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Follow-up to and implementation of the outcome of the 2002 International Conference on Financing for Development and the 2008 Review Conference

Follow-up to and implementation of the Monterrey Consensus and Doha Declaration on Financing for Development

Report of the Secretary-General**

Summary

Pursuant to General Assembly resolution 65/145, the present report provides an annual assessment of the state of implementation of the Monterrey Consensus and Doha Declaration on Financing for Development. The recent developments are presented under each of the six thematic areas: mobilizing domestic financial resources for development; mobilizing international resources for development: foreign direct investment and other private flows; international trade as an engine for development; increasing international financial and technical cooperation for development; external debt; and addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development. Other recent developments related to strengthening of the financing for development intergovernmental follow-up process are presented in a section on "Staying engaged".

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I. Mobilizing domestic financial resources for development

1. After increasing from 25 per cent to almost 31 per cent of gross domestic product (GDP) between 2000 and 2007, the average savings rate in low- and middle-income countries dropped to 28 per cent in 2009 during the course of the financial and economic crisis. However, a number of developing countries and emerging economies were able to enhance the scope for domestic resource mobilization, despite the setback of the recent crisis. Nevertheless, this development has been highly uneven across developing regions. Domestic savings, for instance, stagnated in sub-Saharan Africa, increased moderately in Latin America and the Caribbean and soared in East Asia and the Pacific.[1]

2. Sustained improvement in domestic resource mobilization depends on continued economic recovery. Growth of global output is expected to be 3.3 per cent in 2011 and 3.6 per cent in 2012, down from 3.9 per cent in 2010. Developing countries, particularly the large emerging economies, have been major drivers of the post-crisis expansion of the world economy. In contrast, growth remains feeble in many developed countries.[2] However, there are a number of concerns about growth prospects of developing countries, including the risk of spillovers from developed countries, rising domestic inflation, potential domestic asset price bubbles fuelled by large capital inflows, exchange rate misalignment and commodity price volatility. Macroeconomic policies in many developing countries have shifted to monetary and fiscal tightening and exchange rate appreciation, often in response to higher commodity prices, which may slow down the growth momentum.

3. Financing poverty eradication and expanding employment opportunities, especially for poor and disadvantaged population groups, are important objectives of national development strategies. The Millennium Development Goals Summit (High-level Plenary Meeting of the General Assembly, 20-22 September 2010) recognized the progress made towards achieving the Millennium Development Goals, including in poverty eradication, despite setbacks and mixed performances both within and across developing countries.[3] Extreme poverty worldwide is projected to fall from 25.2 per cent of total population in 2005 to 14.4 per cent in 2015, with sub-Saharan Africa (35.8 per cent) and South Asia (22.4 per cent) accounting for the highest projected poverty rates in 2015.[4] As the ongoing global economic recovery remains fragile and uneven, global unemployment remains elevated compared to the pre-crisis level. The global unemployment rate stood at 6.2 per cent in 2010, well above the rate of 5.6 per cent in 2007. Many countries are facing specific employment challenges such as rising long-term unemployment and high youth unemployment. In terms of economic policies, countries with large trade surpluses and sound macroeconomic fundamentals should consider strengthening domestic demand to boost employment and growth.[5]

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[1] World Bank, *World Development Indicators*.

[2] *World economic situation and prospects as of mid-2011* (E/2011/113).

[3] General Assembly resolution 65/1.

[4] World Bank and International Monetary Fund (IMF), *Global Monitoring Report 2011: Improving the Odds of Achieving the MDGs, Heterogeneity, Gaps, and Challenges.*

[5] International Labour Office, *Global Employment Trends 2011: The challenge of a jobs recovery*; and International Labour Conference, *Recovering from the world financial and economic crisis: a Global Jobs Pact*, 2011.

4. Domestic resource mobilization is a particularly suitable area for exercising national ownership and to developing and implementing policies that are in line with country needs. In contrast to external development financing, key policy and institutional drivers, such as the tax system, are under the direction of Governments. Governments should therefore attach greater importance to domestic resource mobilization within their development strategies.

5. The development of a sound and broad-based financial sector is essential for the effective mobilization and channelling of domestic resources to productive activities. In many developing countries, challenges in financial sector reform remain, including strengthening financial regulation and regional financial markets. However, domestic credit to the private sector in low- and middle-income countries increased from 49 per cent to almost 60 per cent of GDP from 2000 to 2008, albeit with considerable differences across developing regions.[6]

6. In recent years, the concept of financial inclusion has gained higher priority on the policy agenda. The concept is based on the notion that access to a wide range of financial services by poor and vulnerable population groups and small- and medium-sized enterprises is beneficial for development and domestic resource mobilization. Inclusive finance represents a more holistic approach than microfinance and includes savings, payment, insurance and other services tailored specifically to the needs of low-income borrowers and savers.[7] Group of Twenty (G-20) leaders, at their Seoul summit in November 2010, launched the Global Partnership for Financial Inclusion to advance the financial inclusion agenda in cooperation with non-G-20 members, the United Nations and other international stakeholders.

7. Given the need for public investments in the development process, the generation of public revenues is a critical component of domestic resource mobilization. Increasing government revenues remains a major challenge in a number of developing countries. During the recent financial crisis, government revenue in emerging economies and developing countries dropped[8] from an average of about 29 per cent in 2007/08 to 27 per cent of GDP in 2010, mainly on account of slower growth, compared to an average level of 36 per cent in the advanced economies.[9] Growth-promoting policies are central to raising public revenues. Tax collection efforts can also be supported by appropriate tax policies, modernized, transparent and equitable tax systems, effective tax administrations, broadening of the tax base and combating tax evasion. Therefore, developing countries should step up fiscal and tax reform efforts. International tax cooperation, including its institutional arrangements, should be further strengthened.[10]

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[6] World Bank, *World Development Indicators*. In some cases, fluctuations in the ratio of domestic credits also reflect constraints in accessing external financing.

