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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 creditworthiness (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.