the global sharing of resources and benefits. It might help to redress the imbalances which globalisation and liberalisation are exacerbating, with the benefits being captured overwhelmingly by private corporations that have a head-start in the contest that has been unleashed for achieving global competitiveness. If the right protocols for global tax collection and sharing of the revenues could be worked out, it would mark the entry of the international community into more advanced forms and structures of co-operation.

But the time has not yet come for proposals on any kind of global taxation to be taken seriously by industrial countries – despite the sympathies of some of their more radical thinkers. It would be unfortunate if developing countries were to press prematurely for proposals on global taxation at UNCFD only to be branded as a collective that 'did not come across a tax they did not like'. It would be an odd position to take up with the entry of a new political regime in the USA that is determined to embark on one of the largest tax-reduction programmes in recent history. It is unlikely that such an administration, having agreed to UNCFD being a conference instead of a 'high-level event', would play a constructive part in the conference if the UNCFD agenda included proposals on global taxation.

Moreover, many governments in developing countries have embarked on tax-cutting programmes aimed at making their economies globally competitive. It would seem incongruous for them to argue for increasing the overall tax burden with global taxation at the same time. Thus, however attractive the concept of global taxation may be in theory, it would be wise to strike a cautious posture and avoid the risk of losing the larger war to achieve important FfD priorities and objectives because of an unfortunate proclivity to start an irrelevant and untimely battle on the global taxation front.

Sooner or later, the world will have to confront the reality of taxing transactions to replace direct and indirect taxation as the most efficient way of collecting revenues. Sooner or later, governments will have to recognise that a globalising world may well require global taxation. At some time in the future, a major paradigmatic shift may take place with the attendant institutional changes it entails. But that time has not come yet. With the prospect of a global slowdown looming on the immediate horizon, industrial countries face a number of serious economic problems that they need to grapple with before addressing what, in their view, may be an untimely distraction.

Premature proposals for global taxation risk being seen as opportunism to counter an environment in which support for ODA funded through national taxes is diminishing. Proponents see global taxation as having unarguable economic, political, distributional, moral and ethical roots. Opponents see it as an abomination that irresponsible governments with a chronic inability to control public expenditure should not be permitted to activate at any time for any reason. Given the intensity of feeling on the part of proponents and opponents, any discussion of global taxation is likely to result in more heat than light at UNCFD. If developing countries are to champion the cause of global taxation, they should eschew doing so at UNCFD. Instead, they should take time out to lay the preparatory intellectual groundwork, begin building alliances with influential parts of civil society in industrial countries and launch a global debate on the issue. Although nothing is as powerful as an idea whose time has come, it is equally true that nothing is as counter-productive as an idea that is too far ahead of its time.

7

Reducing External Debt Burdens to Revive Growth and Development

An as yet unresolved issue that obfuscates determination of additional ODA requirements is the hardy perennial of external debt. In discussing this question it is instructive to recall that, in the 1980s, the Latin American (or middle-income country) debt crisis was serially mishandled for eight years with one misguided plan following another.[50] That happened because the nature of the crisis was only partially diagnosed. The fault was seen to lie in irresponsible borrowing, rather than with equally irresponsible lending by creditors. The main emphasis, therefore, was on protecting the interests of commercial creditors (ostensibly to avoid destabilising the international financial system), regardless of the enormous economic cost and social and political damage inflicted on debtor countries. As a result, by 1989 the debt problem of Latin America, as well as of a few other middle-income countries, ballooned out of all proportion to the initial problem. Effectively Latin America lost two decades of development. Its standard of living in 1990 regressed to that of 1970. A solution to the crisis came belatedly in 1989 (under the Brady Initiative) with the reduction of a significant part – approximately 40 per cent – of the outstanding commercial bank debt of that region through exchanges of syndicated loan balances for marketable bonds of different types.

However, as Table 8 shows, the region's residual debt overhang (along with that of other countries like Turkey, Russia and Indonesia) remains excessive, with disproportionately larger debt service obligations. These resulted in a gross resource outflow on the debt account equivalent to 6 per cent of Latin America's GDP in 1999 and 8 per cent in 2000. It would be inconceivable for such a large debt-service burden not to act as a brake in preventing the region's accelerated development. A debt service burden of that size makes the region excessively vulnerable to financial crises as the experiences of Mexico (1995), Brazil (1998) and now the even more serious debt problems of Argentina and Ecuador (2000–1) suggest. Although Latin America turned a corner with the Brady Initiative, the debt problem of Africa remains largely unresolved 12 years later.[51]

The overall external debt and debt service situation of the developing world, and how it has evolved since 1970, is summarised in Table 14. It highlights the following features:

- In 30 years (1970–2000) the external debt of developing countries increased by nearly 40 times. It increased 9 times between 1970–80

50 These plans, of which there were too many to mention, included the notorious Baker Plan of 1985 which relied on using massive multilateral lending to pay back commercial banks, thus replacing non-preferred creditors with preferred creditors and making the second generation debt problem of these countries even more intractable in terms of debt restructuring. See Rowan, H. *Self-Inflicted Wounds: From LBJ's Guns and Butter to Reagan's Voodoo Economics*. New York: Times Books Random House, 1994, pp. 279–306.

51 This is so despite a series of initiatives to reduce Africa's debt burden since 1985. These include successively more generous rescheduling actions by the London Club (for private debt) and Paris Club (for official bilateral debt). That the debt burden remains suggests that, although progressively more generous, rescheduling terms have still been insufficient; suggesting also that what is needed is outright cancellation of outstanding debt on a much larger scale than the 40 per cent reduction brought about in Latin America. In Africa such reduction may need to range between 75–100 per cent. The most recent efforts to resolve the problem were the highly indebted poor countries' (HIPC) Initiatives of 1996 (HIPC-1) and 1999 (HIPC-2). Notwithstanding the hyperbole surrounding them, these initiatives have yielded little except to divert attention from higher priority development concerns.

Table 14. External Debt and Debt Service Burdens of Developing Countries 1970–2000
(Amounts in US$ billion)

	1970	1980	1991	1995	1996	1997	1998	1999	2000*
Total External Debt	**68.3**	**609.5**	**1,561.3**	**2,162.6**	**2,238.4**	**2,316.6**	**2,536.0**	**2,554.0**	**2,640.0**
of which									
Long-term	61.2	451.6	1,243.3	1,674.0	1,726.2	1,782.8	2,030.3	2,070.7	2,110.0
Short-term	6.3	145.7	279.9	427.4	452.1	463.0	411.9	402.3	420.0
IMF Credit	0.8	12.2	38.1	61.1	60.1	70.8	93.8	81.0	110.0
Official Debt	**33.1**	**190.4**	**691.6**	**927.9**	**894.4**	**865.2**	**946.7**	**956.5**	**1,087.0**
o/w Multilateral/IMF	8.1	61.1	263.0	351.3	346.6	360.5	420.1	426.7	500.0
Bilateral Debt	25.0	129.3	428.6	576.6	547.8	504.7	526.6	529.8	587.0
Private Debt	**35.2**	**419.1**	**869.7**	**1,234.7**	**1,344.0**	**1,451.4**	**1,589.3**	**1,597.5**	**1,553.0**
o/w Guaranteed	13.5	202.9	510.2	587.4	609.4	625.7	676.3	704.6	695.0
Unguaranteed	15.4	70.5	79.6	219.9	282.5	362.7	501.1	490.6	438.0
Short-term	6.3	145.7	279.9	427.4	452.1	463.0	411.9	402.3	420.0
Memo: External Debt									
Low-income Countries	18.5	102.0	360.4	411.4	402.5	387.3	721.6†	730.2	755.0
Middle-income Countries	49.8	507.5	1,200.9	1,751.2	1,835.9	1,929.3	1,814.4†	1,823.8	1,885.0
Total External Debt Service	**6.0**	**93.3**	**162.4**	**241.9**	**279.4**	**305.2**	**316.1**	**349.4**	**398.0**
of which									
Interest Payments	4.1	48.9	72.3	98.6	104.5	109.1	122.6	135.3	153.1
Principal Repayment	1.9	44.4	90.1	143.3	174.9	196.1	193.5	214.1	244.9
Debt Service									
Low-income Countries	2.2	9.3	21.5	30.0	28.4	26.8	65.7†	70.6	78.0
Middle-income Countries	3.8	84.0	140.9	211.9	251.0	278.4	250.4†	278.8	320.0
Net Transfers on Debt	**2.5**	**26.3**	**50.0**	**150.6**	**196.0**	**221.9**	**–43.8**	**–114.6**	**–120.0**
Official	4.7	28.8	41.1	22.8	1.2	10.3	19.2	10.2	24.0
Private	–2.2	–2.6	8.9	127.8	194.8	211.6	–60.0	–124.8	–144.0
Low-income Countries	1.3	12.7	–0.3	–3.1	–3.7	–0.3	–28.6	–26.3	–29.0
Middle-income Countries	1.2	13.6	50.3	153.7	199.7	222.2	–15.2	–88.3	–91.0

Source: GDF-1999 (for annual figures up to 1997) GDF-2001 op. cit. (for 1998–99 figures)
*Figures for 2000 are preliminary estimates subject to revision.
†The sharp discontinuity between the 1997 figures (in GDF-1999) and 1998–99 figures (GDF-2000) for the debt burdens of low- and middle-income countries remains unexplained. It probably involves a different classification resulting in countries that were formerly middle-income moving to the low-income bracket.

from $68 billion to $610 billion. Between 1980–90 it increased by 2.5 times to $1.5 trillion. In the last decade it has nearly doubled yet again to stand at an estimated $2.64 trillion in 2000;

- Debt service burdens have risen even faster – from $6 billion in 1970 to over over $93 billion in 1980, $155 billion in 1990 and nearly $400 billion in 2000. Debt service has thus increased nearly 70 times in the same 30 years; it now accounts for 2.5 per cent of

the annual GDP of the developing world compared to less than 0.5 per cent in 1970;

- Between 1998–2000 developing countries have, in net terms, transferred a total of nearly $280 billion in real resources to industrial countries on the debt account.

Continually growing burdens of external debt and debt service impose a pre-emptive charge on the domestically generated resources and trade earnings of developing countries. Two decades of debt crises since 1982 have made clear the inability of all too many countries to manage such burdens. Although several debt relief initiatives have tried to address the problem, the approach has invariably been piecemeal and on a too-little-too-late basis. In each case the approach taken by creditors to solving the problem has been reluctant, grudging and painfully slow. A plethora of unnecessary, onerous and often counter-productive conditionalities have been applied with each rescheduling to the countries that have sought debt relief. The terms for rescheduling have invariably been unrealistic at the outset. The protracted process has compromised outcomes and delayed the recovery of many indebted countries. In some instances, it may have permanently crippled them.

7.1. Issues Raised by ZPR on External Debt

In the light of this history, ZPR is lamentably weak in its treatment of the unresolved debt issue. Acknowledging that HIPC-1 was a failure and discussing the need for further progress on debt relief, especially in the context of inadequate ODA, the ZPR expects that:

- Under HIPC-2 the debt service of HIPCs will decline by $1.1 billion annually from what would otherwise have been paid and $2.4 billion annually from what would have been due. (If the past record of their over-optimistic projections is taken as a guide, these reductions are probably overestimated by the World Bank and IMF by about 100 per cent, i.e. only half these reductions are likely to materialise as time unfolds.)
- Donors will finance additional debt relief under HIPC-2 with additional ODA.
- If HIPC-2 were further enhanced by HIPC-3, as many debt campaigners are already calling for, it might result in a redistribution of aid among developing countries with the moderately indebted low-income countries effectively paying for the severely indebted ones. That would undermine the fight against poverty.

With no serious recommendations to make on this issue, ZPR acknowledges that the Panel was split in its views. Some of its members believed that further enhancement of debt relief through HIPC-3 would be desirable. Others felt it was worth serious consideration but were concerned that, without assurance of additional ODA by donors, it would have effects on other developing countries that were best avoided and that it would create a borrowers' moral hazard.

7.2. Issues for Consideration at UNCFD on Resolving External Debt Problems

ZPR's concerns about not moving ahead with HIPC-3 in the absence of increased ODA to finance it, and about the possibility of creating moral hazard on the part of borrowers by providing further debt relief are misplaced. It should have been more concerned about creating moral hazard on the part of *preferred creditors* when it accepted, without scrutiny, the arguments put forward by the IFIs. Ever since 1994, when the issue was first brought up,[52] these institutions have resisted writing-down their own claims on HIPCs in the same way that commercial creditors are required to by their respective regulatory authorities, i.e. by

52 Mistry, P. S. *Multilateral Debt: An Emerging Crisis?* Forum on Debt and Development (Fondad), The Hague, 1994.

(a) reducing the provisions that they have made on loans to these over-indebted countries, making a charge against reserves if necessary and then writing down equity capital as a third step; and (b) cancelling outstanding balances of concessional multilateral credits that have been funded by donors in the first place. The IFIs have raised a number of arguments against such action (repeated in ZPR) and suggested a spectre of substantial collateral damage if such action were to be contemplated or mandated by their shareholders to accelerate debt relief.

These arguments have been examined by independent financial experts on a number of occasions and dismissed as invalid. Yet the intransigence of the IFIs has been permitted to undermine the effectiveness of HIPC-1 and HIPC-2, and now to block HIPC-3. If the IFIs were required to write-down their own claims on HIPCs, with official bilateral and private creditors doing the same, the amount of ODA required to fund HIPC-3 would not be an obstacle to further debt relief. It is only an impediment because the IFIs (with donor complicity) choose to make it one. The cost of IFI recalcitrance is being borne by HIPCs in foregone development and deferral of urgent expenditures on health and education.

In influencing SGR and ZPR on this issue, the IFIs have gone a step further in introducing another argument against HIPC-3. In the absence of incremental ODA to finance all the enhanced debt relief likely to be provided under HIPC-3, they suggest that any attempt to enhance debt rescheduling or debt reduction terms would adversely affect the interests of other developing countries and especially the other low-income countries (because of the playback impact of writing down concessional credits). This line of reasoning is both false and unfortunate. It should be repudiated by the international community as a regrettable attempt on the part of the IFIs to resort to divide-and-rule tactics. It should be condemned by the Commonwealth and collectively by all developing countries.

The reality is that all IFIs are effectively global or regional financial co-operatives. It is in the nature of such co-operatives that the more financially capable members should bear the cost of relieving other members from distress when their long-run viability and solvency have been compromised. When write-downs occur, provisions are written down first, then reserves and then capital. The provisions made by all the MDBs against doubtful loans now exceed $8 billion. Their combined reserves exceed $30 billion.

Except in the case of the African Development Bank, writing down the outstanding balances of the non-concessional (or hard window) multilateral debt of HIPCs is unlikely to absorb a significant proportion of the provisions made. It would certainly not eat into their reserves, nor threaten their capital structure, nor increase the borrowing cost of any MDB. The IMF would be unaffected since it does not raise resources through market borrowings. It could engage in whatever write-offs it chose to without any significant consequence for its financial standing.

The group likely to be most affected in the future by cancellation of the outstanding balances of concessional credits to HIPCs (through reduced new commitments that would have been financed by reflows of funds from concessional sources) are the HIPCs themselves. Moreover, the net present value of cancelling their debt now is far greater than the net present value of future disbursements from credit commitments that may or may not be made. The interests of other low-income countries could be protected through appropriate eligibility and allocation criteria applicable to new concessional credits.

If donors are required to increase ODA, they do

not need to do so now in order to provide more concessional resources to the MDBs to finance debt relief. They could just as easily increase ODA gradually later, and allocate the increment to other low-income countries that have not received any benefit from debt relief. There are a myriad ways in which a conflict of interest between severely indebted and less indebted low-income countries could be avoided and could be easily managed if it did arise. Finally, when financial co-operatives take write-downs on their balance sheets, the 'cost' of such write-downs is distributed in direct proportion to the shareholding of individual members. In the case of the Bretton Woods Institutions, the bulk of the cost would be borne by the industrial countries – the same group that is being asked to provide more ODA for the same purpose. Thus the arguments put forward by the IFIs and accepted without challenge by ZPR are misleading.

At UNCFD, this issue should be resolved once and for all. A genuinely independent panel of financial experts needs to consider the issues and implications of IFI write-downs for funding HIPC-3 and to make a final recommendation for all shareholders of these institutions to consider. Such a step is necessary for another reason. What the arguments put forward by the IFIs amount to is implicit, permanent enshrinement of the principle of insulation from any penalties (applied to these institutions or their managers and staff) for the damage they cause through default. That is a dangerous principle to accept in theory or apply in practice. At UNCFD the international community needs to reconsider the type of regulatory oversight needed over the IFIs. Current mechanisms for governance (through Boards of Directors and Governors) are too easily subject to regulatory capture and do not work effectively enough. UNCFD should also consider how financial and other penalties and sanctions can be applied to these institutions when they are in default and when their actions harm the interests of their borrowers. The complete insulation of IFIs from any sanctions creates a more dangerous moral hazard than any incurred by HIPC borrowers.

Contrary to the rhetoric, and the expectations created when it was announced, the first HIPC Initiative (HIPC-1) did not result in reducing swiftly the burden of external debt for the poorest countries. Indeed, as some critics noted at the time, HIPC-1 seemed to have been designed in an overcomplicated fashion so as *not* to work. Elephantine in terms of the staff resources, time and financial resources that went into developing and implementing it, HIPC-1 produced an ant-sized result. At the same time it resulted in the injection of additional conditionalities (unrelated to the specific purpose at hand) that were complex, onerous, intrusive and counter-productive. What HIPC-1 delivered was smoke and mirrors. The debt relief process was made extraordinarily complex and drawn out over too long a period. After three years of HIPC-1 being in place, only a handful of HIPCs had qualified for debt relief and none had actually received it.

It was only when considerable public pressure – organised by the Jubilee 2000 coalition for debt relief – was put on donor governments, that the terms of the first HIPC initiative were revised and relaxed in 1999 to permit meaningful debt relief. HIPC-2 appears to be faring marginally better than HIPC-1 but it does not go far enough. Though relief has been accelerated, the actual relief granted is in most instances insufficient to reduce cash outflows from the exchequers of the poorest HIPCs. What have been reduced, in the main, are contractual obligations that were accumulating arrears and that could not (and would not) have been paid in any event, i.e. creditors writing down debt that was not being serviced but was accumulating arrears. Such debt would not have been repaid in any conceivable circumstance.

After five desultory years, it is evident that the

HIPC initiatives need to be redesigned to reduce the period for pulling the qualifying, decision-point and actual relief triggers. Experience suggests that future versions of these initiatives should not be administered by the IFIs because they have a vested interest in slowing the process down. *Debt reduction for developing countries should, instead, be the responsibility of an Independent Commission on Debt Rescheduling and Reduction that is not controlled by any creditor group with a vested interest in the outcome.* Relief to HIPCs needs to be front-loaded rather than back-loaded if it is to have the desired developmental effect. Concern that the financial resources released by debt relief should not be misappropriated or misused by beneficiary governments is legitimate. But it is doubtful that the procedures aimed at preventing that eventuality under HIPC-1 and 2 will yield the desired outcomes. Instead, with relief being front-loaded, the disincentive for *mala fide* behaviour on the part of the debtor government should be the risk of losing all future ODA flows, bilateral or multilateral, if the resources released by debt-relief, or any other public resources in the country's fiscal system, continue to be misused.