[7] United Nations, *Building inclusive financial sectors for development*, 2006; *United Nations Secretary-General's Special Advocate for Inclusive Finance for Development, Annual Report to the Secretary-General*, September 2010.

[8] For discussion of the impact of the global economic crisis on fiscal space in developing countries, see *The Global Social Crisis: Report on the World Social Situation 2011* (ST/ESA/334).

[9] IMF, World Economic Outlook database, April 2011, available from www.imf.org.

[10] E/2011/76 provides an overview of initiatives to increase international tax cooperation, including the International Tax Dialogue (a joint initiative by the World Bank, IMF, OECD and other stakeholders).

8. Dynamic private sectors are the main drivers of growth, employment, investment and innovation. Governments should continue to establish regulatory and policy frameworks that are conducive to private productive activities. A number of developing countries have improved business regulations and developing countries in general have become increasingly active in regulatory reform.[11] Policies should in particular target small- and medium-sized enterprises to foster productive employment and strengthen local industries.

9. Illicit financial flows constitute a drain on resources that could be used for development purposes.[12] It remains vital that effective national and international measures be taken to combat money-laundering and tax evasion. The Committee of Experts on International Cooperation in Tax Matters has enhanced efforts to address tax evasion and to foster relevant information exchange. The Committee is also preparing a manual on transfer pricing to provide practical guidance on this issue to developing countries.

10. Corruption represents an obstacle for domestic resource mobilization and allocation. It is necessary to continue combating corruption at all levels, including through effective legal and judicial systems and enhanced transparency. An important international legal instrument in this regard is the United Nations Convention against Corruption, which entered into force in December 2005 and currently has 152 parties.

11. In the future, substantial resources will need to be mobilized for the transition towards a green economy, as well as to address the impacts of climate change. It is estimated that about 2 per cent of global GDP, or $1.3 trillion, should be spent annually for green technology investments.[13] While a part of this need in developing countries will be covered through external sources, it will also require adjustments in domestic resource generation and allocation and public investment. In addition, for many developing countries a priority is to invest in food security and reduced vulnerability against shocks emanating from global markets.[14]

II. Mobilizing international resources for development: foreign direct investment and other private flows

12. There has been a strong revival in private capital flows to developing countries, following the sharp downturn during the recent global financial and economic crisis. Net private capital flows to developing countries are estimated to have risen from about $325 billion in 2009 to about $392 billion in 2010.[15] Stronger growth and higher interest rates in developing countries have attracted investors, especially when compared with sluggish economic prospects and low interest rates in a number of advanced economies. In addition, developing economies exhibit

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[11] World Bank/International Finance Corporation, *Doing Business 2011: Making a Difference for Entrepreneurs*.

[12] See United Nations Development Programme (UNDP) discussion paper, *Illicit Financial Flows from the Least Developed Countries: 1990-2008*, May 2011.

[13] United Nations Environment Programme (UNEP), *Towards a Green Economy: Pathways to Sustainable Development and Poverty Eradication*, 2011.

[14] *World Economic Situation and Prospects as of mid-2011*.

[15] IMF, World Economic Outlook database, April 2011.

favourable risk characteristics, given continuing fiscal and public debt problems in some developed countries, especially in Europe.

13. Foreign direct investment remains a major component of private capital flows to developing countries and is estimated to have amounted to over $300 billion in 2010.[16] While foreign direct investment and other private capital flows have been concentrated in selected developing countries, there are signs of greater diversification. Investment in Africa is significantly higher than a decade ago. Whereas a large portion of these flows continues to go into the natural resource sector and to some commodity-rich countries, the region has also been attracting investments in agriculture[17] and new service sectors. Since 2006, foreign direct investment flows to the least developed countries have been larger than bilateral official development assistance (ODA). Nevertheless, the distribution of foreign direct investment flows among least developed countries remains uneven, with over 80 per cent of the capital going to resource-rich economies in Africa.[18] By contrast, while a far lower share of foreign direct investment has gone to least developed countries in Asia, those investments have tended to flow towards such sectors as telecommunications and electricity.[19]

14. The development impact of foreign direct investment tends to be most pronounced where it forges linkages with the wider local economy. Foreign direct investment has generated positive linkages in Asian least developed countries while its effect has been more limited in Africa. This could relate to its concentration in a few primary sectors in Africa, with limited linkages to the rest of the economy, unlike Asia where it is more diversified.[20] While in the longer term efforts need to be made to diversify investments in Africa, it is also important to have in place appropriate policies and regulation to ensure that foreign investment into the extractive industries is consistent with the broader objectives of sustainable development.

15. While each country is responsible for its tax system, decisions taken in this area, including with the objective of attracting foreign direct investment, can have adverse effects on other countries. In this respect, there remains a need for broader and deeper international cooperation, including in United Nations forums, to minimize harmful tax competition and to stem the resulting loss of tax revenues, particularly in resource-rich nations.

16. In recent years, developing and transition countries have become increasingly important investors and their share in total global foreign direct investment outflows increased from 16 per cent in 2007 to about 29 per cent in 2010.[21] Countries such as Brazil, China, India, the Russian Federation and South Africa have become increasingly significant outward investors. Over two thirds of their investments have

[16] Ibid.

[17] There are concerns that large-scale foreign investments in agriculture will displace small farmers and local food production with adverse impacts on employment and the environment.

[18] IMF, World Economic Outlook database, April 2011. Four mostly natural resource-exporting countries — Angola, Equatorial Guinea, the Sudan and Zambia — received over half of total foreign direct investment in least developed countries.

[19] United Nations Conference on Trade and Development (UNCTAD), *Foreign Direct Investment in LDCs: Lessons Learned from the Decade 2001-2010 and the Way Forward*, May 2011.

[20] Ibid.

