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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 the Doha Declaration on Financing for Development

Report of the Secretary-General**

Summary

Pursuant to General Assembly resolution 64/193, 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, namely: 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 section VII, entitled "Staying engaged".

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** The present report was prepared in consultation with staff from the major institutional stakeholders involved in the financing for development process. Responsibility for its contents, however, rests solely with the United Nations Secretariat.

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I. Mobilizing domestic financial resources for development

1. The world economy is in a fragile recovery from a contraction of 2 per cent in 2009, with growth expected to reach 3 per cent in 2010 and 3.1 per cent in 2011.[1] However, growth prospects are uneven across countries. There is a significant risk of a protracted period of muted global growth as large fiscal deficits, high unemployment and lacklustre recovery in developed countries have prevented them from generating growth for the global economy. Developing Asian countries, particularly China and India, are the growth leaders, but recovery is much weaker in Africa and Latin America. Continued policy support in the near term is still critical to solidify and broaden the current economic recovery, targeting employment growth.

2. The international economic environment for developing countries has generally improved. In a reversal of conditions during the financial crisis, capital inflows have returned, costs of external financing have declined, trade flows are rebounding, some commodity prices are stabilizing and remittance flows are strengthening. However, high unemployment and poverty persist, resulting in negative medium-term consequences for the achievement of the internationally agreed development goals, including the Millennium Development Goals.

3. The number of unemployed worldwide increased by 34 million from 2007 to 2009, with most of the upsurge in 2009, resulting in a rise of the global unemployment rate from 5.7 per cent to 6.6 per cent.[2] The outlook is for gradual recovery in employment to pre-crisis levels. Current policy efforts in stimulating employment creation such as through the use of subsidies for hiring new workers, facilitating credit to small firms and retraining programmes for the unemployed need to be stepped up. Implementation of the Global Jobs Pact should be a priority.[3]

4. The crisis is estimated to leave an additional 64 million people in extreme poverty by the end of 2010 and the global poverty rate is projected to be 15 per cent by 2015, almost one percentage point higher than it would have been without the crisis.[4] Similarly, for sub-Saharan Africa, the poverty rate is expected to be 38 per cent in 2015, rather than 36 per cent.

5. While demand for social protection and services has been increasing, government resources in developing countries are still limited owing to the sharp drop in revenues resulting from the global recession. Some developing countries were able to exploit fiscal policy space built up during the previous decade of solid economic growth to implement counter-cyclical policy responses to the crisis. More than one third of developing countries instituted fiscal stimulus programmes in 2009.[4] Spending on social safety nets has also been relatively well protected, except for some countries with pre-crisis fiscal and debt problems. Given depressed public

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[1] See E/2010/73.

[2] See International Labour Organization, *Global Employment Trends, January 2010* (Geneva, International Labour Office, January 2010); and International Labour Organization, “Economically active population estimates and projections 1980-2020, LABORSTA database (available from http://laborsta.ilo.org).

[3] See E/2010/64.

[4] See World Bank and International Monetary Fund, *Global Monitoring Report 2010: The MDGs after the Crisis* (2010).

revenues, however, national fiscal deficits increased sharply in 2009 and remain large in 2010.[5]

6. In the medium term, macroeconomic policies should target sustained economic and employment growth as well as poverty reduction, while maintaining the capacity to implement counter-cyclical measures. However, to rebuild fiscal space while improving sustainability of the fiscal balance and debt levels, Governments are under pressure to limit expenditures.[4] In the short term, budgetary support from aid commitments can help to reduce the funding gap. International financial institutions should continue to place priority in counter-cyclical lending to strengthen the international financial safety net (see sect. VI).

7. The private sector is the main source of employment generation, investment and technological innovation. Regulatory frameworks and policies should provide an enabling environment for private productive activities that advance economic and social development. For their part, private companies need to take seriously their corporate social responsibility to contribute directly or indirectly to development goals.

8. The boom-bust cycle of international capital flows during the financial crisis and its aftermath has shown the pressures that financial globalization can place on national macroeconomic management. In order to mitigate financial volatility and economic decline resulting from capital mobility and external financial shocks, developing countries need their national policy space in exchange rate and capital account terms, including the use of capital controls when warranted (see sect. VI).