Because the HIPC initiatives have not resulted in a significant, real alleviation of debt burdens, debt crisis management continues to absorb too much of the time and resources of the treasuries and central banks of developing countries. It drains them of scarce resources, financial and human, to address development challenges of a more pressing nature. Debt rescheduling has become an industry whose growth is being fuelled by the IFIs, replete with the panoply of a typical aid industry, including specialist consultants who perhaps benefit more from these initiatives than the HIPCs themselves.

The poorest, least developed countries remain the worst affected by debt. But external debt burdens continue to impede development progress in other developing countries as well. HIPCs account for less than one-tenth of total developing country debt ($225 billion out of $2.6 trillion). As observed above, Latin America's debt overhang remains large enough to be a threat to continued development progress if external shocks were to occur simultaneously on a number of fronts. Apart from these two major groups of severely indebted debtor countries, there are a number of countries with debt overhangs that fall between the cracks of the various formal relief initiatives that have been launched. These countries have external debt levels that are above the safety level of 35 per cent of GDP (often with internal and external debt levels that are together between 70–100 per cent of GDP) and debt service levels that are well above the safety level of 10–15 per cent of sustainable export earnings. Many such countries are small micro-states (often remote islands) with undiversified economies and few prospects for enhancing competitiveness in a globalising world. Regrettably, no action is being contemplated or taken regarding the debt burdens of these countries, many of which are members of the Commonwealth.

External debt therefore continues to be a key financial constraint on development. It has attendant domestic social and political consequences that are difficult to cope with. Therefore it would be appropriate for developing countries as a collective to pursue the idea of a decisive resolution of the external debt issue at UNCFD. New ideas should be considered and studied. These might include notions such as:

- Reviving debt-equity swaps aimed at accelerating privatisation and increasing the equity financing available for privately funded infrastructure projects on a major scale in countries where debt and debt service levels are above prudential limits (35 per cent of GDP for debt and 15 per cent of exports for debt service);
- Applying 'extendable mortgage' principles

to *automatic* sovereign debt rescheduling by keeping debt service payments at a constant dollar level, or at a level not exceeding 15 per cent of export earnings, while automatically extending or shortening the maturity of the adjusted outstanding debt obligation depending on global interest rate movements and the impact of financial crises;

- Activating automatic debt-service reductions or stand-stills in the event of financial crises with automatic debt service rescheduling through maturity extensions;
- Eligible countries with a debt-overhang earning 'debt-write-down credits' for sustained development performance (for example with official creditors agreeing to write down 10 per cent of their outstanding debt obligation for each year if countries sustain a growth rate of at least 6 per cent annually for five years).

Most of all, the unsatisfactory situation whereby creditors, especially the IFIs, continue to monopolise debt alleviation, as well as being the final arbiters and judges of the 'affordability' of debt service and the allowable extent of a debt overhang, needs to be changed. As suggested by SGR, developing countries should collectively press the case for an independent international debt arbitration mechanism, involving creditor and debtor, as well as impartial expert interlocutors, in assessing, adjudicating and passing judgement on debt reduction options. In that connection, an International Convention on Sovereign Debt Restructuring in Financial Emergencies may need to be considered to incorporate the lessons that have been learnt over the last 20 years to remove the inconsistencies and avoid the 'make-it-up-as-you-go-along' approach that has been the hallmark of IFI interventions in restructuring debt burdens.

In the absence of a sea-change in approach to the process of sovereign debt reduction and relief – of a kind that applies the concepts of Chapters 9, 10 and 11 in the US Bankruptcy Code approaches to debt reorganisation to avoid bankruptcy – the experience of 1982–99 casts doubt on the wisdom of continued resort to non-concessional debt-creating flows for financing soft investments in poverty reduction. It is particularly disconcerting that the two main IFIs are now attempting to persuade developing countries to assume further non-concessional debt obligations to finance social investment, international public goods and poverty-reduction programmes (for example in education and health). Necessary though such social investments are, the medium-term financial returns from them will not support the debt-service obligations being created. The notion that the broader economic gains accruing from such investments will result in a sufficiently large increase in growth to accommodate increased debt-service obligations needs to be treated with caution (if not suspicion) by developing country borrowers.

8

Systemic Issues and Changes in the Global Institutional Architecture

In mid-2001, supranational (and national) processes, institutions and mechanisms for effective global governance – in a world that has been globalising very rapidly over the last 15 years – are obviously inadequate. They have been inordinately slow in responding to the demands of rapidly changing circumstances. They lag too far behind the reality of globalisation for it to proceed as smoothly as it should, or for ironing out the asymmetric concentration of its gains and losses across countries in real or conscionable time. In addressing these truisms, SGR makes 22 recommendations about what might be done to remedy the situation. Of these only two involve specifically actionable measures.

SGR makes the case that the UN should be the centrepiece of any future system of global governance; with other international institutions being well-articulated parts of the UN system and coming under a single UN roof. Unfortunately the case is unconvincing. It is presumptuous and axiomatic. It ignores the failings of the UN system which make it: (a) a dysfunctional bureaucratic quagmire; (b) impervious to the tenets of organisational logic and to a long overdue requirement for streamlining and rationalisation of its multiplicity of fragmented agencies, programmes, conferences and funds determined to maintain their own unviable identities; and (c) immune to the principles of sound institutional management. In short, the UN appears incapable of governing itself properly and thus lacks the public credibility needed for it to be the pivot around which any future system of global governance might revolve.

8.1. Systemic Issues Raised by the Zedillo Panel Report

Perhaps with this deficiency in mind, ZPR is more cautious and selective about its views on systemic issues and modifications in the existing global architecture and limits itself to the following seven key recommendations:

- Increase the administrative budget of WTO substantially to enable it to provide a wider array of assistance to its developing member countries;
- Establish a small steering group in WTO responsible for negotiating consensus on future trade accords among member countries;
- Strengthen and reform the ILO to deal with the issue of labour standards;
- Collapse and consolidate the various intergovernmental environmental bodies that exist into a single Global Environment Organisation with a standing equivalent to that of the WTO, IMF and World Bank;
- Prune back conditionality applied by the IMF and World Bank to the bare essentials required and correct anomalies in the governance of these institutions in which industrial countries have the majority (and the decisive voice);
- Create a new International Tax Organisation to: (a) cope with a world in which the principle of national territoriality is becoming obsolete and which permits, if not encourages, legal tax avoidance by individuals and corporations that have multiple

domiciles; (b) recapture the increasing proportion of public revenue that is not being collected because it is falling between the cracks of tax jurisdictions inhibited in their reach by national boundaries; (c) limit, if not eliminate, harmful tax competition among countries; (d) conduct research, engage in surveillance of emerging tax policies and developments, permit multilateral sharing of tax information, and provide a forum for co-operation and co-ordination among national tax authorities; in due course (e) develop and secure international agreement on the unitary taxation of multinational entities; and (f) develop, negotiate and operate international arrangements for the taxation of emigrants;

- Convene a Global Economic Governance Summit as a prelude toward enshrining it as an Economic and Security Council within the UN.

ZPR's seven recommendations have been made on the basis of reasoning that appears artificially truncated. It is perhaps limited in presentation to avoid making the report too long, thus omitting the deeper deliberation that probably took place in Panel discussions. Its recommendations are, in some respects, sweeping and have substantive implications. By the same token, it is silent on key issues, especially on global financial architecture, that are of great concern to developing countries. The following sub-section attempts to deal with these issues in greater depth.

8.2. An Agenda for the Commonwealth

Reforming the WTO

The WTO was set up after the Uruguay Round to ensure that future rounds of trade liberalisation were not 'zero-sum games' but 'positive-sum games' from which all sides won through a progressively liberalised, open world economy. It is widely perceived – in the developing world, labour organisations and pro-active NGOs (euphemistically labelled civil society) – that the rules of the game in international negotiations, and the dice used to play the game, are loaded in favour of global firms, mainly from the developed world. These entities are seen to have an embedded structural advantage in terms of greater financial, managerial, technological and institutional capacity, as well as domination of cutting edge knowledge that will shape future products and markets. When competitors from developing countries learn how to play the game and pose a competitive threat, as in East Asia, the rules and/or dice are changed. Such perceptions are adversely affecting the implementation of Uruguay Round Agreements and delaying a new round of WTO negotiations. These were to have begun in 2000 but were derailed by the failure of the Seattle meeting in November-December 1999.

One reason for WTO negotiations being stymied is that the expectations generated by the URAs are not being realised by developing countries to the extent anticipated. The positive-sum game is turning out to be a zero-sum game after all. TRIPS and GATS are proving to be extremely problematic for most developing countries. Through the 1990s, there has been backsliding by OECD countries on a variety of their UR commitments. They have not yet liberalised trade in agriculture and textiles. Arrangements that were agreed to provide special and differential treatment for the least developed countries have not as yet been legislated for by many OECD countries. Yet pressure is being exerted on developing countries to open up sensitive markets in telecommunications, transport and financial services, and in government procurement, that OECD firms have an interest in dominating. At the same time, issues have been introduced for the new round that developing countries are deeply concerned about, for example labour and environmental standards. They believe that such standards are being introduced into trade

discussions not on their merits but as devices to justify continued protectionism on the part of industrial countries. There has been increasing, often unfair, resort to contingency protection measures against imports from developing countries with frequent resort to litigation that violates the spirit of the URAs.

Developing countries have been unable to cope with the administrative and legal workload imposed by URAs and by delaying tactics being deployed by industrial countries to slow down market opening. Many developing countries face serious difficulties in implementing these agreements and drafting the domestic legislation that would bring them into force. Most do not have the institutional capacity to do so. The investment required for improving the institutional and negotiating capacity of developing countries to cope with another round of trade negotiations has not been made. As a critical part of the global institutional architecture, WTO's organisation, governance and functioning need to be geared more toward enhancing the knowledge and capacity of its developing member countries than they are now.

At the moment WTO is too small and too driven by OECD country interests to be as useful as it should to its developing members. Its transformation from GATT – which was a rich country club – is still incomplete. Whereas the IMF and World Bank need to be shrunk in size and scope, the WTO almost certainly needs to be enlarged but in an intelligent manner.

Hemispheric and region-to-region dimensions, as well as certain preferential dimensions of arrangements such as those between the ACP (African, Caribbean and Pacific) countries and the EU, need to be accommodated in the process of continued trade liberalisation rather than treated as exceptions to global rules. WTO's processes and staff capabilities need to facilitate such hemispheric and region-to-region trade dialogue in virtually every region, while ensuring its compatibility with the emerging global regime. To avoid circuit overload in developing countries in dealing with all of these issues during a new trade round, WTO will need be more responsive, and provide substantially more technical and advisory assistance to developing countries than it was able to do under the Uruguay Round. Its present budget, staffing and institutional capacities simply do not permit this.

For all these reasons, ZPR's recommendation that WTO's administrative budget, staffing and overall institutional capacity should be increased should be supported by Commonwealth Finance Ministers. They should ask at UNCFD for a plan of action from WTO's management outlining the steps to be taken towards making it a more accessible organisation for its developing country members and lessen its institutional bias in catering primarily to the interests of its industrial country members who now account for the bulk of world trade but are unlikely to do so in coming decades.

Labour Standards and the ILO

ZPR's recommendation that labour standards should be delegated to the ILO should be supported by Commonwealth Finance Ministers. Industrial countries need to agree to this proposal and co-operate in strengthening the ILO sufficiently to develop appropriate standards that take into account the structural attributes and characteristics, as well as levels of income and stage of development, of developing countries and their labour markets. In doing so, ILO must avoid the trap of being too heavily influenced by trade unions in industrial countries that are determined to see unrealistic and inappropriate standards applied to developing countries. Such insistence is aimed at diminishing the trade competitiveness of developing countries and amounts to imposing protectionism through an indirect route. ILO must also develop the capacity, the credibility and the

legitimacy to propagate voluntary adherence to agreed but properly attenuated labour standards and enforce such standards when this becomes necessary. In supporting this recommendation, Commonwealth Finance Ministers should ask for a study that would outline the practical and cost implications of implementing this proposal before endorsing it in practice.

Environmental Issues and the Global Environmental Organisation

ZPR's recommendation that all international environmental organisations should be consolidated into a single GEO is unarguable in theory and in principle. It might well facilitate overdue institutional rationalisation in a key area of global concern. But this recommendation appears to have been made without awareness of its practical implications. ZPR does not provide any indication that the Panel was aware of how many such organisations there are at present, under which parent agencies and umbrellas they are located, how they are funded and managed, and how they interact (or fail to). It provides no indication that the Panel was aware of what these multifarious agencies do, why they exist, how they are co-ordinated and what the net result of the present situation is. Until these aspects are clearer, Commonwealth Ministers run the risk of endorsing and supporting a recommendation that may be sound in theory but inoperable in practice.

Many large environmental units are located within the MDBs as part of their departmental structures. One significant institution – the Global Environmental Facility (GEF) – is effectively a joint venture between the World Bank and UNEP but is run under the aegis of the World Bank. It is unclear how much these units cost, exactly what it is they do, how effective they are and what their objectives are. It would be unwise for Commonwealth Ministers to take any position on this issue – except to say that it is an idea that should be examined further – until: (a) an exhaustive inventory has been undertaken of all the international and multilateral environment units and agencies that presently exist and their parent organisations; (b) an assessment has been made of whether the extant fragmented structure is dysfunctional or not; and (c) how consolidating them into a single GEO would work, what the governance mechanisms would be, how voting power would be distributed and how much this would cost.

The Official Financial System and the Bretton Woods Institutions

ZPR's treatment of the global financial system and the urgent need to change its architecture to accommodate evolving circumstances, is weak. Its analysis is conspicuous by its absence and does not address the concerns of developing countries. With the breakdown of the Bretton Woods Agreement in 1971, followed quickly by the first oil shock in 1973, a spate of financial crises have occurred with destabilising effects on the global financial system. Post-1971, the world has seen a departure from the stability of a fixed exchange rate system that brought with it 25 years of unprecedented stability and prosperity. Since then the world of global finance has become more uncertain and fraught with risk for countries that are not industrialised and are financially and economically weak.

Since 1971 much has been learnt about how and why financial crises arise and about the usefulness and effectiveness of the different kinds of measures attempted to remedy them. In one way or another, apart from the ever-pervasive issues of policy and governance, all these crises relate to the adequacy and appropriateness (i.e. type, concessionality, terms and tenor) of the financing made available for development before the crisis occurred. The 1970s were shock-prone, with tectonic shifts in the pattern of global resource transfers altering the foundations of international finance. It was the post-1982 era, however, that witnessed

repeated default in response to the successive financial shocks that derailed development. In light of this, developing countries have been pressing for overdue reforms in the policies, instruments, *modus operandi*, governance arrangements and architecture of the IFIs and the international financial system. Apart from their basic problems with (and lack of sufficient influence in) the governing structures of the principal IFIs, developing countries have become concerned about a systematic bias in these institutions toward crisis management remedies that result in greater dislocation and structural damage in developing countries than is necessary or desirable before recovery occurs.

The contrast is striking between remedies applied when a financial crisis threatens, or a recession looms, in *industrialised* countries (for example in 1971, 1987, 1994 and 1998) and when these events occur in developing economies. In the developed world the usual policy-response combination is for domestic and global liquidity to be loosened, fiscal policy to become more accommodating, internal corporate debts to be quickly re-organised through orderly proceedings to avert bankruptcy, co-ordinated OECD central bank action being taken to stabilise global exchange and interest rates, social safety nets being widened and strengthened, with contingency financing being made available to facilitate expeditious economic restructuring in order to ensure a rapid rebound.

When a financial crisis occurs in the *developing* world (1982, 1985, 1994–95, 1997–98, 2000–01) the policy response is the opposite. Domestic liquidity is stifled through draconian increases in interest rates, ostensibly to stabilise exchange rates and avert capital outflows, though this rarely happens as quickly as anticipated. Exchange rates are devalued and/or floated, resulting in either spiral devaluations thereafter (for example in Africa) or free falls and excessive overshooting on the downside (in Asia) before any attempt is made at stabilisation. Fiscal policy is simultaneously tightened with wasteful recurrent expenditure being protected (because of the absence of time, in a crisis, to create the necessary political consensus for cutting it), but essential development investment being cut back, along with subsidies that protect the poor. Budget cutbacks result in the reduction or elimination of social safety nets. No contingency financing is made available and debt-rescheduling policies are applied that make early economic recovery almost impossible.

The stark asymmetry between the ways in which financial crises in the industrial and developing worlds are managed has two different outcomes. It ameliorates financial, economic and social costs in industrial countries, while it exacerbates those inflicted on developing countries, particularly on the weakest countries and the weakest segments of their societies. In some instances, for example Indonesia, *financial* crisis management has a hidden *political* agenda on the part of creditor nations (and the IFIs they control) in achieving a change of regime. The success of Malaysia's home-grown approach to crisis management has been arguably more successful than events in Thailand and Indonesia where external interlocutors played a controlling role. It offers a contrasting alternative to the IFI template if developing countries are bold enough, and resourceful enough, to shun the ministrations of these institutions and take the risk of devising their own approach to crisis management.

Crisis management in developing countries has another peculiarity. Foreign private creditors, who often trigger a crisis through imprudently excessive short-term lending followed by panic withdrawal that drains reserves and creates a run on the currency, are invariably the first to be bailed out at public expense. The immediate gains of crisis management are thus privatised and exported, while the costs are socialised and

borne by the poorest segments of society in the country affected. Consequently, the crisis is prolonged with all its attendant costs in terms of corporate bankruptcies, loss of export markets, increased unemployment and retrenchment, with almost no funding for retraining, retooling of skills and re-absorption of the labour force. What starts out as a financial crisis, resulting from creeping disequilibria exacerbated or detonated by an external shock, becomes a structural social and political crisis (for example in most of Africa and Indonesia).[53]

This entrenched asymmetry in policy responses to crisis management bears further scrutiny. It is becoming less acceptable to developing countries as the theoretical and practical justifications for these divergent policy responses are inexplicable. It simply reflects the structural reality that the present international monetary system, and the policies governing it, have a systemic bias toward protecting the interests of creditors (official and private) in industrial countries while prejudicing the financial and economic interests of developing countries. For the latter, international liquidity is artificially limited, unevenly distributed and inaccessible. In a crisis they are compelled to pay an excessively heavy price over which they have no say and no control.