[21] UNCTAD, *World Investment Report 2011*.

been directed towards other developing and transition countries and their companies have accounted for a rising share of investment in least developed countries.[22] While the activities of these investors in Africa have mostly focused on the natural resources sector, there are signs of diversification into sectors with higher development impact, such as telecommunications, financial services, infrastructure and tourism. More generally, the scope for beneficial linkages and technology absorption from South-South foreign direct investment is increased by the fact that the technology and skills of developing-country transnational corporations are often closer to those used by firms in host countries. Policymakers should therefore promote South-South investment flows, particularly those with a positive development impact, through greater South-South cooperation.

17. Other components of private capital flows to developing countries, including international bank lending and portfolio investments, have continued to recover following the crisis. A large share of the increase in cross-border lending to emerging markets has been directed towards rapidly growing economies, especially China and Latin America, where Brazil has accounted for a large proportion of international bank loans. Cross-border bank lending nevertheless remains weighed down by continuing financial difficulties faced by advanced-country banks.[23]

18. Portfolio investments also staged a recovery in the aftermath of the crisis and have been directed mainly towards middle-income emerging economies, especially in Asia and Latin America. Equity flows to developing countries were particularly strong in 2010 and stock markets in developing countries have regained much of the value lost during the crisis.[24] Equity issuance rose to historically high levels in some countries, especially Brazil and China, and was buoyant in other emerging economies such as the Republic of Korea and India. The recovery in portfolio debt inflows has also triggered strong issuance of corporate debt in a number of emerging markets, especially in Latin America.[25]

19. Despite its possible contribution to development, the surge in foreign capital may make the domestic financial sector more vulnerable and cause asset price bubbles. Moreover, short-term capital flows are increasing at a time when inflationary pressures are rising in some economies. This may complicate policies to curb inflation, since higher interest rates may attract greater short-term capital flows. The sharp rise in short-term capital inflows is also putting upward pressures on exchange rates, with the potential of adversely affecting the export competitiveness of some countries. There are also concerns that these economies may be vulnerable to sharp reversals in these sources of capital brought about by external developments.

20. Stability risks associated with capital flows have led several emerging economies to introduce measures to contain the negative impact of the surge in short-term capital flows. While the effectiveness of capital controls may vary, it is important that countries have the policy space to employ measures to effectively curb excessive short-term capital inflows in line with article VI of the International Monetary Fund (IMF) Articles of Agreement. More broadly, there is a need for consideration at national, regional and international levels of ways to mitigate the

[22] UNCTAD, *Global Investment Trends Monitor*, 27 April 2011.
[23] Bank for International Settlements, *BIS Quarterly Review*, March 2011.
[24] World Bank, *Global Economic Prospects 2011: Navigating Strong Currents*, January 2011.
[25] IMF, *Global Financial Stability Report*, April 2011.

pro-cyclicality of private capital flows. These include the adoption of countercyclical regulations and instruments, as well as effective supervision of all the sources of systemic risk, including those arising from hedge funds and derivative instruments. Better designed exchange rate systems based on the principle of constant and sustainable real exchange rates of all countries could further reduce the scope for speculative capital flows.

21. Officially recorded remittances to developing countries are estimated to have totalled $325 billion in 2010, representing a year-on-year increase of 6 per cent after a modest decline in 2009.[26] While the largest recipients of remittances in 2010 were India, China, Mexico and the Philippines, they have constituted an important source of income for smaller low-income countries and amounted to more than 20 per cent of GDP in a number of them.[27] The large growth in remittances during the past decade reflects the increase in international migration and better measurement of remittances. It also highlights the increasingly important role of diaspora communities as providers of external finance. Apart from remittances, their contribution has included the provision of equity finance and the facilitation of foreign direct investment and trade linkages. Greater efforts need to be made by both host and home countries to tap the economic potential of diasporas, for example through diaspora bonds, including through providing an enabling legal, regulatory and institutional environment and reducing remittance costs.

III. International trade as an engine for development

22. After a deep decline in 2009, world trade rebounded by almost 12 per cent in 2010 and is expected to grow by about 7 per cent in both 2011 and 2012.[28] Developing countries have been leading the recovery, while trade by developed economies continues to teeter below pre-crisis levels. As a result, the share of developing countries in global trade increased from about one third to more than 40 per cent between 2008 and 2010. However, since mid-2010 world trade growth has lost steam and the short-term outlook is clouded by a number of significant risk factors, including rising prices for food, energy and other primary products, high levels of unemployment and debt crises in developed economies.

23. As a reaction to economic uncertainties, protectionist measures are on the rise. G-20 Governments have introduced more trade barriers between mid-October 2010 and the end of April 2011 than in the previous periods since the financial crisis began. In addition, new import-restrictive measures taken by G-20 economies over the period from October 2010 to April 2011 have doubled to 0.6 per cent of total G-20 imports compared to the previous six months.[29] Greater export restrictions have further increased the total of world trade affected by new restrictions since the crisis began.

24. The global crisis has distracted some of the attention of policymakers from the Doha Round of multilateral trade negotiations, which was launched a decade ago by the World Trade Organization (WTO). As part of their continued efforts to work

[26] However, the local currency value is smaller owing to United States dollar depreciation.

[27] World Bank, *Outlook for Remittance Flows 2011-12*, Migration and Development Brief No. 13, 8 November 2010.

[28] *World economic situation and prospects as of mid-2011* (E/2011/113).

[29] OECD/UNCTAD, *Fifth Report on G-20 Investment Measures*, 24 May 2011.

towards a balanced, development-oriented and far-reaching outcome of the Doha Round, WTO members should pay particular heed to key issues of special interest to developing countries, particularly those contained in the Monterrey Consensus. However, despite several attempts, progress has been slow on these issues, especially in the areas of agriculture, non-agricultural market access and services and special and differential treatment for developing countries.