9. As each country has the primary responsibility for its development, domestic resource mobilization needs to be aligned with integrated social and economic development strategies aimed at advancing the long-term objective of inclusive growth. These include long-term public investments in infrastructure and human resource development, expansion of productive capacity, food and energy security, response to climate change, delivery of public services and provision of social protection for the most vulnerable.

10. In many developing countries, domestic resource mobilization is limited by the narrow fiscal space and uncertain growth prospects. Therefore, in addition to appropriate macroeconomic, foreign exchange and capital account policies discussed above, national efforts should include adopting appropriate tax policies supplemented by sustainable public borrowing and improved management of public expenditures (see sect. V).

11. Fiscal reform in developing countries, including tax reform, should be stepped up in order to raise tax revenues through modernized and equitable tax systems, effective tax administrations, the broadening of the tax base and combating tax evasion. Reducing compliance costs for taxpayers and collection costs for Governments would help to maximize available revenue while encouraging further investment. Capacity-building in this area is needed, particularly in low-income countries.

12. Illicit financial flows, especially those related to tax evasion, constitute an enormous drain on resources of both developing and developed countries. The

[5] See International Monetary Fund, "Navigating the fiscal challenges ahead", *Fiscal Monitor*, 14 May 2010.

linkages between tax evasion and other illegal international activities, such as money-laundering, terrorism and drug trafficking, underscore the urgency for effective international responses. The Committee of Experts on International Cooperation in Tax Matters has proposed a code of conduct on cooperation in combating international tax evasion and has enhanced its work in the areas of exchange of information and transfer pricing.[6] Increased efforts in combating corruption, crime and abuses at all levels are also needed, including through the accession to the United Nations Convention against Corruption and additional measures to prevent the international transfer of stolen assets and to assist in their recovery.

13. A sound and broad-based financial sector is essential for the effective mobilization and channelling of financial resources to productive activities. Inclusive finance aims to increase access for the poor, women, and small and medium enterprises to the supply of financial means for consumption, as well as production and employment generation. Hence, financial regulation in developing countries should aim at promoting both financial stability and inclusion. At the Group of Twenty (G-20) Summit in Toronto, G-20 leaders noted progress in finding promising models for public-private partnerships to catalyse small and medium-sized enterprise financing. The G-20 has also developed a set of principles for inclusive finance that will form the basis of its action plan for improving access of the poor to financial services.[7]

14. Good governance at all levels, based on appropriate policies and sound institutions, is essential for achieving development goals. There is a growing emphasis on outcome-oriented governance reform with regard to development objectives. It is also increasingly recognized that the goals of good governance are also outcomes of development and therefore should be pursued in conjunction with long-term development goals.[8]

15. Resource needs to address the challenge of climate change are onerous for the most vulnerable countries, such as the least developed countries, small island developing States and other susceptible countries in Africa. Long-term climate change adaptation and mitigation strategies should be incorporated in national development plans to properly frame predictable domestic and international resources for sustainable development. The Copenhagen Accord recognized the need to mobilize new and additional financial resources in the amount of $30 billion for the period 2010-2012 and $100 billion annually by 2020. The High-level Advisory Group on Climate Change Financing is formulating recommendations on potential public and private sources of revenue to meet these targets for consideration at the Conference of Parties to the Framework Convention, to be held in Mexico in December 2010.

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[6] See E/2009/45.

[7] See the G-20 Summit Declaration, Toronto, 26-27 June 2010, available from http://g20.gc.ca.

[8] See A/65/130.

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

16. The financial crisis led to a sharp fall of net private capital flows to developing countries, from $377.2 billion in 2007 to $104.1 billion in 2008. However, latest estimates show a strong recovery in inflows, especially to some emerging economies, totalling $278.8 billion in 2009.[9] This recovery has been aided by policy measures to recapitalize financial institutions and stabilize markets, as well as by rapid growth and buoyant stock markets in some emerging economies. According to some investors, the relative risk characteristics of advanced and emerging economies may have changed in favour of the latter, owing to budget deficits and public debt problems in some European economies.[10] Nevertheless, despite the upward forecast for 2010, the overall level of private capital flows to developing countries is likely to remain well below the peak registered in 2007.