On the other hand, issuers of international reserve currencies reap significant benefits by way of seignorage, large cash holdings of their currencies in safe-haven accounts (including holdings from illegal capital flight as well as proceeds from criminal activity) on which they derive a large interest-saving benefit. Their advantaged position confers on them the ability to borrow almost unlimited amounts in their own currencies, if not formally, then by having their otherwise unsustainable current account deficits financed through capital inflows reflecting purchases of their debt obligations or inflows of foreign direct and portfolio investment. This enables them to incur larger current and capital account disequilibria for longer periods of time without dislocating adjustments being forced upon them by either the world community or by any agency. They have the ability to inflate or devalue their way out of debt or pass on the costs of their own delayed adjustment to other participants in the world economy.

Since the mid-1970s, mutual support arrangements among members of the G-7, the OECD and/or EU clubs have enabled developed countries to elude the disciplines of the IMF in managing their monetary, fiscal, trade and exchange regimes in ways that contribute to a wider global interest. They are no longer subject to official international criticism (except of the mildest variety in the annual Article IV surveillance reports that are produced). Nor are they obliged to take corrective measures when their policies impinge directly and adversely on the interests of developing countries. The implicit notion is that these few countries are developed enough for their *national* policy-making mechanisms to suffice in exerting the necessary economic disciplines and self-correcting measures in order to avert crises while other countries must have *extra-national* discipline imposed on them.

That conviction has resulted in seven countries placing themselves beyond international discipline and deploying power asymmetrically (through G-7 that also controls OECD) to manage the global economy, govern the conduct of international finance and control the IFIs. The appropriation by G-7 of the right to make all the critical decisions affecting the global economy, without participation by others, has resulted in the arrogation of global power without the necessary global consensus legitimising this model of economic domination.

53 The exception was the Tequila crisis of 1994–95. It was more sensitively handled by the IFIs (under the watchful eye of the US Treasury Department) to avoid the spill-over into the USA of yet another crisis in Mexico.

Though not explicated as a salient feature of the present global financial system architecture, the G-7 arrangement has effectively resulted in a hierarchy of nations differentiated by the degree of sovereignty they retain over their economic affairs.

A global caste system has now emerged. It has two major divisions – the industrial and developing worlds. In the first division, G-7 members are the *brahmins*; larger member countries of the OECD/EU clubs (the warriors) come next; with the smaller economies of the same clubs (the merchants) occupying the third tier of the first division. The second division is headed by seven or eight of the larger, littoral developing powers (not necessarily with the highest per capita incomes) in the fourth tier (the servants), followed by middle-sized, middle-income countries in the fifth, and the least developed countries (the untouchables) in the sixth.

The application of greater imagination might yield a larger number of castes and a different basis for determining their memberships; but it would not invalidate the point being made. What has evolved in the post-Bretton Woods era is a global financial system in which developing countries have little or no influence. Nevertheless, they are obliged to accept its oppressive, neo-colonial disciplines and strictures. Continuing dissatisfaction with the way in which such a system operates will weaken it and make it increasingly dysfunctional. That is not in the interests of the industrial or the developing worlds. UNCFD presents an opportunity to scrutinise thoroughly, but dispassionately, how the international financial system and the IFIs are evolving, and to consider measures that deflect them from the path of eventual paralysis and change their evolutionary trajectory in a way that restores their functionality.

With the shift that has occurred in managing the balance of payments under the pressures of globalisation, and with developing countries moving progressively toward opening their current and capital accounts, their requirement for balance of payments financing, and especially for large amounts of emergency balance of payments support in the event of a financial crisis, are changing. The financial crises of the 1990s suggest that in countries that rely on private capital flows to finance their development, managing movements on the capital account – especially the inward and outward surges referred to earlier – is becoming more important than managing the current account. Such countries need to hold sufficient international reserves to give global markets a sense of comfort and to convey an image of credibility and liquidity, as well as having the robustness to withstand occasional financial tremors.

The issue for these countries is no longer a matter of the number of months of imports that their reserves can finance. This has become almost irrelevant, as long as countries retain sufficient creditworthiness and market standing to obtain large credit lines from global banks and mobilise resources from global financial markets to fund their 'working capital' requirements for regular trade. Instead, the focus is now on whether they have sufficient reserves to withstand a sudden outflow of their liquid foreign capital liabilities – especially foreign-held portfolio equity and short-term bank borrowings – without incurring the risk of recession-inducing monetary policy and a collapse of currency values. It is not just the extent of FPI and short-term bank borrowing that heightens their vulnerability. Recent experience suggests that when a crisis looms, even foreign direct investors (and domestic investors) are becoming sophisticated risk-managers in reducing their net exposure to a troubled economy. They borrow (from domestic sources) against their asset holdings and move that liquidity abroad, thus hedging their risk of loss. Hence even immovable foreign assets can be liquefied and add to volatility.

Of course, not all developing countries are in this situation as yet. As recognised earlier, private capital flows to the developing world are concentrated in the 25–30 larger and more industrialised developing countries that account for the bulk of the population, trade, reserves and output of the developing world. The 175 or so other developing countries include about 55 poorer countries in Africa, South Asia and East Asia, and more than 100 small middle-income countries, including island micro-states dependent for their export earnings on tourism, sugar, bananas, rum or copra. This numerous, but mixed, group of countries continues to have the old problem of managing their external accounts; they remain vulnerable to sudden shifts or secular declines in prices of (and demand for) their primary exports. They are also particularly vulnerable to the vagaries of nature – cyclones, floods, droughts and earthquakes – as well as to movements in global exchange rates and overall economic conditions in their major markets. Since the 1980s, many of these economies have become burdened with debt overhangs beyond their capacity to service on contracted terms.

When disequilibria in *current accounts* were the only matter for concern in ensuring adequate balance of payments support – in the event of sudden changes in circumstances – the extant instruments and facilities available to these countries from the IMF, the World Bank or the regional and sub-regional development banks, in meeting their needs were inadequate. That reality was borne out during the three successive energy price shocks of the 1970s, and in the global interest rate shock of 1981–82 that triggered the debt crisis. Since 1990, a substantial increase in private capital flows has created the added need, on the part of the larger developing countries, to manage their capital accounts adroitly as well.

If the external resources available to the IFIs to manage transient current account balance-of-payment crises were insufficient, it is obvious that the system does not have sufficient resources to cope with unanticipated disequilibria in capital accounts as well, regardless of what the IMF believes. The deficiency would become tragically obvious if financial market crises were to erupt and contagion spread across even 15 of these 25–30 countries leading to systemic failure. To an extent, that reality is compelling too many developing countries to hold much larger levels of reserves (over $850 billion) than was formerly necessary or financially desirable. Reserves in many of these 25–30 countries are approaching or exceeding levels that would finance 12 months of imports. The cost of such holding such reserves can be unduly high, especially when they are borrowed and do not represent accumulated current account surpluses.

With each crisis that occurred in the 1990s, calls were made to increase the resources available to the IFIs and to create new financing facilities and contingency mechanisms that would be prophylactic as well as curative, in nature. Though some ideas were floated in the late 1980s and early 1990s, they gained momentum and currency with the crises of 1994–5 and 1997–8. Intellectual, policy, institutional and instrumentation advances on these issues have been made, for example the compensatory and contingency financing facilities that have been developed in the IMF. But progress in this direction has not been as rapid or as wide as evolving circumstances require. Too many developing countries that might find themselves in balance of payments difficulty would be at risk in the event of a systemic, contagious crisis affecting several countries simultaneously. With increasing regionalisation of trade and investment, especially in Asia and Latin America, such a risk cannot be dismissed.

Regional Monetary Funds

In Asia and Latin America there is an immedi-

ate need to create a second line of defence to cope with sudden balance of payments disequilibria at the *regional* level through the creation of appropriately designed institutional, instrumentation and financial capacity that would result in the equivalent of a *regional monetary fund* (RMF). The idea of establishing such funds should constitute a basic plank in the platform of developing countries at UNCFD. But the specific modalities, structures and frameworks for such regional funds need further exploration. Different types of frameworks may be needed in different regions rather than all such arrangements being based on one standard template.

An RMF could be linked to existing regional or sub-regional development banks (i.e. those that are financially quite strong). Alternatively, it could be an independent, free-standing institution in its own right. In that connection it is interesting to ask whether, if the Bretton Woods Conference were taking place today, instead of 55 years ago, it would result in a separate IMF and World Bank or whether the two institutions would be fused. The answer to that question should guide thought about whether an RMF should be linked to RDBs or be separate. By the same token an RMF could be a loose arrangement providing a framework under which participating central banks took a cascading set of pre-agreed measures to cope with a crisis, snuffing it out before the risk of contagion spread. Alternatively, it might be a tighter arrangement mirroring the IMF in the same way, for example, that the regional banks mirror some of the capacities of the World Bank (the wrong model for them to follow in the twenty-first century).

8.2.5.3. Some of the functions of the RMF and its institutional provisions may also require a design that permits some of the activities performed by the Bank for International Settlements (BIS) at the global level to be performed at the regional level under the same institutional structure as the RMF. Two key conditions are paramount in creating RMFs: (a) the involvement of the developed countries of the region – the USA and Canada in the case of Latin America and Japan in the case of Asia – to convey to markets the strength of resolve and financial capacity behind them; and (b) a larger voice for developing countries in the application of these funds and the triggering of their facilities than they have in the IMF. In retrospect, the Japanese proposal to create an embryo for such a fund in Asia in September 1997 was an opportunity that should have been accepted and followed through. In 2001 it certainly needs to be revived.

Bolstering balance of payments support at the global level: Under the above proposal, in the event of a balance of payments crisis, a country's own reserves and stand-by credit lines would represent the first line of defence. The RMF would provide the second. There would still need to be a third line of defence at the global (IMF) level. It is possible, that *if* a regional line of defence is created, and *if* the additional resources needed to support developing countries in a balance of payments crisis are allocated to that tier first, then there may not be a case for adding to the resources that already exist with the IMF. This issue, along with the configuration of facilities and instruments at the regional and global levels respectively, and the co-ordination of institutions acting at those two levels, needs to be more carefully considered at UNCFD.

Given the implications of the RMF idea, and the number of issues that need to be examined and resolved in connection with it, it may be premature to attempt to examine and resolve all the pertinent issues and reach agreement on creating RMFs at UNCFD. But it would be the right occasion on which to introduce the concept and to agree on a time-bound plan for following through on its implementation, with RMFs in Asia and Latin America being in

place within two years of UNCFD being concluded. RMFs would obviously incorporate some arrangements involving the pooling of reserves and swap facilities among the central banks of the participating countries of the region. But such arrangements may need to be bolstered by formal agreements with the IMF to avail of its facilities through the RMF.

The SDR-FfD Link

In the same connection, the idea of an SDR-Aid link should be revived. The creation of RMFs may require a new SDR issue with SDRs created under the new issue being allocated to the RMF quotas of countries, where RMFs exist, and to their IMF quotas where they do not. This issue should be revisited under the new circumstances that have emerged, although these will keep changing and evolving as globalisation proceeds.

Reforming the International Financial Institutions

The need for root-and-branch reform of the Bretton Woods Institutions, i.e. the IMF and World Bank, has been discussed *ad nauseam* since the Bretton Woods regime ended in 1971. But it has never been properly attempted. Instead a series of steps have been taken in response to crises and the need to address FfD needs. A patchwork of measures deploying the IMF, World Bank and the regional development banks has been cobbled together on different occasions to cope with the various financial crises that have occurred since 1973. On each occasion demands have been made for more durable arrangements to be put in place. But that task has yet to be undertaken. It remains puzzling that a wiser, more far-sighted approach to modifying the global financial architecture has proved so elusive. That a better division of labour, along with improved co-operation and co-ordination, is needed among all the institutions in the *official* multilateral system is beyond dispute. But it has yet to be acknowledged that these institutions are really parts of a single *official* financial system.

Reform of the IFIs should be a priority at UNCFD. The objectives should be to change: (a) the roles, orientations, governance structures, management selection processes and *modus operandi* of these institutions in financing development; and (b) the way in which IFIs respond to structural or transient disequilibria in the external and internal accounts of developing countries. Reform should aim at making these institutions more transparent, participatory, democratic, development-friendly, and more supportive of developing countries, while being less oppressive and intrusive in their approach.

To begin with *the weights of developing countries within the quotas and shareholding of these institutions should be changed as soon as possible by using PPP exchange rates rather than nominal exchange rates in the standard formulae that are used to calculate quotas in the IMF, shareholdings in the World Bank (and regional banks) and voting rights in these institutions*. Such a step would go a long way toward reflecting more accurately the reality of the global situation, including the increasingly important role of developing countries in the global economy and their growing share of global output (45 per cent at PPP exchange rates vs. the 22 per cent reflected in nominal exchange rate comparisons).

In a globalising world, it is neither tenable nor acceptable that developing countries should be indefinitely (if not permanently) disenfranchised as second-class ticket-holders in the IFIs. Nor should industrial countries remain permanently as the only legitimate holders of decisive authority and power while, at the same time, exempting themselves from the surveillance and disciplinary functions that IFIs are supposed to exercise in the global interest. It is often the case that crises in developing countries have their origins in the imbalances that build up in industrial countries and that trigger

large external shocks. Developing countries are then drowned in the backwash.

In contemplating IFI reform, particular attention needs to be paid to: (a) the nature and adequacy of capital flows (and particularly of net transfers) from IFIs to developing countries; and (b) the roles and mandates of IFIs, including their roles in influencing national decision-making, governance and patterns of development through the conditionalities imposed. In the interests of inducing more transparent, fairer and better performance on the part of the BWIs, autonomous, external governance mechanisms involving experienced senior global statesmen from around the world need to be established to evaluate, monitor and critique the work and performance of the BWIs on a five-yearly basis. These commissions should be detached from the managements of IFIs, their evaluation offices, which are not independent despite their claims to that effect, and from their Boards of Governors and Executive Directors. The mandate of these independent bodies should be to hold the IFIs accountable for the outcomes of their prescriptions in developing countries, and to moderate the excessive influence of some industrial countries over the activities and policy orientation of the IFIs.[54]

The case for revamping the architecture of the international financial system rests on three realities. The *first* is that financial globalisation will occur at an accelerated pace. This will happen irrespective of whether it is seen as good or bad. It is inexorable. The *second* is that the risks of damage to the global economy and to the stability of the global financial system are too great to incur if financial globalisation occurs through a purely *laissez-faire* approach. *Third*, official or quasi-official intervention capacity to cope with regional or global financial market disruption is necessary. Such intervention has to provide compensating capital inflows to balance sudden outflows triggered by financial shocks and market failure. The institutional capacity for undertaking such intervention needs to reside in the IFIs. What appears to be missing at this juncture is an effective mezzanine *regional* tier of intervention in present global financial architecture.

Experience in several emerging markets over the 1990s suggests that financial market failures will probably become more, not less, frequent as globalisation intensifies. Such failures are not exceptions that can be avoided at any cost. They are unavoidable when capital flows at great speed in large volumes across borders into markets with different levels of capacity, liquidity, efficiency and institutional development. In small illiquid markets incapable of absorbing the shocks of large capital surges, financial and asset price distortions *will* occur when standards for regulation, transparency, accounting, disclosure and valuation are inadequate. In such instances, opportunities for arbitrage in differential operating and regulatory standards can and will be exploited. That should be expected even though it is officially frowned upon or condemned. It cannot be stopped by fiat.

The answer is not simply to inhibit capital flows till markets are better developed. It lies instead in developing more rapidly the capacity of all financial markets, and particularly emerging markets, to cope with capital flows that will occur anyway, efficiently or inefficiently, and legally or illegally. Large differentials in operating, and regulatory standards across financial markets, can only be ironed out when markets around the world have more or less the same standards and characteristics. That will happen only when artificially segregated small markets transcend national borders and become large enough, through regionalisation and globalisation, to display the common characteristics

54 In some instances, IFIs have behaved as extensions of the Treasuries of major industrial countries rather than as independent institutions with wider obligations.

that are essential for financial markets to work properly.

The Role of the Bretton Woods Institutions

In a globalising world, the only plausible rationale for official intervention in the global financial system is not to intermediate official resources *ad infinitum* but to enhance the creditworthiness (or more accurately the 'marketworthiness') of developing countries as rapidly as possible. This is necessary to ensure that, in the long run, all countries have access to global market resources for financing needs that cannot be met from tax revenues without relying on the largesse of other countries. As part of that process, the BWIs need to focus on ensuring that domestic financial markets in emerging economies are developed quickly. That needs to be accomplished perhaps even ahead of changes in the real economy, in order to enable emerging markets to interface and integrate more effectively and seamlessly with global financial markets, whose inexorable evolution is now forcing the pace of change in that arena.

Accelerated development of *domestic financial markets* is essential not just to meet the pressures of financial globalisation. Achieving world-class standards of regulation and functioning will impel commensurate improvements in the real economy of these countries as well. As financial globalisation occurs, domestic financial markets will reflect the same intolerance as global markets of political systems and machineries of governance that do not permit economic freedoms and are not transparent and accountable. They will punish lax corporate behaviour and demand higher standards of transparency, probity and accountability in commercial dealings. Financial globalisation will unleash a variety of positive domestic impulses that militate in favour of better governance through internal compunctions rather than the demands of external interlocutors through conditionalities.

That implies a continuous evolution in the role of the IFIs commensurate with, and responsive to, globalisation. As global markets develop greater capacity and extend the risk-reward spectrum in their financing preferences, IFIs should vacate the space they formally occupied in favour of markets and go beyond it to the next frontier. But in doing so they need to ensure the global financial system is not weakened but strengthened as globalisation unfolds. For that, two types of *official intervention capacity* are needed:

- *normal or proactive* intervention capacity on an ongoing (non-crisis) basis aimed at improving the macro-policy framework as well as meso/micro-institutional functioning of firms in emerging markets (i.e. the prophylactic role);
- *extraordinary or reactive* capacity to intervene decisively and effectively when crises do erupt, i.e. the curative role.

If facilitating market-driven globalisation is to be the future agenda of the IFIs and RDBs, what roles should these institutions play? The obvious division of labour, given their respective institutional heritages and areas of comparative advantage, would be that:

- The **IMF** should focus on dealing with the *macro* policy, problems and issues (with a view to achieving co-ordination at the national, regional and global levels) that are likely to influence the course of financial market globalisation;
- The **World Bank** should focus more on the meso and micro policies, institutions, markets and market-supporting structures, enabling conditions, and tackle the practical, ground-level problems and issues involved – i.e. those of market-building, market-supporting institution-building and capacity-building in its broadest sense, in and across emerging markets;

- The **Regional Development Banks** should take over ground-level development support, poverty reduction, and human and social capital development, i.e. activities that the World Bank presently attempts to monopolise, as well as regional infrastructure financing and facilitation of the processes of closer economic integration in their regions.

In the twenty-first century, the IMF should not compete with the World Bank to occupy development financing turf to justify its existence. It should be concerned with ensuring that financial globalisation occurs in an orderly fashion with as few dislocations and crises as possible. In performing this role, it should deal with the cross-border impact of changes in global monetary policies and in capital-flow, investment and exchange regimes by:

- Ensuring that the interplay of macro-financial (i.e. monetary, fiscal and exchange rate) policies at the global, regional and national levels supports rather than subverts the process of financial globalisation;
- Averting, or swiftly correcting, disruptions caused by temporary market failures in either developed or emerging markets through macro measures such as bolstering central bank reserves, restoring credibility and arresting contagion by activating pre-arranged and pre-negotiated stand-by lines of credit to central banks and other key institutions in crisis-affected emerging markets;
- Undertaking continual oversight and support for the progressive *regional and global linkage* of *national* monetary, investment, exchange and financial system regulatory regimes through both its normal Article IV surveillance and consultations, as well as added surveillance powers over processes of financial regionalisation.