25. In addition, agricultural subsidies, particularly those on rice, sugar and cotton, continue to pose economic burdens on developing countries. Overall, developed-country support to agricultural production experienced the first increase after five years in 2009 and now totals $253 billion.[30] Disconcertingly, the most distorting forms of support accounted for more than half of those measures.[31] While tariff levels and structures remain a barrier to trade in many sectors, non-tariff measures are proliferating as well. More progress is therefore needed to ensure that regulations, standards, testing and certification procedures do not create unnecessary trade obstacles.

26. In the absence of significant progress of multilateral trade negotiations, regional, bilateral and plurilateral trading arrangements continue to proliferate. More than half of world trade is subject to multiple preferential arrangements. Of the almost 300 preferential trade agreements currently in force, about half have come into effect since 2000. While regional integration and bilateral trade have been important elements of the multilateral trading system, they tend to discriminate against other trading partners by eroding the most favoured nation principle. Furthermore, deeper and broader commitments than those taken within the context of the multilateral trading regime of WTO have made it difficult for many developing countries to utilize policy space, a constraint which is evidenced by the large gap between WTO bound and applied tariff rates.[32]

27. Despite the growing role of developing countries in world trade, the share of least developed countries in global trade has remained constant at 0.33 per cent (excluding oil) since the adoption of the Monterrey Consensus.[33] The 2010 Millennium Development Goals Summit reiterated the call for duty-free and quota-free access for least developed countries by 2015. While most countries offer import concessions to least developed countries, the proportion of the latter’s global exports that actually enter markets duty-free and quota-free is in some cases as little as 50 per cent.[34] Duties on imports from least developed countries still amount to almost as much as duties saved through special non-reciprocal preferences for those countries.[35] Greater coverage for products of commercial interest to least developed countries and simplified rules of origin could substantially strengthen the development impact of duty-free and quota-free market access. Yet, important market access measures of benefit to least developed countries remain blocked within the Doha Round, essentially because of policy disagreements between developed and emerging economies on other matters.

[30] OECD, *Agricultural Policies in OECD Countries 2010*, p. 5.
[31] Ibid.
[32] UNCTAD, *LDC Report 2010*, p. 183.
[33] Ibid., p. 90.
[34] “An ‘Early Harvest’ not so ‘early’ after all”, UNCTAD Policy Brief No. 20/B, April 2011.
[35] International Trade Centre (ITC), “Market access, transparency and fairness in global trade-export impact for good 2010”.

28. Least developed countries have called for an “early harvest”[36] on the implementation of the provisions of the WTO Hong Kong Ministerial Declaration concerning duty-free and quota-free access for all products originating from all least developed countries.[37] Critical elements of an early harvest also include a waiver to accelerate services exports from least developed countries, preferential and more favourable treatment to services and service suppliers and the elimination of trade-distorting support measures for cotton. Efforts are currently under way to reach such a first-step Doha Round outcome at the December 2011 Ministerial Conference in Geneva. At the same time, it is important to address potential adjustment challenges, as extending product coverage to 100 per cent will lead to an erosion of trade preferences for some least developed countries.

29. Least developed countries feature limited productive capacities, which constrain their ability to diversify their economies and increase their exposure to international price shocks. While commodity exchanges have the potential to reduce this type of volatility by facilitating price discovery and the transfer of risk, their increasing “financialization” has threatened to undermine their hedging potential. Financial investments have caused price shifts that are unrelated to the relative scarcity of primary commodities. As a result, increased transaction costs have reduced the affordability of hedging for many developing countries.

30. Concerted measures and actions will be needed to support efforts by least developed countries to reduce commodity dependence, including through the diversification of their export base, and to mitigate the adverse effects of commodity price volatility. This includes helping developing countries to enter vertically integrated production chains, as well as increase the value added involved in their participation in global value chains.

31. Total aid for trade grew to $40.1 billion in 2009.[38] Well-targeted and country-owned support measures can help develop trade-related skills, build trade-related infrastructure and promote measures for product diversification. These types of strategically integrated trade support measures are of particular benefit to least developed countries, whose export portfolios are typically not diversified. Aid targeted at very specific constraints, such as the Standards and Trade Development Facility projects for building capacity in the area of food safety, plant and animal health, can also be particularly beneficial to least developed countries.

32. Recent increases of aid for trade directed to least developed countries have been encouraging. Commitments rose from $5.2 billion in 2002 to $12.1 billion in 2009. Yet, the distribution of aid for trade remains skewed, as two thirds of the assistance goes to only 10 least developed countries. In this context, the 2011 Istanbul Programme of Action (A/CONF.219/3/Rev.1) has called for development partners to implement effective trade-related technical assistance and capacity-building to least developed countries on a priority basis, including by enhancing the share of assistance to least developed countries for aid for trade and support for the Enhanced Integrated Framework. Given the economic vulnerability of least developed countries, new aid for trade commitments should be predictable, mostly grant-based and additional to existing ODA commitments. Trade finance

[36] See the Dar es Salaam Declaration adopted at the Sixth LDC Trade Ministers’ Meeting, held in Dar es Salaam from 14 to 16 October 2009 (WTO document WT/MIN(09)/2).

[37] WTO document WT/MIN(05)/DEC, decision 36 of annex F.

[38] WTO/OECD, *Aid for trade to the LDCs: Starting to show results*, 2011, p. 9.

programmes should also be available to reduce transaction costs and ensure stability to exporters.