17. The impact of the global economic crisis on private capital flows to Africa has been relatively limited as risks in the majority of financial markets in the region tend to be uncorrelated to those in the advanced economies. Indeed, inflows of foreign direct investment to Africa reached record levels in 2008, but are estimated to have declined in 2009. A large portion of these flows have gone into the natural resource sector and to mineral-rich countries. A central question relates to the impact of such foreign direct investment on development, since, in a number of instances, the economic gains have failed to materialize and the extraction of minerals has been associated with various social and environmental costs. While the crisis led to a sharp decline in net private capital flows to East Asia and South Asia, there has been a strong recovery over the past year, led by an upturn in portfolio flows and bank lending. While net private capital flows to Latin America continued to decline over the past year, there are signs of stabilization, led in particular by a rebound in portfolio investment.

18. Foreign direct investment remains the largest single component of private financial flows to developing countries, although net inflows in 2009 ($230.6 billion) were considerably below the levels registered in 2008 ($342.2 billion) and 2007 ($307.2 billion).[11] The crisis had a negative impact on foreign direct investment through reduced access to finance for investing firms and low investors' confidence as a result of gloomy economic prospects and market conditions. Most regions have experienced a decline in foreign direct investment inflows and any recovery will be weakened by a reduced desire on the part of firms for "green-field" development.[12]

19. The crisis has thus far had no major impact on policies related to foreign direct investment. The general trend across countries remains one of greater openness,

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[9] See International Monetary Fund, World Economic Outlook database, April 2010.

[10] See International Monetary Fund, Global Financial Stability Report, April 2010; World Bank, *Global Economic Prospects 2010*.

[11] See International Monetary Fund, World Economic Outlook database, April 2010; United Nations, *World Economic Situation and Prospects 2010* (United Nations publication, Sales No. E.10.II.C.2) (January 2010).

[12] See International Monetary Fund, *Global Financial Stability Report: Meeting New Challenges to Stability and Building a Safer System* (April 2010).

including lowering investment barriers and corporate income taxes.[13] However, there have been concerns regarding the risk of investment protectionism as a response to the crisis. Many countries, both developed and developing, have implemented stimulus packages, including public investment programmes, cuts in taxes and interest rates, bailouts and other forms of temporary support for certain sectors of the economy. These measures may have a positive effect on inward foreign direct investment, provided they are designed in a non-discriminatory manner and open to participation by foreign investors. At the Toronto Summit, G-20 leaders emphasized the importance of enhancing foreign investment opportunities and avoiding new protectionist measures.

20. Evidence suggests that, in spite of the crisis, the network of international investment agreements have continued to expand.[13] While these agreements play an important role in ensuring predictability, stability and transparency of national investment regimes, they could also serve as a tool to counter the risk of investment protectionism. While the plethora of international investment agreements may create a more enabling framework for foreign investment, their increasing complexity also poses challenges for Governments and firms, especially in developing countries. It is important to ensure coherence between the international investment regime and the international financial system.

21. Increased attention has been given to foreign direct investment that generates and disseminates technologies to mitigate greenhouse gas emissions, also referred to as low-carbon foreign direct investment. There has been a rapid increase in low-carbon foreign direct investment in recent years, though it declined in 2009 as a result of the crisis. In the period 2003-2009, around 40 per cent of identifiable low-carbon foreign direct investment by value were in developing countries and, while multinational companies were major investors, about 10 per cent of projects in this field were generated by investors from developing and transition economies. While low-carbon foreign direct investment can make a valuable contribution to developing countries' response to climate change, policymakers in developing countries need to be cognizant of possible disadvantages, including the crowding out of domestic companies and higher costs for essential goods and services.[13]

22. The crisis has also affected other categories of private capital flows to developing countries. While bank lending has undergone a recovery in parts of Asia, it continues to be subdued in other regions. Conditions are especially muted in transition economies of Europe and Central Asia, where mounting non-performing loans are likely to restrain lending.[14] Portfolio flows to developing countries also declined markedly during the crisis. However, there has been a recovery in capital movements to some countries in Asia and Latin America that are viewed as having better growth prospects. In general, there are strong signs of improvement in the cost and availability of debt financing in emerging countries. Emerging market corporate and sovereign bonds have been issued at a record pace this year.[15]

23. There is concern that a recovery in investors' appetite for emerging market risk could herald a surge in short-term capital flows to certain countries that may generate inflationary pressures and have the potential to destabilize currencies and

[13] See United Nations Conference on Trade and Development, *World Investment Report 2010: Investing in a low-carbon economy* (United Nations publication, Sales No. E.10.II.D.2).