The IMF should cease to compete with IDA and the RDB soft windows for scarce grant aid resources for its Enhanced Structural Adjustment Facilities (ESAF) (rechristened Poverty Reduction and Growth Facility) to be replenished. It should depend instead on *quota increases*, part of which should be lent on concessional terms. It should also expand its ability to raise intervention resources and contingent facilities directly from markets – a justifiable amendment to its charter since the IMF would not be directly engaged in assisting global markets to expand their scope and reach. In fulfilling its new role, the IMF needs to continue developing a range of prophylactic products and services. These should include a wider range of *contingent facilities* to suit a variety of circumstances. Such facilities could operate in the same way as guarantees. They could be associated with co-financing arrangements involving private market sources. These should be organised so as to result in private creditors incurring immediate moral hazard risk and confronting a conflict of interest if they were to indulge in counter-productive speculative attacks on currencies and securities markets in emerging economies when the threat of a crisis loomed. Added to the IMF's normal range of facilities for crisis management, contingent facilities could provide an additional bulwark to discourage crisis-exacerbating market speculation of the kind that occurred in Asia. They would provide the IMF with ongoing operational relationships in many emerging markets, in addition to monitoring and surveillance relationships. Such contingent facilities might incorporate clauses that required countries to adhere to a time-bound agenda for financial system and other supporting reforms on a number of fronts – reforms aimed at bringing all financial market standards up to the level of standards prevailing in developed markets.

In contrast to the *macro*-orientation of the IMF, the World Bank should focus on handling the *meso* (i.e. sector level) and *micro* policy and institutional issues and tasks, aimed at accelerating the development of emerging financial

markets. It should recede into a wholesale role with the bulk of its operations focused on attracting private capital to developing countries. *The World Bank should leave retail development financing to the RDB concerned in each region.* Its involvement with the RDBs should become closer – possibly even going so far as to become the custodian of industrial country shareholdings in the RDBs. While the World Bank's shareholding might continue to reflect a 60/40 ratio, moving rapidly to 55/45, in the shares of industrial and developing countries respectively, that ratio should be reversed in the shareholdings of all the RDBs with the developing countries in each region holding a majority of at least 60 per cent.

Reflecting this change in role, the World Bank's range of products should be modified, with guarantees replacing loans as its main instrument. Indeed, direct World Bank loans should be made only in exceptional instances. As a wholesaler, the Bank should focus on the *financial sector* of developing countries and aim at improving the efficiency and quality of domestic financial market firms and operations. Its agenda for 2002–2020 should be to:

- Strengthen commercial banking systems in developing countries;
- Create asset reconstruction funds;
- Improve regional investment banking and corporate finance capacity, as well as securities trading and brokerage capacity;
- Develop and strengthen electronic exchanges to enable more efficient functioning of secondary markets;
- Develop national and regional derivatives markets to permit global standards of risk management;
- Participate in building stronger institutions at the long–term and involuntary savings end of the financial services spectrum, such as insurance companies, asset management firms, mutual funds, investment trusts and pension funds;
- Facilitate rapid privatisation in a manner that is in keeping with government efforts to maximise domestic resource mobilisation and to attract foreign capital to finance productive investment in infrastructure and increasing the goods/services output capacity of the economy.

The World Bank also needs to create direct access to financial markets for *sub-sovereign* levels of government, both in domestic financial markets and in regional and global markets. Confining market access to the sovereign level of government in developing countries has damaged and retarded the quality of governance at sub-sovereign levels. It is time to consider whether the task of inducing fiscal responsibility at lower levels of government might not be better performed through market discipline than via centralised heavy-handedness. The Bank should support projects and programmes that directly or indirectly improve the transparency and accountability of all government operations in emerging markets as an essential precondition for access to domestic and global financial markets.

Second to its task of improving domestic financial market capacity as rapidly as possible, the World Bank needs to accelerate *privatisation* and *private investment in infrastructure*. It needs to focus on arranging and financing the exit of governments from activities that can be undertaken more efficiently by the private sector and serve to attract more private investment from abroad. That approach would relieve the binding budget constraints that now limit the ability of governments in emerging markets from making the necessary capital investments and maintenance expenditures for essential physical infrastructure. In performing this role, the World Bank should confine itself to very large projects and privatisations (in excess of $500 million in total financing requirements), leav-

ing smaller projects and programmes to the regional banks.

In addressing its reformed agenda, the World Bank should co-operate more closely than it does at present with regional and sub-regional development banks, not as an overbearing senior partner, but as an equal. It should construct appropriately structured 'wholesale-retail' partnership arrangements with each RDB that reflect a better division of labour based on comparative institutional advantage in each region. Despite many calls to achieve such partnerships, insufficient thought has been given to how the World Bank and the RDBs can operate as an inter-linked family of complementary institutions. The reform agenda proposed should require the World Bank to leave 'micro-development' functions and poverty reduction tasks to the RDBs, bilateral aid agencies and the increasingly influential and pervasive NGO community that can relate and communicate much more effectively with the poor in developing countries than can the World Bank.

Taking the reforms outlined above for the World Bank as a point of reference, the future agenda of the RDBs should be developed around five key themes. In pursuing this agenda an appropriate division of labour and *modus vivendi* must be worked out in each region. The areas of activity on which the RDBs should focus are:

- Improving the quality of governance, empowerment and inclusion;
- Promoting the development of efficient markets for factors, goods and services;
- Promoting integration regionally and globally;
- Investing in their region's human and social capital;
- Enabling their regions to manage 'regional commons'.

Regional Development Banks

The distinguishing characteristic of RDBs is that they are quintessentially regional. They should therefore differentiate their operations and activities from those of the World Bank by highlighting that attribute and using it as a comparative advantage. *They should model themselves on the European Investment Bank (EIB) rather than on the traditional World Bank-type MDB model.*

Financing Regional Integration: RDBs should focus on supporting the regional integration impulses of private players and transnational enterprises that aim to expand their operating space and to benefit from static and dynamic gains, as well as economies of regional scale. They should support regionalisation of national markets by helping to remove the barriers that obstruct natural processes of market integration, i.e. tariff and non-tariff trade barriers, as well as those embedded in laws, rules, regulations, product standards and specifications, and in their discretionary (rather than rule-based) application. The RDBs should also finance physical and social infrastructure that enables their regions to better co-ordinate themselves. They should do so less through regional projects than through supporting *private* and *quasi-private* enterprises involved in constructing, managing and operating infrastructure assets and services (for example transport, power and communications) on a trans-regional basis. The same should occur with social infrastructure, especially in health and education services. The RDBs can and should do more to build productive alliances with one another to create region-to-region trade and financial linkages between and across all developing regions.

Financing Regional Commons and Public Goods: What sovereign states do within their borders affects the environment of their neighbours and of the world. Developing countries and the international community have simply

not done enough to minimise the negative consequences of their actions or to maximise positive outcomes. RDBs need to initiate programmes of managing regional commons better. Their interventions in such programmes need to be selective, carefully focused and properly targeted. Along with the relevant UN agencies and the GEF, the RDBs should develop specific programmes to monitor the commitments made by their members to the Montreal, Rio and Kyoto protocols. They should be proactive in developing quickly their regional markets for trading carbon emission rights in an organised manner in association with work aimed at strengthening financial markets. The RDBs should also play a deeper and wider role in examining the effects of other issues, such as deforestation and dams, on the ecology and environment of their regions. They should go beyond merely examining these effects and devise remedial measures or viable development alternatives, and be prepared to finance them.

Unifying the MDB System

At present the World Bank, the major RDBs and several sub-regional development banks act as a disparate, fragmented set of institutions that overlap in their operations and activities. They duplicate their resources and efforts to an excessive degree in the same countries and operate at odds with one another. The MDB system needs to function instead as a streamlined network of inter-linked financial institutions that maximise the joint throw-weight of their equity capital, their global borrowing power and their staff resources, which are very uneven in terms of quality and effectiveness.

The aim should be to create a more holistic global MDB system of institutions linked through a leaner World Bank at the apex, performing wholesale rather than retail functions. That would imply cutting the World Bank's staff from around 10,000 to no more than about 2,000 people at headquarters and concentrating its role on global issues. The bulk of its operational staff resources, i.e. all its resources in its regional vice-presidencies, the staff supporting these units, and all staff in the field, along with their respective budgets, should be distributed across the respective RDBs as quickly as possible. This would result in immediately strengthening the institutional capacity of all the RDBs, especially that of the African Development Bank. The AfDB is at present the weakest link in the MDB system; given the challenges its region faces, it needs to be the strongest.

In a revamped MDB system, the RDBs should become the key line agencies (retail financing entities) interfacing directly with borrowing countries. The World Bank's role at the interface should be limited to financial system and capital market development, financing large infrastructure projects and accelerating privatisation, until that process reaches its logical limit. Eventually – by 2050 at the latest – the World Bank should become a financial holding entity that combines industrial and developing country shareholdings on a 50–50 basis to support the global official financing system. It should operate through the RDBs and, where necessary, through private commercial financial institutions and capital markets (global, regional or domestic) in guaranteeing and underwriting risks which private entities are as yet unwilling to finance. The RDBs would eventually evolve into institutions like the EIB, owned and operated entirely by countries in their respective regions.

A beginning toward this type of 'integrated MDB system' could be accomplished by swapping the shares held by industrial countries in the RDBs for shares in the World Bank. The World Bank would reinvest the equivalent amount in the shareholding of each RDB to a maximum of up to 40 per cent of each RDB's shareholding structure. It would nominate suitably qualified statesmen to represent the indus-

trial countries (one each for the developed countries of Asia, Europe and North America) on the Boards of Directors of each RDB, thus saving on unnecessary administrative expenditures by individual countries and introducing greater consistency in policies and decision-making in all the Boards of these regional institutions. The shareholding structure of the World Bank would, of course, need to be adjusted, through rights issues, to reflect at all times a minimum shareholding of 45 per cent by the developing countries, mirroring their real weight in the global economy at PPP exchange rates. That share might reach 50 per cent by 2025 and even go beyond that as the share of these countries in the world economy (in PPP terms) grows.

Global Taxation and the International Tax Organisation

Section 6 of this report set out arguments on the impracticality of global taxation and the issues to be considered in implementing it. The same reasoning leads to the conclusion that ZPR is premature in recommending the creation of a new International Tax Organisation. Notwithstanding the possible theoretical benefits of such a step – and there may be many – this proposal is likely to create a firestorm of opposition in key industrial countries, for example the USA. This could stop UNCFD having any positive outcome.

Many of the problems and issues about which ZPR expresses concern, for example public revenue being foregone through legitimate tax avoidance because it falls between the cracks of territoriality, can be easily resolved by changes in national tax laws and through revisions of bilateral tax treaties that already exist and that could be standardised to a greater extent. A new international organisation is not needed to bring this about. If OECD governments agreed that they wanted to avoid these anomalies, they would have done so by now. Nor is there any obvious need for an ITO to undertake the other functions that ZPR suggests. Its argument is belaboured and contrived.

The tasks of statistical compilation and analysis of global tax data, reporting on global tax developments, tax monitoring and surveillance, sharing tax information across countries, converging toward unitary taxation of multinationals and taxing emigrants could just as easily be performed by national tax authorities, informal groupings or associations of such authorities or, in some instances (for example data, reporting and surveillance), by the IMF and the OECD. The OECD is already in the process of persuading tax havens to desist from 'harmful' tax competition. Many countries are convincing each other of the pointlessness of offering competitive tax incentives to attract FDI or FPI. None of these tasks justifies creating ITO.

It is disconcerting that ZPR actually legitimises the notion of 'harmful tax competition' recently invented by OECD countries. Most tax havens have been created in response to the domestic tax legislation of OECD countries themselves. They are operated almost entirely by offshore banks, global law firms and global accounting/audit firms with headquarters in OECD countries. This issue reared its head when continental European governments encountered widespread public antagonism to further taxation and decided belatedly (and retrospectively) to prevent tax leakage. In these unfashionably *dirigiste* economies, the public sector absorbs 45–70 per cent of GDP and faces public demand to reduce that proportion closer to the 33 per cent level of the USA, or the 38 per cent level of the UK, in order to remain globally competitive. The response of continental European economies has, unfortunately, been the same as in other areas, such as labour and environmental standards, i.e. that tax should not be an issue on which countries compete.

It is unfortunate that the concept of harmful

tax competition has gone unchallenged from an intellectual viewpoint. It is an oxymoron. If governments are to provide public goods and services efficiently and effectively, at the least possible cost, how can tax competition among governments be harmful? If there were no pressure against raising public revenue, and no competition among governments to provide the most attractive home for risk capital, governments would have a perverse incentive of wasting public revenue with no incentive to be efficient or effective. They would know no restraint.

Before the spectre of unfair or harmful tax competition is raised, the different circumstances of developed and developing countries need to be taken into account. Industrial countries need to encourage consumption to keep their production engines going. They do not need to encourage savings to the same degree. Their need for development investment is not as great as that of developing countries. Their emphasis on social equity requires steeply progressive marginal tax rates to discourage wealth accumulation and achieve redistribution. They can manage with investment (and saving) ratios of 18–20 per cent of GDP to maintain real growth of 2–3 per cent. They can indulge in higher marginal rates of direct and indirect taxation and capital gains tax, levied on individuals and corporations, to provide the public goods and services their societies choose to have provided through the public sector. Except for a few exceptions in Continental Europe, where some countries have marginal rates on income and corporate taxation of 55–68 per cent, the global average appears to be converging toward a top marginal income tax rate (for individuals and corporations) of 30–40 per cent, indirect taxes (usually in the form of a value-added tax on goods and services) of 15–25 per cent and capital gains taxes of 10–40 per cent, depending on the period over which the gain is derived (long-term gains are taxed less).

Developing countries face an entirely different situation. They need to mobilise domestic and foreign private resources to sustain growth rates of at least 8 per cent annually if they are to have any hope of converging, even very slowly, with the industrialised world. East Asia is already performing at that level; in spite of the hiccup in 1997–99, growth rates in that region are again recovering. For that to happen in other developing regions and countries their investment rates need to be increased from an average of 20 per cent to 30–33 per cent of GDP. Correspondingly, their savings need to increase from an average of 17 per cent to 28–30 per cent of GDP. At the same time, they need to attract foreign private capital equivalent to 3–6 per cent of GDP annually on a sustained basis.

Developing countries therefore need to encourage domestic after-tax income, discourage public dissaving, and encourage financial saving and capital accumulation to the greatest extent possible. They are disadvantaged in not having the same degree of physical and social infrastructure, the same endowment of human, social and institutional capital, or the same monopoly over knowledge and intellectual property, as the industrial countries. Enterprises in developing countries have to pay a much higher risk-adjusted, real cost of capital (6–10 per cent compared to 2–3 per cent in industrial countries) and of energy and imported inputs, than their counterparts in the industrial world. Their main advantage is a lower cost of unskilled and semi-skilled labour, which is shut out of the global labour market and the cost of which is being artificially increased through insistence on labour standards and pressures to exercise good corporate citizenship. This means that TNCs pay wages that are far out of line with domestic affordability, creating a dual labour market with unfortunate consequences.

It should not be surprising then that developing countries, with their limited competitive options, should choose to offer attractive after-

tax returns to domestic savers and to global capital by having lower marginal rates of direct and indirect taxation. If the argument is taken to the extreme, the poorest developing countries should consider abolishing income and capital gains taxes (as many tax havens and some successful economies, such as Dubai, have done). They should rely instead on expenditure and transactions taxes that are broadly based but that apply a low average tax rate. To increase savings to the extent desired, the marginal rate on income and profits tax in developing countries should be no higher than 20 per cent, capital gains tax should be abolished if such gains are reinvested, expenditure taxes (for example sales taxes and VAT) should be in the range of 5–10 per cent to avoid being too regressive, and appropriately designed transactions taxes (similar to the Tobin Tax) should be introduced, not to throw sand in the wheels of activity but to raise revenue.

These differences make it immediately obvious that the circumstances of industrial and developing countries should lead to tax competition as a naturally desirable state, rather than as an undesirable aberration. Indeed, tax competition should be encouraged rather than discouraged in order to make developing countries less dependent on official transfers and more reliant on their own resources and global capital markets. If that line of reasoning is accepted, then ZPR's suggestions about global taxation and ITO require fundamental reconsideration as being against the interests of developing countries.

Global Governance Summit and the Economic Security Council

ZPR's rationale for proposing a Global Governance Summit harks back to the recommendation of the Commission on Global Governance in 1995 on the creation of an Economic Security Council (ESC). The Commission envisaged a Council with no more than 23 members and with the same standing on international economic matters that the Security Council now has with respect to peace and military security matters. The world's 10–12 largest economies (in terms of GDP measured in PPP exchange rates) would be represented on the ESC as a matter of right. The remaining 11–13 seats would rotate among constituencies organised to provide balanced representation among regions and permit participation by smaller states. The organisation of constituencies would be facilitated if established regional organisations (for example the EU, ASEAN, the African Union and Mercosur) had a permanent single seat representing all their members.

The tasks of an ESC would be to: (a) monitor the state of the world economy; (b) supervise interactions across major policy areas; (c) provide a strategic framework for policies made in several international organisations to secure consistency among their various policy goals; and (d) promote intergovernmental dialogue on the evolution of the global economic system. The ESC's legitimacy would be based on the authority of leaders who participated in its deliberations rather than constitutional powers to make binding decisions. It would meet twice annually, once at a heads-of-government level and once at the level of finance ministers, and have a supporting infrastructure of deputies and a small secretariat.

The ESC would extend the G-7 and G-20 concepts to their logical conclusion in permitting a greater developing country voice in the determination of global economic affairs. But whether it would necessarily result in improved global economic and financial governance remains an open question. It is not clear that G-7 plays an effective role in global economic governance or in achieving economic co-ordination within the OECD. After several years, meetings of the G-7 have become tedious, routine media circuses. They are now attracting undesirable attention that further reduces their utility and makes them an unnec-

essary (and extremely expensive) security risk that the global public is unwilling to subsidise. It is not clear that an ESC, operating under UN auspices, would fare better in achieving the co-ordination and co-operation needed – especially in bridging the divide, and reconciling conflicts of interest, between the industrial and developing worlds.