IV. Increasing international financial and technical cooperation for development

33. Despite increases in aid flows to developing countries, aid delivery fell short of commitments. In 2010, net ODA from member countries of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) reached a record level of $129 billion, representing 0.32 per cent of DAC members' combined gross national income (GNI). This represents considerable progress from the 2001 aid level (i.e. $53 billion or 0.22 per cent of GNI).[39] However, net ODA/GNI ratios of many larger donors remain below the United Nations target of 0.7 per cent, while five countries (Denmark, Luxembourg, the Netherlands, Norway and Sweden) exceed that target. Global aid delivery also fell $21 billion short of the $50 billion increase pledged for 2010 at the 2005 Gleneagles Group of Eight Summit.[40] Moreover, the Group of Eight did not deliver on its promise to increase aid to Africa by $25 billion (in 2004 prices). With aid delivery to Africa estimated at $46 billion in 2010 (or $40 billion in 2004 prices), the delivery gap is projected to be $18 billion (or $15 billion in 2004 prices).[41] At the same time, South-South cooperation increased from $1.9 billion in 2005 to $4.6 billion in 2009.[42] Moreover, two thirds of DAC donors have become involved in triangular cooperation.

34. From 2000 to 2009, the DAC member countries' ODA to least developed countries rose from 0.05 per cent (or $12 billion) of aggregated GNI to 0.10 per cent (or $37 billion).[43] Yet, this level of ODA is still well below the target of 0.15-0.20 per cent by 2015. Moreover, while country programmable aid[44] to the majority of least developed countries is projected to increase by a total of $3.1 billion from 2009 to 2012, 13 countries are likely to face a reduction of $0.8 billion, with virtually no growth projected for 2012.[45] The 2010 Millennium Development Goals Summit reiterated the critical importance of fulfilling all ODA commitments and encouraged all donors to establish timetables to reach their goals.[46] Likewise, the Istanbul Programme of Action called upon donor countries to implement their ODA commitments by 2015 and consider further enhancing the resources for least developed countries.[47]

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[39] OECD aggregate aid statistics database, "ODA by donor" (available from http://stats.oecd.org).

[40] United Nations, *The Millennium Development Goals Report 2011*, chap. II.

[41] Ibid.

[42] Calculation based on OECD "Statistics on resource flows to developing countries", 23 December 2010, table 33.

[43] Ibid., table 31.

[44] Country programmable aid is the portion of aid that each donor can programme for each recipient country, thus reflecting more predictable flows of aid that are available for recipient country planning and spending according to national priorities.

[45] Economic and Social Council Development Cooperation Forum, "Background study for the 2012 Development Cooperation Forum: Trends in international financial cooperation for LDCs", 29 April 2011.

[46] General Assembly resolution 65/1, para. 78 (f).

[47] A/CONF.219/3/Rev.1, para. 116.2.

35. A large share of aid continues to be allocated to social infrastructure and services. In 2009, DAC members' aggregated commitments to this sector accounted for 43 per cent of total commitments, compared to 32 per cent in 2000.[48] Aid to productive sectors represented only 8 per cent of DAC commitments in 2009.[49] The Istanbul Programme of Action requests development partners to focus aid to least developed countries on productive capacity development. In addition, to enhance agricultural productivity and sustainability in developing countries, the Millennium Development Goals Summit stressed the need for directing more aid to agriculture.

36. The concentration of aid in a limited number of developing countries has not changed in the past decade. The top 20 of around 150 DAC ODA recipients received 40 per cent of the total annual average ODA in both 1990-1999 and 2000-2009.[50] To avoid over-concentration of aid, the allocation of aid requires further improvement on the basis of recipients' needs and consideration of vulnerabilities. Although some least developed countries are included in the top 20 aid recipients, they have not received a greater share of ODA than other developing countries.

37. Further advances have been made in increasing the grant element of total ODA commitments. Grants as a share of ODA increased from 94 per cent in 1998-1999 to 96 per cent in 2008-2009. Progress has been slower, however, in the areas of untied aid, donor coordination and appropriate financial support in post-conflict situations.[51] Likewise, further progress is needed to improve aid predictability, especially medium-term predictability and aid transparency.[52] More donor information on multi-year spending intentions would help facilitate better forward planning by recipient countries. Greater aid coordination and harmonization would help avoid further fragmentation and duplication of donor programmes.

38. There is a need to further strengthen the follow-up to commitments on development cooperation by improving existing global monitoring and evaluation mechanisms and exploring new modalities, such as international peer reviews. The Fourth High-Level Forum on Aid Effectiveness, to be held in Busan, Republic of Korea from 29 November to 1 December 2011, and the 2012 Economic and Social Council Development Cooperation Forum will provide important opportunities to reassess the aid effectiveness agenda.

39. Aid flows to fragile and conflict-affected countries have been more volatile than those to other countries, despite their greater need for sustainable and predictable aid. Volatility in development assistance reduces aid effectiveness. Furthermore, donors often undertake small short-term projects implemented through systems parallel to national institutions and thus important opportunities for institution-building are missed.[53] In the Dili Declaration, the representatives of the g7+ addressed these and other challenges in peacebuilding and State-building and called for improved aid delivery systems in support of a transition towards Government-led delivery through country systems.[54]

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[48] OECD aggregate aid statistics database, "ODA by sector" (available from http://stats.oecd.org).
[49] Ibid.
[50] *OECD, Development aid at a glance, statistics by region: 1. Developing countries, 2011 edition* (www.oecd.org/dataoecd/59/5/42139479.pdf), table 1.2.9.
[51] United Nations, *The Millennium Development Goals Report 2011*, chap. II.
[52] See also International Aid Transparency Initiative.
[53] World Bank, *World Development Report 2011: Conflict, Security, and Development*.
[54] "Dili Declaration: a new vision for peacebuilding and statebuilding", 10 April 2010 (www.oecd.org/dataoecd/12/30/44927821.pdf).

