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'.