What appears to be needed instead, as more practical and meaningful interim measures toward effective global economic governance, are the following steps:

- More representative structures for decision- and policy-making in the governance mechanisms of the IMF, World Bank, WTO and BIS that would reflect the 45 per cent *real* weight (in PPP terms) of developing countries in the global economy;
- Closer relationships between the World Bank and the RDBs cemented through cross shareholdings so that the MDB system operates as a singular system;[55]
- Quarterly meetings at the heads of institution level in these four key global economic institutions, with a clear agenda aimed at achieving better dovetailing and co-ordination of the global economic agenda;
- Frequent liaison at senior management and operating levels of these institutions;
- Restructured Boards of Executive Directors in these international institutions with seats being filled by a much higher level of representation than is presently the case, i.e. by former heads of government, finance ministers and central bank governors rather than by relatively inexperienced mid-career bureaucrats without the requisite experience at sufficiently senior political and technocratic levels;
- Consolidating the 100 or more separate funds, programmes, conferences and specialised agencies that litter the landscape of the UN's fragmented development assistance system into a single UN Agency for International Development (UNAID) that would deal primarily with the human dimensions of development, i.e. social policy, democratisation, governance and human rights,[56] and complements the IFIs. That would rationalise the enormous waste that goes into paying salaries and administrative costs at the UN and redirect a more significant proportion of the funds provided by donors directly to developing countries.

These measures would bring about more meaningful global economic co-ordination and a more effective voice for developing countries in the management of global affairs than the creation of yet another talking-shop at the UN. For global *economic* institutions to articulate better with the UN's *political* system, regular meetings could be held between the head of the UN and their counterpart in the four key global economic institutions. These institutions could be represented at head-of-institution level at G-7 meetings, at ECOSOC and at G-20 whenever necessary, to avoid a situation of ritualistic meetings being held for no practical purpose in the name of co-ordination.

The Role of the UN in Development

Since 1980 the presence of the UN in development affairs has progressively diminished. It no longer plays the commanding role it did between 1950–80 in: (a) focusing the world's attention on development challenges; and (b) prioritis-

55 See Section 8.2 on this subject.

56 See, for example: (1) Swedish Ministry for Foreign Affairs, *Mobilising Support & Resources for the UN Funds & Programmes*, 2001, Stockholm, Sweden; (2) The Nordic UN Project, *The United Nations in Development* (1996), Ministry for Foreign Affairs, Stockholm, Sweden; and (3) The Nordic UN Project, *The United Nations: Issues & Options* (1990) Ministry for Foreign Affairs, Stockholm, Sweden. See also the following paragraphs where this theme is developed further.

ing the development agenda to be pursued by the global community and its institutions. As the UN (and particularly UNDP) has waned, the BWIs have waxed. With the onset of the era of debt and adjustment, neo-liberal market solutions to development failure became resurgent in the 1980s. Since then the IMF and World Bank have occupied centre-stage as preferred creditors policing developing economies, setting priorities, objectives and targets for their governments, establishing the development agenda, as well as strategy and policy, and promoting neo-liberal market paradigms. With the benefit of hindsight, it is clear that the BWIs were the main vehicles through which the Reagan-Thatcher ideological revolution of the 1980s was exported to the developing world. That was something that a highly politicised UN would not have been able to do. In fairness, it must also be acknowledged that the restoration of the market paradigm and the rolling back of the predatory state that emerged (rather than the developmental state that was intended), was overdue. In that era the UN was by-passed. Deliberations concerning development in ECOSOC became exercises in the repetition of futile rhetoric.

The focus of global policy-making and decision-making – not just on loans to countries for projects and programmes – but on development ideology, strategy, policy, tactics and operations has now shifted decisively to the Boards of the IMF and World Bank and, regrettably, even more so to their managements. The full-time Executive Boards in both institutions and the RDBs – who have to cohabit on a daily basis with the management and staff of these institutions – are unusually prone to regulatory capture. They have effectively become rubber-stamps (perhaps less so in the IMF than in the World Bank and RDBs) that invariably endorse, rather than influence, decisions made by management. These decisions are usually made in close co-ordination with G-7 Treasuries with which the senior managers of IFIs often communicate directly, thus by-passing the Board.

The decisions and precedents set by the managements of the BWIs and their Boards establish the framework and benchmarks within which the executive and governing boards of the RDBs operate. Unlike the UN, decision-making in the BWI Boards is weighted (2:1 in terms of voting power) in favour of the majority shareholders, the OECD countries, which provide both the market and concessional funds that these institutions deploy. The OECD club dominates in these Boards. Decisions rarely come to a vote. Executive Directors representing the G-7 countries work hand in glove with the management of the institutions in organising the Boards' agenda and affairs, so that contentious issues affecting development are usually steam-rolled in the direction favoured by them.

This shift in the centre of gravity from the UN system to the BWIs for determining the international community's response to development challenges, has not resulted from the actions of OECD governments and the IFIs alone. It has occurred because the UN's operational capacity in development matters has atrophied, with the lack of sufficient financial support from its vociferous constituency in the developing world to offset declining contributions from industrial countries which still finance 97 per cent of the free resources of the UN's *development* funds and programmes (UN-DFPs).

Consequently, the UN and its development agencies no longer have the same weight, legitimacy or credibility in the development debate. Their internal disorganisation and fragmentation within the UN system exacerbates the problem. Yet, despite these disabilities, the UN has made seminal contributions over the last two decades in influencing development thinking. For example, UNDP and UNICEF have succeeded – despite initial resistance from the IFIs – in putting a human face on adjustment, drawing the world's attention to human devel-

opment, and to the importance of human and social capital. These clothes have been stolen by the BWIs and donned as their own garb. Its intellectual contribution notwithstanding, the effect of the way in which the UN system works (or does not work) has been for the value of any UN development-oriented initiative to be dissipated by the time it actually reaches the outside world.

Individual UN-DFPs are too many, too small and too fragmented to have any impact on their own, against the weight of the IFIs. The survival of these disparate agencies often depends on the scraps that the IFIs dole out by way of sub-contracting their services for soft interventions. UN-DFPs spend more of the limited resources available to them on administrative costs and bureaucracy than on development *per se*. They have separate offices in too many developing countries, leading to even more duplication and waste. That makes them unattractive to the major donors as vehicles of choice for delivering technical assistance. Their internal jealousies, their proclivity to cling to their outdated individual identities, and their inability to co-ordinate as effectively as they should, makes them unattractive to donors as an alternative to the BWIs for setting the development agenda or delivering effective development services. Some of that unfortunate heritage is changing. But it is changing much too slowly to make a difference.

The shift of locus from the UN to the BWIs has been sustained for over two decades. As a result, OECD countries are ambivalent about whether the UN should play a role in global economic and development affairs, instead of concentrating on global political and security issues and on maintaining structures for supporting world commerce and global commons. Left unresolved, that uncertainty will lead to the development agenda being determined entirely by bilateral aid agencies and the IFIs, raising several difficult questions. These questions require thoughtful answers if global trade and aid architecture in the twenty-first century is to achieve more positive outcomes than in the previous half-century.

For example, should the global system for development assistance accommodate, and perhaps encourage, constructive intellectual co-operation and competition across intergovernmental institutions in the public domain? Or should it permit (by design or default) an IFI-driven *global creditor monopoly* to dominate development thinking? Is it appropriate for institutions that are quintessentially creditors, and have their own vested financial interests at stake, to set the agenda for four-fifths of the world to which they lend? Might that kind of monopoly not detract from their role and judgement as lenders of supposedly last resort? Does it not compel multiple conflicts of interest in the roles that IFIs play? Might the developing world and the global community at large not benefit from more neutral, multilateral 'safety-valves' (without a creditor's axe to grind) that might permit more impartial, disinterested and objective interlocution and intervention in development matters, especially of the 'soft intervention' (technical advice and assistance) rather than the hard (credit and finance) variety?

If the UN system did not exist, it would need to be invented. The world cannot do without a legal-cum-constitutional, as well as an operating, framework for dealing with a plethora of cross-border problems and issues that national governments – on their own or in self-selected groups, working on a bilateral or plurilateral (regional) basis – cannot handle. It is likely that a *de novo* construction of a UN system in the twenty-first century would be quite different from the inherited patchwork quilt that now exists. Its present design dates back to the very different world of 1945. The system has evolved in fits and starts ever since to accommodate continual geopolitical change. Regret-

tably, much of its ethos (especially the nexus between OECD members and others) still seems trapped in the artificial divisions created and nurtured by the Cold War.

It is questionable whether the UN system's evolution suits the post-1990 world that is taking shape or whether the constraints operating on it have led to an institutional mutation. Yet any future UN edifice or system that evolves must necessarily be built on foundations that exist. There does not appear to be any desire on the part of the global community to scrap what has emerged and start afresh. What is clear is that the UN cannot continue for long with the degree of internal fragmentation, overlapping and lack of co-ordination that characterises the operations of its specialised agencies and its DFPs. Its capacity to provide value-added services depends on how well it can intermediate between conflicting economic interests that could spill over into becoming major political problems between countries and regions. To do that it needs its own internal capacity to assess and advise, and particularly to advise developing countries on global economic developments and how best to protect their economic interests.

However long it takes, the objective for the UN has to be that of rationalising and merging its disparate DFPs into a *single UN organisation for development*, with an appropriate organisation and management structure that would embrace both sectoral and regional divisions for assisting global development through soft interventions. The sector divisions could be formed by consolidating under a single organisation the specialised sector agencies, funds and programmes that have been set up willy-nilly and that have 'grown like Topsy'. The *regional divisions* could be formed by collapsing the present Regional Economic Commissions under the same roof. Such an approach would result in significant cost, staff and administrative savings. It would also result in better co-ordinated and more credible UN interventions in economic affairs *within* the UN system and between the UN and the WTO, IFIs, RDBs and bilateral aid machinery.

Hopefully, UNCFD will be a landmark event that marks a fundamental change in course and rolls back the role that IFIs now play in dominating development in the same way that the IFIs argued for rolling back the role (and diminishing the importance) of government in development at the national level. The twenty-first century should see the BWIs returning to the boundaries of the roles circumscribed under their respective Charters. UNCFD should pave the way for the UN to regain a key policy role in dealing with development and FfD issues. That would require reinforcing and updating its mandate, and endowing its economic affairs secretariat, as well as UNDP and UNCTAD, with the necessary human and financial resources to play more effective research, policy, and advocacy roles.[57]

Bilateral Aid and OECD-DAC in the Global System

Coherent architecture for FfD cannot be structured without taking into account the role that bilateral aid agencies play in influencing international economic relations between the industrial and developing worlds. Strictly speaking, national aid agencies are not part of inter-governmental global economic architecture, although OECD-DAC certainly is. Like central banks, the role of the bilateral aid agencies of major donor countries is sufficiently pervasive (and pernicious) to influence the behaviour of the international system, especially when their policies are co-ordinated within the OECD club through the Development Assistance Committee. What IFIs do in the global arena where aid and lending are concerned is a

57 *Mobilising Support and Resources for the UN Funds and Programmes* (Study 2000:1); Ministry for Foreign Affairs, Stockholm, Sweden.

derivative of the priorities and preferences of the national aid agencies that fund them.

Twisting the Development Agenda out of Shape

One reason why the aid system is losing coherence is the increasing difficulty that OECD governments face in extracting parliamentary appropriations for aid. There are, of course, exceptions, as in small like-minded countries (for example the Nordic group and the Netherlands) with a wide public constituency for aid. But even in these countries, bilateral aid agencies seek political support from any quarter they can find for increasing aid appropriations. That process is resulting in the development agenda becoming hostage to single-issue lobbies that are passionate in their beliefs and quite energetic in 'getting the vote out'.

National aid agencies are finding that they have to accommodate a number of such interests in order to avoid a collapse of aid appropriations. These include environmental, pro-democracy, right-to-life and gender lobbies, animal rights activists, advocates of nuclear disarmament, active religious groups, children's rights organisations, protectionist labour lobbies or whatever other special interest happens to be in vogue. Unholy alliances between national aid agencies and single-issue lobbies (i.e. civil society – which excludes government and the private corporate sector) are destabilising the development agenda and leading to an increasing degree of dissonance and incoherence in the aid system. In a sense, this phenomenon is also a reflection of globalisation, albeit of a different sort. It is twisting the development agenda out of shape. There is now a serious conflict between what providers of aid think is necessary to achieve sustainable development, which appears to have boiled down to the simplistic singularity of poverty reduction, and what governments actually responsible for delivering development know to be necessary, where poverty reduction is only a minor part.

A strong case can be made for re-orienting the agenda and *modus operandi* of national aid agencies. These organisations need to stop micro-managing aid programmes and become lean, minimalist organisations rather than employment-creating organisations with field offices in every developing country that they can justify being in. Such justification is invariably achieved by having large, but ineffective, aid programmes, the motives of which are not driven by development objectives *per se* but by the objective of gaining bilateral advantage over other OECD countries in commercial relationships. As far as poverty reduction is concerned, bilateral aid agencies might be more effective in channelling their funds through NGOs in their own countries, the recognised international NGOs and local level NGOs in the developing countries concerned.

They could extend their reach by dealing with and through chambers of commerce, professional associations and academic institutions. A major step toward achieving greater coherence in the aid system would be to have national aid agencies lessen their dependence on single-issue lobby groups for ensuring adequate levels of aid appropriations from their parliaments. Another step would be to have such aid agencies detach themselves from cosy, incestuous relationships with the IFIs, concentrating instead on working with the UN's development funds and programmes, with organisations like the Commonwealth Secretariat and with RDBs and NGOs to achieve cost-effective delivery at the ground level and make a more meaningful impact on poverty alleviation.

Development strategies in individual countries, and for the developing world as a whole, are being grossly distorted. Aid programmes are becoming more sensitive to use of the right 'labels' and to development fashions than to substantive content. Developing country governments are being deflected from putting in

place and anchoring the real foundation blocks of development. They are being compelled to pursue strategies that are politically correct rather than sticking to unfashionable strategies that are the only ones that work in the long run.

Donors and their instrumentalities, for example IFIs, invariably portray themselves as knowing more than developing country governments about how to deliver development. More often than not they do not even bother to establish their credentials. As long as money is attached to a particular priority the development agenda is compromised in terms of balance and sustainability. Aid donors and IFIs do not have the task of managing development in impossibly difficult environments. Developing country governments do. When the perception gap is large, then 'ownership' and 'partnership' become meaningless subterfuge. Regardless of whatever policy or strategy papers they may sign, developing country governments can never, in any substantive sense, be expected to 'own' or be genuine 'partners' in an agenda they do not believe in, looked at from the day-to-day challenges they face and the domestic constituencies (not necessarily democratic) that they are accountable to.

Good Governance of the International System

In suggesting how a coherent international architecture might be best structured, it needs to be emphasised (especially in OECD countries) that *good governance*, like charity, begins at home. At the end of the Cold War, development assistance ceased to be an instrument for influencing recipient governments to choose which of the two or three main global camps they wanted to belong to. Aid donors were then seized by the idea of propagating *good governance* as part and parcel of the multi-faceted globalisation process. They have stressed the importance of that attribute at every opportunity and introduced good governance conditionality in lending by IFIs and RDBs. In a logical world, no one can possibly argue for *bad governance*. But there is considerable debate about precisely what good governance is (apart from knowing it when you see it) and how it might be brought about in developing country circumstances. That issue aside, industrial countries might contemplate, with some humility and realism, the moral authority with which good governance can be preached when the simplest concept of good governance is not applied in the case of global financial institutions.

Recent embarrassing *contretemps* in the appointment of the heads of several multilateral institutions illustrate the point. To extend it further, the quality of leadership in most international institutions of significance leaves much to be desired. In rare cases, leadership is of exceptional calibre (for example at the Inter-American Development Bank (IADB)). But these seem to be the exceptions that prove the rule. The way in which heads of global institutions are selected and appointed would find no favour in any respectable civil service or other walk of life. The process is so flawed that the most qualified people do not make themselves available for these jobs. Clearly something needs to be done if the international system's credibility is not to be damaged irreparably. The problem affects not just the heads of global agencies but the appointment of second and third ranking officials as well. It threatens sensible management and the coherence of the global system. What some governments do to get favourite sons appointed is tantamount to corruption no matter how elegantly the transaction is clothed.

Beyond the question of leadership lies the selection of members of Executive Boards and governing bodies. Again, the selection processes that apply to these positions in the global economic system are flawed. As a result, governing bodies do not function as they should in exercising checks and balances over

management. The result is institutional and policy failure. Boards of multilateral institutions are co-opted by managements, resulting in a lack of transparency, accountability and responsibility. There are a host of governance obstacles to be overcome in reforming the global system. Global institutions need to be governed differently and managed differently and more efficiently. They need different kinds of leaders, managers and staff, vetted through more rational and transparent processes than are presently applied to ensure that they have the requisite attributes, knowledge and qualifications. Suffocating bureaucratic cultures need to undergo substantial change to achieve overdue downsizing. Without such measures, whatever else is done to introduce rationality and coherence in global economic architecture is unlikely to have much effect.

A New Rationale for Government-to-Government Resource Transfers

Although its rationale is becoming weaker and less justifiable with each passing day, the present system of development assistance (aid) has become sacrosanct because it has existed for over 50 years. In that time it has created an array of vested institutional interests in both the public and private sectors that prevent it from being abandoned or changed. Yet contrary to popular belief, the system protects the industrial world at the expense of developing countries. It lowers the cost of OECD resource-flow obligations to poorer countries while suggesting the opposite to their taxpayers who are now disillusioned with the failure of aid to achieve its goals.

In a globalising WTO-orientated world – in which the primacy of markets, of open market access and of legally enforceable redress are accepted as the foundation stones for global transactions – the proper basis for resource transfers from rich to poor countries must be compensation for the damage done by discriminatory denial of access to, and protection of, developed country markets for certain goods, for example textiles, certain types of basic services, agriculture and particularly for unskilled and semi-skilled labour. Estimates of the damage done to developing countries in each instance, industry and factor market vary widely depending on the source and available information. But data that are available suggest that an order of magnitude of US$500–600 billion in compensating damages would be defensible. That is more than 10 times what the present development assistance system yields by way of ODA transfers. Clearly the technical details and mechanical intricacies of operating such a compensatory system would be more complex than is the case with the present development assistance system.