40. Innovative financing mechanisms are estimated to have generated $37 billion in revenues for climate change and environment, mostly from carbon emission trading. Given the tremendous financing needs of developing countries in these sectors, these initiatives should be further explored and, where appropriate, expanded. Moreover, it is important to ensure that least developed countries, with relatively low levels of emissions, are not by-passed by these mechanisms.[55] Since these financial and investment flows mostly come from private sources, they are considered additional to existing ODA.[56] However, the extent of "additionality" of innovative financing to traditional sources of development finance in other sectors is much lower. For example, in the health sector, with the largest number of operational mechanisms, only $0.2 billion of the total estimated revenues of $5.5 billion raised by selected mechanisms in 2002-2010 was reported as "additional" to ODA, based on OECD classification.[57]

41. The Leading Group on Innovative Financing for Development recently identified a centrally collected multicurrency transaction tax as the most appropriate mechanism to fund global public goods, with the potential to raise $25-34 billion annually (at the rate of 0.005 per cent).[58] Financial transaction taxes were also examined by the Secretary-General's High-level Advisory Group on Climate Change Financing as a potential mechanism to finance the Copenhagen Accord commitments.[59] A further step would be to devise appropriate modalities to manage these resources. Recognizing the development potential of innovative sources of finance, the General Assembly decided to convene at its sixty-sixth session a separate meeting of the Second Committee to consider the question of innovative mechanisms of financing for development.[60]

V. External debt

42. Debt indicators improved in many developing countries in 2010, despite an increase in nominal external debt of 8 per cent, thanks to a recovery in growth and exports.[61] The ratio of external debt to GDP decreased from 23.7 per cent in 2009 to 21.6 per cent in 2010. Estimates for the ratio of external debt service to exports of goods and services for 2010 also show a return to pre-crisis levels for all income groups, reaching 6.5 per cent in low-income countries, 19 per cent in lower-middle-income countries and 35 per cent in upper-middle-income countries.[62] However, there is considerable divergence across regions and countries. For example, debt levels in the Caribbean continued to deteriorate and the debt service ratio reached

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[55] World Bank, *Carbon Finance at the World Bank, 10 years of Experience in Carbon Finance: Insights from working with the Kyoto mechanisms*, 2010.

[56] OECD Working Party on Statistics, "Mapping of some important innovative finance for development mechanisms" (OECD document DCD/DAC/STAT/RD(2011)1/RD1), 7 February 2011.

[57] Ibid.

[58] Leading Group on Innovative Financing for Development, *Globalizing Solidarity: the Case for Financial Levies, Report of the Committee of Experts to the Taskforce on International Financial Transactions for Development*, Paris, 2010.

[59] United Nations, *Report of the Secretary-General's High-level Advisory Group on Climate Change Financing*, 5 November 2010.

[60] General Assembly resolution 65/146.

[61] IMF, *World Economic Outlook April 2011*, table B22.

[62] IMF, World Economic Outlook database, April 2011, available from www.imf.org.

17.3 per cent in 2010, up from 11.5 per cent in 2006, while in Southern Asia it stayed around the 19.4 per cent average observed in 2008-2009, as compared to 16.7 per cent in 2007. In Oceania, the increase in debt slightly outpaced the increase in exports.[63] Moreover, across regions, 20 countries remain at high risk of or are already in debt distress.[64]

43. The Heavily Indebted Poor Countries Initiative, together with the Multilateral Debt Relief Initiative, had reduced the debt of 36 post-decision-point heavily indebted poor countries[65] by over 80 per cent by the end of 2010.[66] From 1999 to 2010, the aggregated debt-service payments of the 36 post-decision-point countries fell from 18 per cent of exports to 3 per cent and the present value of debt to GDP declined from 114 per cent to 19 per cent. The fiscal space created by the reduced debt burden has been used in part to increase spending for poverty reduction. Related expenditures were projected to have increased from 44 per cent of revenue in 2001 to 57 per cent of revenue in 2010.[67]

44. The rise in public expenditure and decreased revenue resulting from the global crisis increased fiscal deficits, partly financed through rising domestic debt, to 3.7 per cent of GDP for low-income countries and 4.5 per cent for middle-income countries in 2009. Owing to the economic recovery, however, fiscal deficits decreased slightly in 2010 to 3.6 per cent and 3.7 per cent in low- and lower-middle-income countries, respectively. Upper-middle-income countries have not yet recovered the surplus they exhibited until 2008, with a deficit of 3 per cent of GDP in 2010, compared to a surplus of 1 per cent in 2006-2008.

45. High public debt-to-GDP ratios in many developing countries can be a cause for concern, particularly for countries with external vulnerabilities. Sixty countries featured public debt-to-GDP ratios over 40 per cent in 2010 (17 low-income countries, 22 lower-middle-income and 21 upper-middle-income countries).[68] In order to better assess the implications of such high levels of public debt, vulnerability indicators need to be refined further and incorporate other closely related factors, such as the composition and the maturity structure of debt, purpose of loans, the level of interest rates, inflation, growth prospects and the potential for external shocks.

46. Spillover effects from the European debt crisis and other risk factors, such as volatile energy and food prices and exchange-rate instability, could significantly affect the outlook for debt sustainability in many developing countries and emerging economies. The prospects of economic growth in developed countries, and thus global demand, are also expected to be affected by the deleveraging of the sizeable public and private debts in those countries, affecting the prospects for developing countries through the real economy. The policy response in Europe has been to bail out the affected countries with official resources and recently some “bail-ins” by the

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[63] Ibid. Discrepancies exist between World Bank and IMF databases.

[64] IMF, “List of LIC DSAs for PRGT-Eligible Countries, As of August 4, 2011” (www.imf.org/external/pubs/ft/dsa/dsalist.pdf).

[65] The number of Multilateral Debt Relief Initiative beneficiary countries is 32, excluding 4 interim heavily indebted poor countries.

[66] World Bank, “HIPC At-A-Glance Guide (Spring 2011)”.

[67] International Development Association and IMF, “HIPC Initiative and MDRI — Status of Implementation”, 14 September 2010.

[68] Based on IMF World Economic Outlook database, April 2011.

private sector. The subsequent lack of confidence of the private sector highlights the challenges and limited efficacy of crisis management without a clear set of principles and procedures. The absence of an efficient and fair debt restructuring mechanism makes resolving debt problems an arduous and costly process. The practical options going forward to enhance the financial architecture for debt restructuring could be discussed at the United Nations, with the participation of all relevant stakeholders from the official and private sectors.