The mathematics and complexities could be handled if there was political will to change the system. The challenge that industrial countries confront is to accept the legitimacy and logic of a new basis for resource transfers instead of clinging to a rationale that is no longer respectable. A WTO-driven world strips away the pretence of charity and goodwill in the present logic of development assistance. It makes transparent the damage being done in denial of market access, while exposing the hypocrisy of providing a sop to developing countries at nine cents on the dollar. That situation cannot last much longer. Developing countries have so far failed to change the raison d'être of resource transfers. Yet it is inevitable that the present basis of resource transfers through aid must eventually change. Even if OECD governments find the change difficult to accept in theory or in practice, there will be no dearth of high-priced international lawyers lining up to argue the case for damages suffered by developing countries in international courts on the basis of lucrative contingency fees as the WTO regime unfolds. Strangely enough, industrial countries are being given a period of grace by developing countries that are resisting the accelerated evolution of a rule-based world

Differing Perceptions of Priorities for Achieving Sustainable Development

Donor Country Priorities

Good Governance:
- Democracy
- Elections
- Political Parties
- Civil Society Representation
- Human Rights
- Corruption

Policy:
- Poverty Reduction
- Macroeconomic (MFE)
- Privatisation/Corporatisation
- Trade Liberalisation
- Education, Health, Social

Gender/Children:
- Rights, Equality, Access
- Participation
- Child Rights/Child Labour/Soldiers

Environment:
- Global Emissions Protocols
- Global Warming, Ozone, CFC

Developing Country Priorities

Infrastructure:
- Electricity, Water, Sanitation, Telecoms
- Roads, Railways, Ports
- Airlines, Shipping

Capital Markets:
- Securities Exchanges
- Derivative/Commodity Markets
- Global Financial System Integration
- NPAs in Banking Systems

Policy:
- Macroeconomic (MFE)
- Deregulation of Controlled Sectors
- Proper Regulation of Markets
- Labour Markets/Employment Absorption
- Industrialisation and Exports
- Global Market Access
- Mitigating Impact of Globalisation
- Cultural Compatibility of Modernisation
- Coping with E-Commerce Revolution

Governance:
- Administrative Efficiency, Effectiveness, Honesty
- Decentralisation/Devolution
- Quality of State, District, Local, Municipal Government
- Civil Service Rationalisation
- Managing Resurgent Ethnicity
- Reducing Costs of Governance

Gender/Children:
- Reducing Malnutrition, Starvation,Poverty
- Assuring Survival
- Reducing Population/Fertility
- Coping with Cultural Traditions/Constraints

Environment:
- Local Focus on Emissions, Pollution
- Protection of Trees, Forest Cover/Fires
- Coping with Drought, Floods, Cyclones
- Water and Irrigation Constraints

Source: Ministry for Foreign Affairs, Government of Sweden, *Mobilising Support and Resources for the UN Funds and Programmes, 2001*, Stockholm, Sweden. (This report was written by P.S. Mistry, Oxford International, UK and Niels Olesen, COWI, Denmark.)

trading and financial regime because of the mistaken view that such an outcome may not be in their best interests.

The War of Global Competitiveness

Of relevance to UNCFD and FfD is the reality that an unprecedented war of global competitiveness has been unleashed with the Uruguay Round. It will intensify with the new WTO round of negotiations. Its outcome remains uncertain. As with every war, the fortunes of combatants will shift with time. This is a war

that has no foreseeable end. Theoretically, it will end only when the world unifies under a single global trade, finance and exchange regime. That may happen. But it is a long way off. A considerable amount of collateral damage will be done along the way. It is not at all clear how the fall-out of global competition will be dealt with, who will pay the price and how?

Policy-makers in the developed world – and in the more successful and competitive developing countries as well – no longer argue against the merits of competition and competitiveness in the universal emerging global market. But policy-makers in dispossessed and disadvantaged countries that do not yet have the basic wherewithal to compete on level terms are perplexed and confused about the enormous challenges they confront and about being marginalised before they have had a chance to emerge. For example, is Africa to become a large game reserve with an advantage only in eco-tourism?

The merits of globalisation have been presented as axiomatic and obvious by supposedly knowledgeable protagonists. Its critics, on the other hand, are invariably portrayed as dinosaurs out of touch with reality and with the times in resisting the forces of natural evolution. But that may be too simplistic. Industrial countries believe, perhaps somewhat complacently, that they will always retain a globally competitive edge in knowledge-based industries and services. That is an odd belief when developed countries are falling over themselves trying to import IT workers from India to cover shortfalls in their own labour markets for these knowledge-intensive skills.

In industrial countries, resistance to globalisation is gathering force as it becomes apparent that there is no plan for taking care of those displaced or marginalised as a consequence of continually shifting advantage in global competition. It is not enough to offer social safety nets through generous welfare payments. These will become increasingly unaffordable as demographic changes manifest themselves in OECD countries. Moreover, such safety nets are a magnet for unwanted immigration. Nor is retraining and retooling of skills a panacea. Not everyone has the capacity to be trained or retooled for knowledge-intensity. The bell-curve distribution of human capacity suggests that a proportion of the populations of developed countries will not have the skills needed for knowledge-intensity no matter how much money is thrown into education or re-education. Jobs that once absorbed the unskilled and semi-skilled in a manner acceptable to them have disappeared. The jobs that have replaced them are jobs that many find demeaning and unacceptable. That attitude problem will have to be overcome with a change in work and welfare culture.

But such problems pale in comparison to those faced in developing countries. There the gaps between haves and have-nots and the educated and the uneducated will continue to widen. Most of these countries have effective unemployment rates of around 20–30 per cent and effective underemployment rates of 40–50 per cent. For absorption of a growing young population to occur, such surplus labour has either to be exported or employed in domestic labour markets. But markets for unskilled labour in developed countries have serious problems of their own. They are unlikely to open dramatically, limiting the scope for labour exports from the developing world. Nor is productive investment in developing countries likely to double or triple from current levels. In the absence of these two conditions, it is difficult to envisage the full absorption of a rapidly growing number of dispossessed people through increased productive employment.

What are the consequences likely to be for a globalising world? In truth, no one knows. Between 1950–2000 a very rapid increase in the number of very poor people (from about 1.5 billion in 1950 to nearly 3.5 billion in 2000) has occurred without severe global disruption. Of

course, local and regional ructions caused by such growth have increased in frequency and severity. This increase has also had social, ecological and environmental consequences the long-term impact of which is only beginning to be appreciated. It has resulted in rapidly increasing crime and reduced personal security along with deforestation, desertification, land degradation and immense pressure on finite water resources.

With the change that has occurred in global communications and access to information in the last decade alone, is it likely that an addition of another two or three billion of the very poor over the next 25 years will be coped with in the same manner? Or is the dam closer to bursting? No one knows. Much more needs to be discovered about how the world can cope with the social fall-out of untrammelled global competitiveness, especially in developing countries, before it plunges headlong into creating a monumental problem with simply a hope and prayer that it may be able to cope with the consequences.

The list of residual issues in this discussion of 'systemic issues' covers many that have not been addressed by SGR or ZPR. It has been offered with the intent of provoking thought among Commonwealth policy-makers, and particularly among its developing country members, about where their interests lie in resolving these difficult questions and the line they wish to take at UNCFD to achieve positive, constructive outcomes.

For the governments of the Commonwealth, this paper represents just a starting point in a process that will unfold over the coming months. Hopefully it will aim at determining the overall platform and position that developing countries as a whole (and the Commonwealth as a unique multilateral body) should take at UNCFD. Clearly, the positions taken by member governments must recognise the differences that exist between regions as disparate as East Asia and Africa. But it should not let that issue weaken its compulsion to construct a common platform and present a common front on the larger, broader issues that affect the developing world as a whole. Eventually the positions taken by both industrial and developing countries must be shaped on the basis of more intensive research and study than this synoptic paper, prepared under the pressures of time, can provide. The development challenges that each country (and region) confront – and what it needs by way of FfD to address those challenges – need to be examined more carefully.

9

Conclusions and Synopsis of Findings and Recommendations

In its first two sections, this report emphasises that UNCFD presents the first opportunity in decades for the global community to address issues concerning FfD in a holistic manner. The requirements and modalities for FfD in present circumstances are entirely different from those of the 1950s when the post-independence development financing enterprise began. The FfD options available at the beginning of the twenty-first century are more varied and fertile than those in the mid-twentieth century when the world was recovering from a devastating war and the Bretton Wood regime had barely established itself. The post-Bretton Woods world has brought uncertainties, risks and complications. But, after a series of debilitating crises between 1970–2000, it has brought new understanding of the complexities of development, as well as of new paradigms, new opportunities and new challenges.

This report argues that it would be unfortunate if the opportunity were missed to construct a new FfD framework – with its requisite institutions, modalities, rules and protocols – that accommodates the sea change that has occurred in circumstances confronting both industrial and developing countries. A world of closed economies and bounded opportunities has given way to a globalising world demanding openness and unbounded capital flows, along with flows of knowledge, technology, investment and human capital. It is a world in which the interests of industrialised and developing countries do not collide; in more instances than not they coincide. Thus, more effective financing for development, that encourages convergence in living standards, is to be encouraged.

In such a world it is right (and probably long overdue) to reconsider what needs to be done to change established institutions, traditions and processes for financing development in ways that are more effective and productive than they have been over the last half-century. This report traces the expectations and disappointments experienced by both the providers and recipients of development financing between 1950–99 and makes the case for change.

In doing so it borrows a structure established in the agenda for UNCFD and adopted by the two key reports (SGR and ZPR) that have been prepared under UN aegis as a starting point for considering the issues that UNCFD hopes to deal with. As noted in the introductory section, these cover the role in financing development of domestic resources, earnings from trade, private capital from foreign sources, official flows and external debt. These topics are dealt with sequentially in Sections 3–7 of this paper. Section 8 covers the sixth, and perhaps most important and contentious, set of issues that UNCFD will have to deal with – systemic issues and the changes that are needed in the global institutional architecture that impinges on the development process through hard financing and soft interventions, such as technical assistance and transfer of knowledge.

This report uses the ZPR as the main point of reference in raising key issues and dealing with them through analysis and the presentation of factual information. It goes further than either SGR or ZPR in dealing with these issues, and especially the systemic issues, for reasons that are fully explained in each section. Its key findings and recommendations are adumbrated

below for convenient ready reference in the order they are made, section by section.

9.1 Domestic Resource Mobilisation (Section 3)

1. Commonwealth Finance Ministers (CFMs) should give qualified support to the proposal in SGR and ZPR for enhancing domestic savings through compulsory provision of pensions in all developing countries. The proposal does not take sufficient account of vast differences in the fiscal situations of different developing countries or of differences in their demographics and levels of employment.

2. Greater attention should be paid to enhancing private voluntary saving in financial form and to reducing public dissaving. Together, these steps could release 8–15 per cent of GDP in incremental domestic resources across the developing world.

3. For divergence in living standards between industrial and developing countries to be reversed, annual GDP growth in the developing world will need to be increased from an average of 4 per cent to 8 per cent. Until 1997 East Asia (with a few exceptions in Indochina and the Pacific Islands) had achieved that level of growth. It still has high levels of savings and investment. In the rest of the developing world, investment needs to be increased from an average of 20 per cent of GDP to 33 per cent while savings need to increase from 17 per cent to 28 per cent of GDP, leaving a resource gap of around 5 per cent that can be financed on a sustainable basis from external sources.

4. This substantial change is unlikely to occur unless governments in developing countries take dramatic action to improve their domestic situations. This report recommends that governments of developing countries should target increasing their domestic savings ratios by an incremental 1 per cent of GDP each year until 2015. To achieve that target the following steps need to be taken:

- Reduce wasteful public expenditures at all levels of government (central to municipal);
- Balance recurrent revenue/expenditure accounts by 2015;
- Reduce fiscal support for public sector enterprises to zero by 2007;
- The PSE contribution to public finances should increase by 3 per cent per year in real local currency terms;
- Privatisation through divestiture of government holdings in commercial PSEs to zero by 2015;
- Withdrawal of government from ownership of all financial institutions by 2015;
- Revise tax structures to encourage private saving and wealth accumulation (reduced direct taxes) and discourage consumption (increased indirect taxes and transactions taxes);
- Rapid development of national and regional capital markets across the developing world.

9.2. Enhancing Earnings from Trade (Section 4)

1. CFMs should support all nine of ZPR's recommendations (see 4.1) on increasing opportunities for developing countries to maximise their earnings from trade through further trade liberalisation measures; they should urge industrial countries to deliver on the commitments they made to open their markets in textiles and agriculture under the Uruguay Round.

2. In supporting initiation of the next WTO round, CFMs should qualify their support by pointing out the substantial disadvantages that developing countries still face in coping with the administrative and legislative burdens created by the Uruguay Round. They should press for substantially expanded technical assistance to their developing members from WTO, UNCTAD and the Commonwealth Secretariat

(and less from the IMF and World Bank with an accompanying transfer of budget resources and grant funds from these IFIs to the other three agencies).

3. CFMs should ask for an authoritative independent study to be conducted by a commission of trade experts to determine what developing countries have gained in net terms from the Uruguay Round compared to what the OECD countries have gained, and how those gains have been distributed between and within these two groups.

4. CFMs should be cautious about endorsing the World Bank's proposal (supported by ZPR) to establish a specialised intermediary within the World Bank Group that would aim to provide commodity risk insurance to small farmers in an attempt to stabilise their incomes. Independent experts are sceptical about the usefulness of such an intermediary, what it would cost and how it would work, and whether it would address the real issue of reducing the risk of large fluctuations in commodity earnings for the poorest developing countries.

5. Although it agrees that the issue of open labour migration should be put on the international agenda, the report cautions against pursuing this issue too aggressively at UNCFD (see 4.2).

6. CFMs should strongly support an enhanced role for the Commonwealth Secretariat in providing a substantially expanded programme of training, knowledge dissemination and technical assistance to developing member countries, and especially the SDS members, on trade issues. Such assistance should be provided to both trade policy officials in capitals and to trade negotiators in Geneva, as well as those in Brussels for ACP-EU negotiations. CFMs should go a step further in carving out a niche role for the Secretariat as the agency of first resort for providing such assistance to SDS and SDIS on behalf of the global community as a whole, and for its TIAF budget to be augmented by budget support contributions from the Trust Fund set up to support the Integrated Framework Initiative (see 4.3).

9.3. Private Capital Flows (Section 5)

1. Excluding ZPR's recommendation for the creation of an International Tax Organisation (see Section 8 for detailed treatment), CFMs should support the other seven recommendations made by ZPR (5.1). But such support is unlikely to advance the argument for increasing private capital flows to developing countries, and especially the poorest ones, very far.

2. The oft-repeated statement that private capital flows are too concentrated in too few developing countries is misleading for two reasons: (a) many of the poorest developing countries have comparatively high ratios of FDI to GDP with FDI concentrated in their natural resource sectors; and (b) the few developing countries to which private capital (especially FDI) does flow account for the bulk of the developing world's population, output, reserves and markets.

3. It would be unreasonable, therefore, to expect private capital to flow evenly across all developing countries since the population and market opportunity distributions are so uneven across these countries. By the same token, official flows are even less evenly distributed, with their allocation across countries being even less logical and rational than private flows.

4. Uneven distributions of PCF within the universe of countries in which it is concentrated are due less to the nature of PCF than to default on the part of destination countries in terms of the poor quality of the overall environment they offer for attracting such flows.

5. The real dangers of FPI are overplayed in official circles while those of FDI are underplayed. Through risk-management techniques and derivatives markets, FDI can behave in a

fashion similar to FPI in triggering financial crises. So too can domestic capital through exaggerated capital flight. The demonisation of FPI in the literature and in policy-making circles needs, therefore, to be tempered with a more balanced perspective on the real risks involved.

6. Although many developing countries have undertaken substantial economic reforms and are pursuing policies more conducive to inflows of foreign investment, the response of foreign investors has not met expectations. Recent studies suggest that may be due to the continued prevalence of high levels of corruption that still deter PCF inflows.

7. MDBs and their affiliated investment corporations need to be more proactive in encouraging and supporting the widening and deepening of PCF to both a wider universe of developing countries as well as increased penetration in countries where it is already flowing.

8. This report recommends that at least two-thirds of the number of operations (not the amount invested) of the MDBs/ICs be concentrated in low-income and least developed countries. They need to be more proactive in supporting the unfinished business of privatisation in countries and regions where it lags behind (see 5.2).

9. MDBs should consider floating their own bonds in the local currencies of middle-income developing countries and using the proceeds to finance physical and social infrastructure investment. Such a measure may attract foreign private investors to invest in developing country bonds and provide a useful benchmark instrument.

10. Together with domestic authorities and global investment banks, MDBs should explore the possibility of designing and making markets in tailored and over-the-counter derivative instruments that are bought by private portfolio investors at the time of entry into developing country capital markets. These instruments should be priced to favour stabilising the interest rates, exchange rates and stock market prices and indices at the time of entry (providing of course they are deemed to reflect real fundamentals).

11. Such instruments should be aimed at discouraging perverse double-plays by private portfolio investors at times of financial crises. They could be designed to result in large automatic losses if portfolio investors behaved in a way (for example by driving down exchange rates, driving down share prices and stock-market indices and driving up interest rates) that exacerbated market failure and was inimical to the interests of the destination country.

12. Similarly, MDBs and the IMF could work with global investment banks to develop synthetic market-based risk-management derivative instruments for central banks and treasuries of developing countries to protect against sudden increases in the prices of crucial imports (for example oil or fertilizers), adverse movements in global interest and exchange rates that may affect debt service, and against sharp drops in export revenues or in sudden outward surges of capital.

13. Commonwealth developing countries have much to learn from developed members, and from countries such as Malaysia and Mauritius, about how to attract PCF.

14. Intra-Commonwealth guarantee and risk protection mechanisms might be intermediated through the Commonwealth Development Corporation to facilitate PCF to developing members. These could improve access to global financial markets in London, Toronto, Sydney and Singapore, as well as to developed member countries, as key sources of FDI.

15. Intra-Commonwealth arrangements could also be designed to facilitate FDI and FPI flows between developing members of the Commonwealth, for example from India, Malaysia and Mauritius to SDS in Africa, the Caribbean and the Pacific.

16. Emphasis should be placed on developing regional rather than national capital markets in the smaller Commonwealth member countries, especially in east, southern and west Africa, the Caribbean and the Pacific. Such regional markets should be linked, through multiple listings on small boards, to more established and developed capital markets in Johannesburg, London, Sydney and Toronto.

17. Industrial countries that are sources of 'hot' FPI should play a more proactive role in preventing surges of capital from their jurisdictions into emerging markets at inappropriate moments by a system of hoisting yellow and red flags to warn against the extreme risks involved. Moreover, they can play a better regulatory role in ensuring that such capital is bailed-in rather than bailed-out during financial crises.

18. Malaysia's non-traditional indigenous approach to adjustment to avert a potentially damaging financial crisis (which its neighbours, under BWI tutelage, succumbed to) offers an interesting and positive case study. The example needs to be studied more carefully and its lessons more widely disseminated. Similarly, Hong Kong's untraditional, and highly successful, extraordinary intervention in equity markets to 'burn' foreign and local investors intent on making spectacular profits from damaging double-plays based on market-rigging, also needs to be developed as a case study from which other developing countries can learn.

19. The standard template applied by the IMF to deal with financial crises in developing countries, relying on very tight monetary policy and a simultaneous fiscal squeeze, has done unnecessary structural damage to many developing economies. It needs to be reviewed and revised with its tools and policies of crisis management being made more similar to crisis management approaches in the industrial world.

20. The IMF's crisis management approach should be symmetrical in distributing the immediate post-crisis cost (and the eventual long-term recovery gains) equally among creditors and debtors, rather than concentrating such costs almost exclusively on developing economies and on the poorest segments of their populations.

21. Financial crises should not be used by industrial countries, or by IFIs as their instruments, as an excuse to pursue political regime changes in the midst of a crisis as happened in Indonesia.