47. Debt-related flows to emerging economies and developing countries increased in 2010, reaching $373 billion after the sharp decrease in 2008-09. Borrowing from banks, and especially from other private creditors, recovered from the steep decline observed in 2008-09, while medium- and long-term financing from official creditors decreased from 48 per cent of debt-related flows in 2009 to 16 per cent, similar to the 15 per cent observed in 2008.[69]

48. The share of Government creditors that are members of the Paris Club in total debt has become relatively small owing to increased borrowing from multilateral, private sector and emerging market creditors and earlier debt reduction operations provided by the Paris Club. Paris Club lenders accounted for 20 per cent and 13 per cent of the debt for low- and lower-middle-income countries in 2009, while their share for upper-middle-income countries was only 2 per cent.[70] Since flows from non-Paris Club creditors are on the rise, new modalities may be needed to deal with problems in debt owed by emerging economies and developing countries to non-Paris Club creditors.

49. In addition, the growing importance of private debt in total external debt poses new challenges for the Paris Club, which requires its debtors to seek comparable treatment from other creditors, including private creditors. The legal basis for private and official non-Paris Club creditors to provide treatment comparable to that of the Paris Club is weak and non-binding. There are also issues related to transparency and efficiency of the process, such as problems in debt data reconciliation and the interest rate at which debt reschedulings are carried out. There are also possible conflicts of interest between the role of IMF as a preferential creditor in official debt restructuring on the one hand and its role in assessing the financing gap to be filled by the Paris Club on the other.

50. The main debt sustainability monitoring instruments — the joint World Bank-IMF Debt Sustainability Framework for low-income countries and the IMF Debt Sustainability Analysis for market access countries — are currently under review. In this connection, it is crucial that the total liability structure of public and private debt, domestic and external, including contingent liabilities in the financial sector, as well as the purpose and cost-benefit analysis of loans, be taken into account when gauging debt sustainability. Further measures should be taken to improve the data availability and reliability for these liabilities in reporting procedures. Debt problems often occur due to natural disasters, international financial volatility and other exogenous shocks, despite good policies and debt management. Structural vulnerabilities to shocks can therefore be as important as policy and institutional quality, which are the main factors accounted for in the current World Bank-IMF debt sustainability frameworks. Further technical work at the inter-agency level

[69] IMF, *World Economic Outlook April 2011*, table B18.

[70] Paris Club website (www.clubdeparis.org) and IMF, *World Economic Outlook April 2011*.

could play a useful role in enhancing the analysis and effectiveness of these frameworks.

VI. Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development

51. The international community has continued its efforts to reform the international monetary and financial system in the key areas of financial regulation and supervision, multilateral surveillance and macroeconomic policy coordination, sovereign debt, global financial safety net and the international reserve system.[71] The issue of international financial stability has increasingly been viewed in the context of reforming the mechanisms of global economic governance. The challenge is to enable the international community to respond to global risks in a more coherent, effective and cooperative fashion.

52. The Bretton Woods institutions have taken steps to improve their governance structures. The second phase of governance reform of the World Bank, agreed upon in April 2010, foresees a shift in voting power to developing and transition countries, with a commitment to move, over time, towards equitable voting power. The IMF 2008 quota and governance reform entered into force on 3 March 2011. In December 2010, the IMF Board of Governors approved quota and governance reforms under the fourteenth General Review of Quotas. The reforms, which still need to be ratified in order to become effective by the 2012 annual meetings, will double member countries' quotas, shift more than 6 per cent of quota shares to developing countries, without lowering the quota shares and voting power of the poorest members, and facilitate the move to a more representative Executive Board. A review of the current quota formula will be conducted by January 2013. Along with the full implementation of the agreed reforms, it is important to continue work on various governance issues, including further improvement of the governance structure, enhancing the diversity of management and staff and developing open, transparent and merit-based selection processes for senior leadership.

53. In response to the financial crisis, a number of international initiatives to reform financial regulation are under way. Important priority areas are the implementation of the Basel III international regulatory framework for banks,[72] new rules for systemically important financial institutions and adequate regulation of the shadow banking system. It is vital to implement new regulations in a globally consistent and development-friendly manner and to discourage attempts to achieve a national competitive advantage in the reform process. Besides regulatory reform, there is a need for a higher degree of international cooperation in financial supervision, as potential systemic risks are mainly a cross-border phenomenon.

54. It is recognized that IMF needs to pay more attention in its surveillance activities to financial sector issues, policy spillovers, especially those coming from systemically important countries and financial centres, and cross-border linkages. In order to strengthen the Fund's global monitoring role, a trial spillover analysis is being conducted for the five major economies. It has also been decided to prepare a

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[71] A/66/167.

[72] There are concerns that Basel III may have an adverse impact on trade and development finance.

new consolidated multilateral surveillance report, which will include analysis of potential spillover effects drawing on a wider range of information. Enhancing international coherence and coordination among national economic policies in the interest of improved financial stability and sustainable global growth should become a central objective of the IMF work.

55. It is recognized that economic policy coordination within the G-20 during the crisis was instrumental in averting an even more serious downturn and in setting the stage for recovery. In the aftermath of the crisis, it is critical that macroeconomic policy coordination be sustained, strengthened and institutionalized on the multilateral agenda to ensure robust recovery. However, the informal G-20 process, from which the vast majority of United Nations Member States is excluded, needs to develop greater legitimacy, including through forging stronger institutional linkages with non-member States and universal international bodies such as the United Nations. There is a need for clearer procedures to ensure complementarity of efforts between the G-20, the United Nations and other multilateral organizations.

56. The attainment of balanced and sustainable growth also requires close coordination of macroeconomic policy issues with other areas of global governance, including those related to the multilateral trading system, aid, debt, migration and climate change. No specific procedure for such coordination exists at present and its creation might warrant consideration.

57. In the aftermath of the financial crisis, the issue of the volatility of capital flows to emerging economies has taken a centre stage on the policy agenda. The debate has focused on the question of how to respond to potentially destabilizing capital movements and which policy instruments to use. Complementary options include macroeconomic and prudential policy instruments as well as capital controls. However, measures to deal with capital flows may have multilateral repercussions. Consequently, in the era of financial globalization, there may be a need for internationally agreed principles on the management of cross-border capital flows.

58. IMF is working to develop a framework to help countries deal with large capital inflows.[73] The goal of the framework is to assess policy options for capital flow management and to determine the appropriate circumstances for such measures. Policy advice and cooperation on capital flows should encompass both recipient and originating countries.

59. Rising public debt in developed countries has increasingly been perceived as a major source of instability for the global financial system. To address this issue, there is a need to ensure medium-term fiscal sustainability without destabilizing financial markets. These efforts should be internationally coordinated and well timed in order not to damage recovery prospects. It has also been suggested to develop an international framework for sovereign debt restructuring.

60. The global financial safety net was strengthened during the recent crisis and its aftermath. In particular, IMF credit facilities have been enhanced by modifying the existing Flexible Credit Line and establishing the Precautionary Credit Line. Resources available for IMF lending have increased significantly, including the

[73] IMF, “Recent Experiences in Managing Capital Inflows — Cross-Cutting Themes and Possible Policy Framework”, 14 February 2011, and IMF Staff Discussion Note, “Managing Capital Inflows: What Tools to Use?”, 5 April 2011.

doubling of quota resources to approximately $750 billion, as yet to be ratified, and expanded borrowing arrangements with member countries and central banks. Despite these initiatives, there is scope for further enhancing international liquidity support. The creation of a multilateral mechanism to provide financing in systemic crises should be kept under consideration. An important element in strengthening the global financial safety net is closer cooperation with regional and subregional mechanisms.

61. The need to explore options for reform of the international monetary system is now broadly accepted. Despite some diversification, the majority of reported international foreign exchange reserves continue to be held in United States dollars.[74] In order to mitigate the flaws of a national currency-based reserve system, there are in particular proposals to strengthen the role of Special Drawing Rights (SDRs). Work is under way at the Fund on the role of this reserve asset.[75] Currently representing less than 4 per cent of total global reserve holdings, SDRs play a very limited role. Realistically, the role of SDRs as a reserve asset can be expected to increase gradually over the coming years in a trend towards a system that combines increased use of SDRs with a range of nationally supplied reserve assets. Progress in this direction will require a number of measures to enhance the acceptance, availability and use of SDRs. It may also require broadening the composition of the SDR basket to make it more representative, in particular by including emerging market currencies.

VII. Staying engaged

62. The special high-level meeting of the Economic and Social Council with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development was held in New York on 10 and 11 March 2011 on the overall theme of "Coherence, coordination and cooperation on financing for development". The meeting featured four thematic debates: (a) follow-up to the 2010 Millennium Development Goals Summit outcome: building the global partnership for development, including in response to new challenges and emerging issues; (b) the role of the United Nations system in global economic governance; (c) financial support for development efforts of least developed countries: development finance, including innovative mechanisms, aid for trade and debt relief; and (d) financial support for development efforts of middle-income countries: development cooperation, trade, capital flows, policy space and reserve system. The deliberations were summarized in the President's summary of the meeting (A/66/75-E/2011/87).

63. To launch the preparation of the General Assembly's fifth High-level Dialogue on Financing for Development, to be held in New York on 7 and 8 December 2011, the Financing for Development Office of the Department of Economic and Social Affairs of the Secretariat convened an expert group meeting on regional cooperation on financing for development in New York, on 15 and 16 November 2010, which explored the potential of existing and new forms of regional cooperation in

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[74] The proportion of United States dollars in global foreign currency reserves, as reported to IMF, has declined by about 10 percentage points over the past decade to a little over 60 per cent (IMF Currency Composition of Official Foreign Exchange Reserves (COFER) database).

[75] IMF, "Enhancing international monetary stability — a role for the SDR?", 7 January 2011.

promoting development finance and macroeconomic cooperation. The Economic Commission for Africa (ECA) held a regional forum entitled "Financing for development: mobilizing resources for economic transformation in Africa" in Addis Ababa from 18 to 20 May 2011 to identify mechanisms to strengthen the capacity of African countries to mobilize more domestic and external resources for development. The Economic and Social Commission for Asia and the Pacific (ESCAP) held its eighth Asia-Pacific Business Forum, on the theme of "Facing challenges, capturing opportunities", in Bangkok on 25 and 26 July 2011 to discuss emerging trade and investment opportunities and promote cooperation and dialogue between the public and private sectors. The Economic Commission for Latin America and the Caribbean (ECLAC) held a regional consultation on financing for development in Santiago on 10 and 11 August 2011 to take stock of emerging needs and strengths of middle-income countries in the new global economic setting and explore innovative financing mechanisms and new arrangements and forms of cooperation in the region.

64. The 2011 substantive session of the Economic and Social Council, under agenda item 6 (a) (Follow-up to the International Conference on Financing for Development), featured panel discussions on "Global economic governance and development: enhancing the coherence and consistency of the international monetary, financial and trading systems" and "Building on Istanbul: financial support for development efforts of least developed countries, including through South-South and triangular cooperation". The Council further adopted a series of resolutions on matters related to financing for development, including (a) "Recovering from the world financial and economic crisis: a Global Jobs Pact"; (b) "Follow-up to the International Conference on Financing for Development"; (c) "Follow-up to the Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development: consideration of the possible establishment of an ad hoc panel of experts"; and (d) "Committee of Experts on International Cooperation in Tax Matters". More information is posted at www.un.org/esa/ffd.