22. Industrial countries can, and should, do more to encourage PCF to emerging markets through suitably designed tax credits, deductions and capital allowances similar to those designed to encourage philanthropy or investment to regenerate depressed areas in industrial countries. Such tax benefits should be calibrated to provide maximum incentives for PCF to the least developed countries with a sliding scale reduction of such benefits to PCF for better off middle-income countries (see 5.2).

23. Tax and other efforts to 'push' PCF from high-income to low-income countries are unlikely to be successful if developing countries do not create a 'pull effect' as well. They need to act on all the measures suggested by SGR and ZPR (see 5.2) to create more friendly environments for PCF in their own countries and in the developing world as a whole.

24. Private voluntary flows through NGOs and philanthropic foundations to the developing world have increased between the 1980s and 1990s though they have been stagnant for the last few years. Though these flows can be double-edged, given the role that some NGOs play, they need to be increased.

25. In calculating PVF no account is taken of PVF generated within developing countries themselves. This report suspects that they may be a multiple of flows from external sources of PVF and should be recorded as a significant

domestic resource effort toward FfD that is rarely if ever taken into account. A study needs to be done of PVF within developing countries to understand the nature and contribution of domestic voluntary giving.

26. Measures need to be taken, through appropriate amendments in tax systems in industrial and developing countries, to encourage PVF for meeting social investment needs, especially those aimed at the poorest. That measure might go a longer (and quicker) way towards meeting IDG-2015 targets than relying on governments alone to increase social expenditures and give higher priority to social spending in their overall public expenditure frame.

9.4. Official Aid and Capital Flows (Section 6)

1. CFMs should be cautious about endorsing the recommendations of SGR and ZPR on official aid. In particular, they should avoid supporting SGR/ZPR views about the desirability of introducing either the proposed Tobin Tax on financial transactions or a Global Carbon Tax in order to raise funding for global public goods (see 6.2).

2. This report concludes that the time has not yet come for proposals on any kind of supranational taxation to be considered by industrial countries regardless of the conceptual arguments that might favour such taxation. Such proposals, if pursued, would antagonise the US administration and legislature to a degree that would result in the failure of UNCFD.

3. Global taxation might also threaten the efforts of developing countries to mobilise more public revenue for their own public expenditures by diverting national taxation for global uses. Premature proposals for global taxation risk being seen as vacuous opportunism to compensate for the failure of donors to provide sufficient ODA.

4. If developing countries are to champion the cause of global taxation, they should avoid doing so at UNCFD. Instead they should take time to lay the preparatory intellectual groundwork more carefully and launch a global debate on the issue at a later, more opportune and propitious juncture (see 6.4).

5. CFMs should support ZPR's proposal for a new issue of SDRs and utilise the proceeds from such an issue mainly to finance development rather than simply to accrue reserves.

6. CFMs should also support ZPR's proposal to increase the concessionality of ODA flows. This report goes further than ZPR in recommending that the threshold of concessionality for funds classified as ODA should be increased from a grant element of 25 per cent to at least 50 per cent.

7. CFMs should reserve opinion on ZPR's call for automatically reaffirming the 0.7 per cent ODA/GNP target. This target needs to be reconsidered on pragmatic grounds. The target has been honoured in the breach rather than the observance. It will not be adopted by large donor countries which provide over 80 per cent of ODA.

8. For practical reasons, and to reflect the reality that private flows will remain dominant in financing development for the foreseeable future, this report recommends that CFMs propose at UNCFD a revised composite target for donors to transfer 2 per cent of GDP by way of both official and private net resource flows with ODA, accounting for at least 0.5 per cent of GDP (see 6.3).

9. SGR and ZPR's calculations of additional ODA requirements of about $70 billion (raising total annual ODA requirements to around $150 billion) are unconvincing. They need to be reworked and supported by detailed calculations built up from national needs to meet IDG-2015 goals. Estimates that cannot be supported by firm evidence are likely to do more harm than good in destroying the case that

more ODA is needed, no matter how self-evident that proposition might be.

9.5. Reducing External Debt Burdens (Section 7)

1. In the 30 years from 1970 to 2000 the external debt of developing countries increased nearly 40 times. It increased 9 times between 1970–80 from $68 billion to $610 billion. Between 1980–1990 it increased again by 2.5 times to $1.5 trillion. In the last decade it has nearly doubled yet again to stand at an estimated $2.64 trillion in 2000.

2. Debt service burdens have risen even faster, from $6 billion in 1970 to over $93 billion in 1980, $155 billion in 1990 and nearly $400 billion in 2000. Debt service has thus increased nearly 70 times in the same 30 years. It now accounts for 2.5 per cent of the annual GDP of the developing world, compared to less than 0.5 per cent in 1970.

3. Between 1998–2000 developing countries have (in net terms) transferred a total of nearly $280 billion in real resources to industrial countries on the debt account.

4. ZPR's recommendations on further action to alleviate the debt problems faced by many developing countries, and not just the HIPCs, are lamentably inadequate. They are unlikely to make any difference to the status quo. The HIPC initiatives taken between 1996 and 2001 (HIPC-1 in 1996 and HIPC-2 in 1999) proved to be inadequate and insufficient in addressing the debt problems of the poorest countries. Other mechanisms, such as the London and Paris Clubs, are not doing enough to alleviate private and official debt burdens quickly enough in debt-distressed economies.

5. CFMs need to go further in arguing at UNCFD for more rapid progress to be made in providing greater debt and debt service relief to HIPCs through a third derivative HIPC-3, which would make rescheduling and cancellation terms applied to eligible countries more generous and more rapidly triggered.

6. Under a revised HIPC-3 Debt Initiative, multilateral preferred creditors should be required to write-down their own claims against eligible HIPCs on their balance sheets, for both their concessional and non-concessional windows, immediately.

7. The HIPC debt relief initiatives should no longer be administered by the two principal IFIs which both have a vested interest as creditors in the outcome of their own actions. These initiatives and, all other debt relief mechanisms, should be the responsibility of an Independent Commission on Debt Rescheduling and Reduction that is not controlled by any creditor group with a vested interest in one-sided outcomes.

8. In order to protect themselves and avoid any penalties for their own lending excesses and defaults, the IFIs/RDBs have put forward a number of arguments against this step on the grounds that it would have catastrophic consequences and do collateral damage to HIPCs and other low-income countries as well.

9. These arguments have been examined closely by a number of independent financial experts and found to be false. The spurious nature of these arguments should be exposed and settled decisively at UNCFD. This question should be exhaustively examined by a panel of genuinely independent financial experts who do not have any financial or working relations with the IFIs/RDBs and no vested interests in this matter.

10. IFI resistance to write-downs on their balance sheets, accompanied by the insistence that donors provide additional ODA immediately to pay for the costs of any further debt relief (which means bilateral donors paying in three ways for debt relief), is slowing down the process of creating HIPC-3. The actual cost is being paid by HIPCs and the next two genera-

tions of the poorest people in terms of foregone social investments that could be made if an excessive and unsustainable debt overhang did not have to be serviced.

11. Moreover, buying into the disingenuous arguments being made by the IFIs to avoid write-downs on their own balance sheets runs the serious risk of enshrining a serious moral hazard on the part of preferred creditors. Instead of encouraging such a moral hazard, the international community needs to explore ways in which effective sanctions can be applied to, and more effective regulatory oversight can be exercised over, preferred creditors to ensure that their protected status is never open to abuse.

12. CFMs also need to draw attention to the debt problems of many middle-income countries and island economies, most of which are Commonwealth members.

13. It would be appropriate for developing countries to pursue a decisive resolution of the external debt issue at UNCFD. New ideas should be considered and studied, including:

- Reviving debt-equity swaps aimed at accelerating privatisation and increasing the equity financing available for privately funded infrastructure projects in countries where debt and debt service levels are above prudential limits (35 per cent of GDP for debt and 15 per cent of exports for debt service);
- Applying 'extendable mortgage' principles to automatic sovereign debt rescheduling by keeping debt service payments at a constant dollar level, or not exceeding 15 per cent of export earnings, while automatically extending or shortening the maturity of the adjusted outstanding debt obligation depending on global interest rate movements and the impact of financial crises;
- Activating automatic debt-service reductions or stand-stills in the event of financial crises with automatic debt service rescheduling through maturity extensions;
- Eligible countries with a debt-overhang earning 'debt-write-down credits' for sustained development performance, for example with official creditors agreeing to write down 10 per cent of their outstanding debt obligation for each year if countries sustain a growth rate of at least 6 per cent annually for five years.

14. As suggested by SGR, developing countries should collectively press the case for an independent international debt arbitration mechanism to be developed, involving creditor, debtor and impartial expert interlocutors, in assessing, adjudicating and passing judgement on debt reduction options.

15. In that connection, an International Convention on Sovereign Debt Restructuring in Financial Emergencies may need to be considered to incorporate the lessons that have been learnt over the last 20 years, and to remove the inconsistencies and avoid 'make-it-up-as-you-go-along' approaches that have been the hallmark of attempts to restructure debt burdens. Such a Convention should apply the concepts of Chapters 9, 10 and 11 in the US Bankruptcy Code approaches to swift debt reorganisation to avoid bankruptcy.

16. The experience of 1982–99 casts doubt on the wisdom of continued resort to non-concessional debt-creating flows for financing soft investments in poverty reduction. Developing countries should avoid assuming further non-concessional debt obligations to finance social investment, international public goods and poverty-reduction programmes, for example in education and health.

9.6. Systemic Issues and Global Institutional Architecture (Section 8)

1. The present international financial system

and the institutional architecture that supports it are unsuited to responding adequately to the changing, evolving needs of FfD in the twenty-first century. Both the system and its institutional framework need major overhaul. In that light, SGR/ZPR recommendations on this issue are regrettably selective and weak. They do not add much value to the debate on systemic issues and do not illuminate the right path for resolving them.

2. In its present form the UN cannot (as SGR implicitly argues) be the centrepiece of any future system of global governance that might evolve. Without fundamental and radical reorganisation, streamlining and rationalisation, the UN will not have the public credibility to play such a role.

3. CFMs should endorse ZPR's recommendation to reform, reorganise and expand the WTO substantially (with a budget to support such an expansion). This report argues that such expansion should be aimed exclusively at enhancing the WTO's capacity to provide a far greater amount of assistance to its developing country members in understanding the issues and implications involved in the completion of the Uruguay Round and in the next negotiating round. At UNCFD the CFMs should ask WTO's management for a plan of action outlining steps to make it a more accessible and responsive organisation to its developing country membership.

4. At UNCFD, the CFMs should support ZPR's recommendation to delegate the issue of labour standards to the ILO and to strengthen ILO sufficiently to develop and enforce standards appropriate to the circumstances of developing countries.

5. CFMs need to be more circumspect about ZPR's recommendation to fold all the international environmental agencies into a single Global Environmental Organisation. Though the idea is sound in theory and principle, the practical dimensions and implications of this proposal need to be made more transparent before it can be supported.

6. ZPR's recommendations on reform of the IFIs fall far short of the needs and expectations of developing countries; they have been arguing for more significant and substantive changes in the way these institutions operate and function.

7. Regional Monetary Funds are the missing link in the architecture of the international financial system. These funds, mirroring the functions of the IMF at a regional level, are an essential second line of defence at times of financial crises. They should be created immediately in Asia and Latin America, two regions that presently have the resources and reserves to create and operate such entities without relying on the largesse of the IMF or OECD. Similar funds should be created in other developing regions in the coming years.

8. A better demarcated division of labour is essential between existing institutions in the official international financial system. They need to operate as well-articulated parts of a single official system, rather than as disparate fragmented entities intent on doing their own thing.

9. Reform of the IFIs should be a priority at UNCFD. The objectives should be to change: (a) the roles, orientations, governance structures, management selection processes, and *modus operandi* of these institutions in financing development; and (b) the way in which IFIs respond to structural or transient disequilibria in the external and internal accounts of developing countries. Reform should aim at making these institutions more transparent, participatory, democratic, development-friendly and supportive of developing countries.

10. The weights of developing countries within the quotas and shareholding of these institutions should be changed as soon as possible by

using PPP exchange rates rather than nominal exchange rates in the standard formulae that are used to calculate quotas in the IMF, shareholdings in the World Bank (and regional banks) and voting rights in these institutions. Such a step would go a long way towards reflecting more accurately the increasingly important role of developing countries in the global economy and their growing share of global output (45 per cent at PPP exchange rates as against the 22 per cent reflected in nominal exchange rate comparisons).

11. In contemplating IFI reform, particular attention should be paid to: (a) the nature and adequacy of capital flows (and particularly of net transfers) from IFIs to developing countries; and (b) the roles and mandates of IFIs, including their roles in influencing national decision-making, governance and patterns of development through the conditionalities imposed.

12. In the interests of inducing more transparent, fairer and better performance on the part of the Bretton Woods Institutions, autonomous, external governance mechanisms involving experienced senior global statesmen from around the world need to be established to evaluate, monitor and critique the work and performance of the BWIs on a 5-yearly basis. These commissions should be detached from the managements of IFIs, from their evaluation offices, which are not independent despite their claims to that effect, and from their Boards of Governors and Executive Directors. The mandate of these independent bodies should be to hold the IFIs accountable for the outcomes of their prescriptions in developing countries, and to moderate the excessive influence of some industrial countries over the activities and policy orientation of the IFIs.

13. In a globalising world, the only plausible rationale for official intervention in the global financial system is not to intermediate official resources *ad infinitum* but to enhance the credit-worthiness (or more accurately the 'market-worthiness') of developing countries as rapidly as possible. This is necessary to ensure that, in the long-run, all countries have access to global market resources for financing needs that cannot be met from tax revenues without relying on the largesse of other countries.

14. As global markets develop greater capacity and extend the risk–reward spectrum in their financing preferences, IFIs should vacate the space they formally occupied in providing FfD in favour of markets. In doing so, they need to ensure that the global financial system is not weakened but strengthened. For that, two types of *official intervention capacity* are needed:

- *Normal or proactive* intervention capacity on an ongoing, non-crisis basis aimed at improving the macro-policy framework and meso/micro-institutional functioning of firms in emerging markets – the prophylactic role;
- *Extraordinary or reactive* capacity to intervene decisively and effectively when crises do erupt – the curative role.

15. The obvious division of labour among the various IFIs, given their respective institutional heritages and areas of comparative advantage, would be that:

- The **IMF** should focus on dealing with the *macro* policy, problems and issues that are likely to influence the course of financial market globalisation with a view to achieving co-ordination at the national, regional and global levels;
- The **World Bank** should focus more on the *meso* and *micro* policies, institutions, markets and market-supporting structures and enabling conditions, and tackle the practical, ground-level problems and issues involved – those of market-building, market-supporting, institution-building and capacity-building in its broadest sense, in and across emerging markets;

- The **Regional Development Banks** should take over the ground-level development support, poverty-reduction, and human and social capital development activities that the World Bank presently attempts to monopolise, as well as regional infrastructure financing and facilitating the processes of closer economic integration in their regions.

16. The IMF should depend entirely on *quota increases* for its funding, part of which should be lent on concessional terms. It should also expand its ability to raise intervention resources and contingent facilities directly from markets – a justifiable amendment to its charter since the IMF would not be directly engaged in assisting global markets to expand their scope and reach.

17. In fulfilling its new role the IMF needs to continue developing a wider range of *contingent facilities* to suit a variety of circumstances. Such facilities could operate in the same way as guarantees. They could be associated with co-financing arrangements involving private market sources.

18. The World Bank should focus on the meso (sector-level) and micro-policy and institutional issues and tasks, aimed at accelerating the development of emerging financial markets. It should recede into a wholesale role with the bulk of its operations focused on attracting private capital to developing countries.

19. The World Bank should leave retail development financing to the RDB concerned in each region. Its involvement with the RDBs should become closer, possibly even going so far as to become the custodian of industrial country shareholdings in the RDBs.

20. In that connection, while the World Bank's shareholding might continue to reflect a 60/40 ratio (moving quickly to 55/45) in the shares of industrial and developing countries respectively, that ratio should be reversed in the shareholdings of all the RDBs with the developing countries in each region holding a majority of at least 60 per cent.

21. Reflecting this change in role, the World Bank's range of products should be modified with guarantees replacing loans as its main instrument. Indeed, direct World Bank loans should be made only in exceptional instances. As a wholesaler, the Bank should focus on the *financial sector* of developing countries and aim at improving the efficiency and quality of domestic financial market firms and operations.

22. The World Bank also needs to create direct access to financial markets for *sub-sovereign* levels of government in domestic financial markets and in regional and global markets. Confining market access to the sovereign level of government in developing countries has damaged and retarded the quality of governance at sub-sovereign levels.

23. The Bank should support projects/programmes that directly or indirectly improve the transparency and accountability of all government operations in emerging markets as an essential precondition for access to domestic and global financial markets.

24. Secondly, the World Bank needs to accelerate *privatisation* and *private investment in infrastructure*. In performing this role, the World Bank should confine itself to very large projects and privatisations, whose total financing requirements are over $500 million, leaving smaller projects and programmes to the regional banks.

25. The reform agenda proposed should require the World Bank to leave 'micro-development' functions and poverty reduction tasks to the RDBs, bilateral aid agencies and the increasingly influential and pervasive NGO community that can relate and communicate much more effectively with the poor in developing countries than the World Bank.

26. The Regional Development Banks (RDBs) should focus on five key themes:

- Improving the quality of governance, empowerment and inclusion;
- Promoting the development of efficient markets for factors, goods and services;
- Financing regional integration;
- Investing in their region's human and social capital;
- Enabling their regions to manage 'regional commons'.

27. RDBs should differentiate their operations and activities from those of the World Bank by highlighting their *regional* nature and using it as a comparative advantage. They should model themselves on the European Investment Bank rather than on the traditional World Bank-type MDB model.

28. The MDB system (comprising the World Bank and RDBs) needs to function as a single entity, a streamlined network of inter-linked financial institutions that maximises the joint throw-weight of their equity capital, their global borrowing power and their staff resources. The aim should be to create a more holistic global MDB system of institutions linked through a leaner World Bank at the apex, performing wholesale rather than retail functions.

29. The bulk of the World Bank's operational staff resources (all its resources in its regional vice-presidencies, the staff supporting these units and all staff in the field, together with their respective budgets) should be distributed across the respective RDBs as quickly as possible. That would result in immediately strengthening the institutional capacity of all the RDBs, especially the AfDB.

30. In a reformed MDB system, the RDBs should become the key line agencies (retail financing entities) interfacing directly with borrowing countries. The World Bank's role at the interface should be limited to financial system and capital market development, financing large infrastructure projects and accelerating privatisation, until that process reaches its logical limit.

31. Eventually (by 2050 at the latest) the World Bank should become a financial holding entity that combines industrial and developing country shareholdings on a 50–50 basis to support the global official financing system. It should operate through the RDBs and, where necessary, through private commercial financial institutions and capital markets, global, regional or domestic, in guaranteeing and underwriting risks which private entities are as yet unwilling to finance.

32. A start towards this type of 'integrated MDB system' could be made by swapping the shares held by industrial countries in the RDBs for shares in the World Bank. The World Bank would reinvest the equivalent amount in the shareholding of each RDB to a maximum of up to 40 per cent of each RDB's shareholding structure.

33. The World Bank would nominate suitably qualified statesmen to represent the industrial countries (one each for the developed countries of Asia, Europe and North America) on the Boards of Directors of each RDB, thus saving on unnecessary administrative expenditures by individual countries and introducing greater consistency in policies and decision-making in all the Boards of these regional institutions.

34. The shareholding structure of the World Bank would need to be adjusted through rights issues to reflect, at all times, a minimum shareholding of 45 per cent by the developing countries, mirroring their real weight in the global economy at PPP exchange rates. That share might reach 50 per cent by 2025 and even go beyond that as the share of these countries in the world economy, in PPP terms, grows.

35. This report's views on the impracticality of

global taxation and the issues to be considered in implementing it have been expressed at length in Section 6. The same reasoning leads to the conclusion that ZPR is premature in recommending creation of a new International Tax Organisation.

36. Many of the problems and issues about which ZPR expresses concern can be easily resolved by changes in national tax laws and through revisions of bilateral tax treaties that already exist and that could be standardised to a greater extent. The other technical tasks, such as statistics, analysis, reporting, monitoring, surveillance and sharing of tax information, could just as easily be performed by national tax authorities, informal groupings or associations of such authorities, or in some instances (data, reporting and surveillance) by the IMF and the OECD.

37. The notion of 'harmful tax competition' needs to be challenged from an intellectual viewpoint. It is an oxymoron. Tax competition is essential if governments are to be restrained and disciplined to be as efficient and effective as possible in delivering the maximum in terms of public goods and services with the minimum in terms of pre-empting available resources for public revenue.

38. Before the spectre of unfair or harmful tax competition is raised, the different circumstances of developed and developing countries need to be taken into account. Industrial countries need to encourage consumption to keep their production engines going. They do not need to encourage savings to the same degree. Their need for development investment is not as great as that of developing countries. Developing countries face an entirely different situation. They need to mobilise domestic and foreign private resources to sustain growth rates of 8–10 per cent annually if they are to have any hope of converging, even very slowly, with the industrialised world. Their investment and savings rates need to be increased dramatically.

39. Developing countries therefore need to encourage domestic after-tax income, discourage public dissaving, and encourage financial saving and capital accumulation to the greatest extent possible. With their limited options for being globally competitive they have to offer attractive after-tax returns to domestic savers and to global capital by having lower marginal rates of direct and indirect taxation.

40. These differences in the circumstances of industrial and developing countries should lead to tax competition as a naturally desirable state, rather than as an undesirable aberration. Indeed, tax competition should be encouraged rather than discouraged in order to make developing countries less dependent on official transfers and more reliant on their own resources and global capital markets.

41. CFMs should be circumspect about endorsing ZPR's recommendation for a Global Governance Summit and the creation of an Economic Security Council. It is not clear that an ESC, operating under UN auspices, would achieve the kind of global financial and economic co-ordination and co-operation needed – especially in bridging the divide, and reconciling conflicts of interest, between the industrial and developing worlds.

42. The following are more practical and meaningful interim measures toward effective global economic governance:

- More representative structures for decision and policy-making in the governance mechanisms of the IMF, World Bank, WTO and BIS that would reflect the real weight of developing countries in the global economy;
- Closer relationships between the World Bank and the RDBs cemented through cross shareholdings so that the MDB network operates as a single system;
- Quarterly meetings at heads of institution level in these four key global economic insti-

tutions with more frequent liaison at senior management and operating levels;

- Restructured Boards of Executive Directors in these institutions, with seats being filled by a higher level of representation than is presently the case – i.e. by former heads of government, finance ministers and central bank governors;
- Consolidation of the 100 or more separate funds, programmes, conferences and specialised agencies of the UN's fragmented development assistance system into a single UN Agency for International Development that complements the financial capacity of the IFIs.

43. Since the 1980s the focus of global policy-making and decision-making on development ideology, strategy, policy, tactics and operations has shifted decisively from the UN, where it lay in the 1960s and 1970s, to the IMF and World Bank. Although the UN no longer has the same weight in arbitrating on development issues, it has made seminal contributions over the last two decades in influencing development thinking. With the shift in locus from the UN to the BWIs being sustained for over two decades, OECD countries are ambivalent about whether the UN should play any role in global development affairs or concentrate instead on global political and security issues, and on maintaining structures for supporting world commerce and global commons.

44. That outcome would lead to the development agenda being determined entirely by bilateral aid agencies and the IFIs, thus compromising any prospect of constructive intellectual co-operation and competition across intergovernmental institutions in the public domain. It would permit an IFI-driven global creditor monopoly to dominate development thinking when such a monopoly detracts from the IFIs' role and judgement as lenders of last resort. It compels multiple conflicts of interest in the roles the IFIs play. And it deprives the developing world and the global community of more neutral, multilateral 'safety-valves' (without a creditor's axe to grind) that might permit more impartial, disinterested and objective interlocution and intervention in development affairs.

45. The UN cannot continue with the degree of internal fragmentation, overlapping and lack of co-ordination that characterises its specialised agencies and DFPs. Its capacity to provide value-added services depends on how well it can mediate between conflicting economic interests that could spill over into becoming major political problems between countries and regions. To do that it needs its own internal capacity to assess and advise on global economic developments and on how developing countries can best protect their economic interests.

46. The UN should attempt to rationalise and merge its disparate DFPs into a single agency for international development. This would permit more credible UN interventions in development matters and result in better co-ordination between the UN and the WTO, IFIs, RDBs and bilateral aid machinery.

47. Coherent systemic architecture for FfD cannot be structured without taking into account the role that bilateral aid agencies play in influencing the UN systems and the IFIs. Because of the pressures operating on them, there is now a serious conflict between what providers of aid think is necessary to achieve sustainable development (which appears to have boiled down to the simplistic singularity of poverty reduction) and what governments actually responsible for delivering development know to be necessary, where poverty reduction is only a minor part.

48. The agenda and *modus operandi* of national aid agencies needs to be reoriented from micro-managing aid programmes to becoming lean, minimalist organisations that support rather

than execute aid initiatives. Bilateral aid programmes should be driven by development objectives rather than for mercantile advantage or to exercise geopolitical influence. Bilateral aid agencies might be more effective in channelling their funds for poverty alleviation through NGOs and for achieving wider development objectives through chambers of commerce, professional associations and academic institutions.

49. A major step toward achieving greater coherence in the aid system would be to have national aid agencies lessen their dependence on single-issue lobby groups for ensuring adequate levels of aid appropriations from their parliaments. Another step would be to have such aid agencies detach themselves from an incestuous relationships with the IFIs and work instead with the UN-DFPs, the Commonwealth Secretariat, RDBs and NGOs to achieve cost-effective delivery at the ground level and make a more meaningful impact on poverty alleviation.

50. Because bilateral aid agencies and IFIs act in the way they do, development strategies in individual countries, and for the developing world as a whole, are being twisted out of shape. As a result developing country governments are being deflected from putting in place the foundation blocks of development. They are being compelled to pursue strategies that are politically correct rather than sticking to unfashionable strategies that are the only ones that work in the long run.

51. For a variety of reasons, international institutions are not being governed or managed as effectively as they should be. The result is institutional and policy failure. Boards of multilateral institutions are co-opted by managements resulting in a lack of transparency, accountability and responsibility. Global institutions need to be governed differently and managed differently and more efficiently. They need different kinds of leaders, managers and staff, vetted through more rational and transparent processes than are presently applied to ensure that they have the requisite attributes, knowledge and qualifications. Suffocating bureaucratic cultures need to undergo substantial change to achieve overdue downsizing. Without such measures, whatever else is done to introduce rationality and coherence into the global economic architecture is unlikely to have much effect.

52. ***A New Rationale for Government-to-Government Resource Transfers:*** Contrary to popular belief, the present aid system of government-to-government transfers protects the industrial world at the expense of developing countries. In a globalising WTO world the proper basis for resource transfers from rich to poor countries must be compensation for the damage done by discriminatory denial of access to, and protection of, developed country markets for certain goods, for example textiles, certain types of basic services, agriculture and particularly for unskilled and semi-skilled labour.

53. Estimates of the damage done to developing countries in each instance, industry and factor market range from US$500–600 billion. That is more than 10 times what the present development assistance system yields by way of ODA transfers. The technical details and mechanical intricacies of operating a compensatory system would be more complex than the present aid system. But the complexities could be handled if the political will to change the system could be mustered. In the twenty-first century it will become essential to accept the legitimacy and logic of a new basis for resource transfers instead of clinging to a rationale that is no longer respectable.

54. The merits of globalisation have been presented as axiomatic and obvious by its protagonists. Its critics are portrayed as out of touch with reality. In industrial countries, resistance to globalisation is gathering force as it becomes apparent that there is no plan for tak-

ing care of those displaced or marginalised as a consequence of continually shifting advantage in global competition. But their problems pale in comparison to those faced in developing countries.

55. Between 1950 and 2000 a very rapid increase in the number of very poor people (from about 1.5 billion in 1950 to nearly 3.5 billion in 2000) occurred without severe global disruption. However, this increase has led to several severe local and regional conflicts, created vast numbers of displaced refugees, led to escalating rates of illegal migration, and had social, ecological and environmental consequences whose long-term impact is only just beginning to be appreciated. It has resulted in rapidly increasing crime and reduced personal security, along with deforestation, desertification, land degradation and immense pressure on finite water resources.

56. Can the addition of another two or three billion of the very poor over the next 25 years be coped with in the same manner? Much more needs to be known more about how the world can cope with the social fall-out of untrammelled global competitiveness, especially in developing countries. For that reason, getting the FfD paradigm for the twenty-first century is a matter of crucial importance and urgency for the industrial and developing worlds alike. The consequences of continued development failure for the next half-century are too dramatic to contemplate.

Annex
Achieving Convergence in Incomes and Living Standards between the Industrial and Developing World – An Illustration

Except in East Asia,[58] the amount of investment presently occurring as a proportion of GDP in other developing regions is inadequate to generate, on a sustainable long-term basis, the kind of growth rates that the developing world as a whole (and each country in it) needs to aim for if a reasonable degree of convergence of incomes is to be realistically achieved.

What would a reasonable degree of convergence be and by when should it be achieved? One way of looking at the issue is to consider relative income levels of people in the OECD and non-OECD worlds in 1950, 2000 and 2050. That dividing line is used for lack of a better, simpler division among the world's haves and have-nots differentiated across (rather than within) countries. There are of course 'haves' in the developing world and 'have-nots' in the industrial world. But for the purposes of this illustration that complication is ignored and taken care of in the averages.

In 1950 the average per capita income of the 3.6 billion people who lived in the non-OECD world was about 15 per cent that of the roughly 0.65 billion people in OECD countries.

In 2000, the number of people in the developing world had grown to 5.2 billion people (which includes the transition economies). They had an average income of less than 9 per cent of the average income of the 0.85 billion people in the North (also in current dollars). Thus, instead of converging, living standards and incomes have diverged significantly over the last 50 years. As an aside it should be observed that in the last 50 years the developing world added 1.6 billion to its population (a 45 per cent increase) while OECD countries added only 200 million people to their population (a 30 per cent increase).

Of course, real incomes and comparable living standards are not properly reflected by nominal exchange rate translations of per capita incomes across countries. Adjusted incomes at PPP exchange rates provide more valid comparisons. But since reliable PPP series are not available (especially for 1950), nominal translations are taken to suffice for illustrative purposes in this Annex. In PPP terms the gap between the industrial and developing world would not be quite as wide as the nominal exchange rate figures suggest in 2000. While nominal per capita incomes in industrial countries were 11 times higher, the adjusted PPP income figures for 1998 (the latest available) suggest that the real income gap was less – about 6.5 times.

An acceptable degree of convergence would be achieved if the average income of the 7 billion (or more) people in developing countries by 2050 rises to at least one-fifth of the average income of the one billion or so people in the industrial world by then (measured in nominal terms which may translate into a difference of between one-third and one-fourth in PPP terms).

58 The averages for East Asia tend to obscure the reality that apart from the obvious success stories in the region (i.e. Greater China, Korea and the ASEAN countries, in which the Philippines has lagged although since 1997andIndonesia's prospects have been compromised by the conversion of a financial crisis into a political crisis), there are a number of countries, for example countries in Indochina, Myanmar and the Pacific Islands that are not doing as well. Their incomes and growth rates approximate those of South Asia and, in some instances, of Africa.

Table 15. The Relative Incomes of People in the OECD and Non-OECD Worlds 1950–2050
(In current and constant 1990 dollars)

		OECD (A)	Non-OECD(B)	A/B
1950				
Population (billions)		0.60	2.48	1: 4.1
Per capita income:	Current $	$ 3,700	$520	x 7.1
	Constant $	$10,500	$1,460	x 7.1
2000				
Population (billions)		0.85	5.21	1: 6.1
Per capita income:	Current $	$23,300	$2,100	x 11.1
	Constant $	$18,800	$1,700	x 11.1
Memo:	*In PPP (1998)*	*$21,763*	*$3,410*	*x 6.4*
2050 (projected)				
Population: (billions)		1.10	9.10	1: 8.3
Per capita income:	Current $ (E)	$75,000	$15,000	x 5.0
(Targeted)	Constant $ (E)	$35,000	$ 7,000	x 5.0

Table 15, which relies on a series of guesstimates and assumptions, should help illustrate the situation a little more clearly.

For a modest degree of convergence, as defined above, to occur over the next 50 years, the table shows that while average real per capita income in the industrial countries might be expected to nearly double, the increase in developing countries would have to be over 400 per cent.

If the OECD countries grew at an average real rate of about 3 per cent per annum (with an average population growth of about 0.6 per cent) over the next 50 years, developing countries would need to grow at an average rate of 9 per cent annually (with an average annual population growth rate that hopefully will have fallen to about 1.2 per cent). For such a growth rate to be achieved and sustained,[59] the average ratio of GDI/GDP in the South would need to be raised from the present average of around 20 per cent to approximately 33 per cent.

Whatever the outcome of UNCFD, no conceivable increase in external FfD would be large enough to finance that degree of convergence and that leap in investment levels. Nor should it be expected to since that might and imbalance some of the more vulnerable, crisis-prone economies of the developing world.

If this growth rate (and the implied attendant domestic investment levels) were, hypothetically, to be achieved, external FfD could, at most, finance about 8 per cent of global development investment instead of the 4 per cent it is financing now. If that were to occur, the absolute incremental dollar amounts involved would be very large. They would impose budgetary burdens on OECD governments, and on capital markets for sustained net outflows to developing countries that are outside the range of feasible outcomes. The size of such burdens would render even this very modest attempt at achieving convergence impossible.

Yet it would be a brave politician or global statesman who would be prepared to say pub-

59 The practical experience of East Asia, as well as countries such as Finland, Ireland, Portugal and Spain in Europe that were classified as middle-income developing countries as late as the 1970s, is pertinent since that region, and the other countries mentioned, has achieved nearly that average rate of growth between 1970–2000.

licly that, over the next 50 years, the international community should not even aim to achieve a narrowing of income differentials between the industrial and developing worlds to the extent suggested above. Converging at a slower rate would mean condemning developing countries to two centuries or more of continued absolute and relative poverty and degradation – an intolerable, and eventually unsustainable, prospect for the global community.

On the other hand, attempting to converge at the suggested rate or faster in the medium term would be regarded as many pragmatists as impractical enough to verge on the foolish. It would automatically imply that domestic savings in developing countries, ODA budgets, and net private capital flows to developing countries should be increased immediately by multiples of their present levels, and sustained at those increased levels over the next half-century.

East Asia and China have shown that the necessary growth rates can be achieved and sustained under the right conditions. It may take 10–25 years for other regions to emulate that example and achieve the right conditions. India is on the threshold of doing so now if it could sustain the momentum of reform that it launched in 1991–92 but has since dissipated. South Asia as a whole could do so relatively quickly if its long-running regional conflicts could be resolved and its political systems were adapted to result in a lower proportion of output being wasted by frictional losses and rent extraction.

Africa could also achieve these growth rates but over a longer period of time, as it puts in place the human, social and institutional capital foundations needed for sustaining such success. Eastern and Central Europe, Latin America, the Middle East and North Africa could achieve and sustain such growth rates almost immediately if they could resolve their internal political and administrative contradictions, moderate their high propensities for consumption and change their incentive structures and tax systems to favour saving and investment instead. Anchoring these regions to the US dollar and Euro respectively might also assist them in overcoming their inherent proclivities toward high inflation and incessant devaluation (thus discouraging financial saving in domestic currency which ceases to be a store of value). But, achievable though these growth rates might be, they would need to be supported by external official and private flows that are at least twice as large as they are now.

What this illustration is intended to suggest is that the substantive room for discussion and negotiation at UNCFD lies in the space between the unacceptable gap in incomes that exists today between the industrial and developing worlds, and the rate at which that gap should (and can realistically) be narrowed over the next 50 years.

The analysis that needs to be done to inform public debate on reversing divergence (which is exactly the opposite of what asymmetric global development should be trying to achieve) and restoring a trend toward convergence should be deeper and more incisive than the broad brush strokes presented above. It needs to be nuanced by region and country because global averages conceal more than they reveal. But such analysis needs to be made in such a way that it sheds light, rather than heat, and avoids UNCFD being side-tracked into issues of significantly less importance. The composite picture developed for the developing world as a whole needs to be a synthesis of a series of much deeper analyses carried out at country and regional levels in order to be robust and credible.

Clearly such analysis has to be undertaken with a backdrop of:

- Dwindling public concessional flows, i.e. ODA, being provided with rapidly diminishing enthusiasm or conviction that they are

having a significant developmental impact;

- Continued regional misallocation of such scarce ODA flows in terms of need; (
- Flows of foreign direct investment that are not yet large enough or sufficiently widely dispersed across the developing world to make as much of a difference to productive investment as is needed;
- Continued, if concentrated, flows of foreign portfolio capital of a short term and volatile nature whose desirability is often vitiated by the inadequate development and robustness of secondary capital markets in most developing countries;
- Artificially restricted earnings from trade because of the lack of openness of those Northern markets in which developed countries – and particularly the least developed – have any comparative or competitive advantage, i.e. agricultural and food markets, markets for textiles and garments and markets for labour;
- Private voluntary flows that are aimed primarily at humanitarian and emergency relief and at small poverty-reduction projects that do not have a significantly large or long-term developmental impact;
- A gross insufficiency of investment capital on appropriate terms for infrastructure development of a kind that is unlikely to attract much private interest in the short-term;
- The insufficiency of FfD enabling developing countries to contribute to financing international public goods and global commons.

UNCFD will focus on each of these areas as the key areas for discussion and debate. But its deliberations will be enhanced immeasurably if debate in each of these areas is informed by the kind of broad analysis and vision of what it is that the international community is trying to achieve with FfD that has been suggested above.

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