[14] See World Bank, *Global Economic Prospects 2010*.

[15] See *Financial Times*, "Emerging markets set pace for debt issuance", 27 June 2010.

financial markets. In this context, standard policy responses call for the framing of appropriate prudential regulation and setting in place measures that restrict the impact of excessive capital inflows on the domestic economy. However, as witnessed over the past decade, such policies may not be sufficient to mitigate the impact of volatile financial flows. Greater consideration should therefore be given to the use of restrictions on international capital mobility, such as international taxes or national capital controls, as a means of reducing the risk of recurrent crises. A number of countries have begun experimenting with capital controls and the issue was discussed at the recent meeting of G-20 finance ministers in the Republic of Korea. It has also been suggested that capital account management could be applied in a counter-cyclical manner by restricting excessive foreign borrowing in good times and controlling capital flight during crises.[16]

24. Officially recorded remittances to developing countries totalled over $300 billion in 2009, which was lower than the previous year, but remained far more stable than other categories of private flows. However, there have been regional variations; remittance flows to some regions, such as Latin America and Eastern Europe, fell sharply in 2009. Nevertheless, remittances have helped build up international reserves and contributed to reducing external deficits in some developing countries, thereby providing a cushion against external shocks during the global economic crisis. Collaboration is required between source and destination countries to reduce the transaction costs of remittances and, where possible, to relax legal and funding barriers to remittances and other financial flows by migrants.[17]

III. International trade as an engine for development

25. After the sharpest decline in more than 70 years, the growth rate of world trade is projected to rebound to 7.6 per cent in 2010. This gradual upward trend is forecast to continue in 2011, with trade volumes expanding by 5.9 per cent.[18] The reversal is welcome news for the world economy. However, the trend will only help recover some of the ground lost in 2009 when the financial crisis triggered a 13.1 per cent contraction in the volume of global trade. Lower export demand, volatile commodity prices, deteriorating terms of trade, high unemployment and limited and costly access to trade finance continue to threaten hard-won progress towards the Millennium Development Goals in many developing countries.

26. Commodity exporters face particular challenges. Following the general upward trend in the prices of oil and non-oil commodities in the years preceding the global crisis, 2009 saw a sharp decline. Prices of exports from the least developed countries have declined drastically relative to the prices of their imports. Least developed countries are currently exporting "more for less". Non-oil exports from least developed countries to their major trading partners decreased by more than 8.5 per cent in value, although the volume of goods exported increased by nearly 6 per cent.[19] Some ground has been recovered for mineral- and oil-exporting

[16] See United Nations Conference on Trade and Development, *Trade and Development Report 2009* (United Nations publication, Sales No. E.09.II.D.16).

[17] See World Bank, "Migration and Development Brief", Brief No. 12, April 2010.

[18] See E.2010/73, para. 26.

[19] See International Trade Centre, "Poorest countries' terms of trade gains eroded", press release dated 1 June 2010.

countries in Africa, South America and Western Asia, particularly through increased demand from China and East Asia. However, prices remain well below their pre-crisis level and highly volatile, which contributes to economic insecurity and poses challenges for long-term development.

27. The G-20 Toronto Summit Declaration reiterated the need to resist protectionist measures. By and large, escalation of protectionism has been prevented. Nevertheless, some countries have raised tariffs and have introduced other trade defence mechanisms. Moreover, several fiscal and financial packages contain measures that favour domestic goods and services at the expense of imports. In view of the relatively slow pace of removal of previously adopted measures, there is a risk of an accumulation of trade restrictions.[20] Frequently, new trade restrictions target highly protected sectors where developing countries have a comparative advantage, such as minerals, textiles and metal products.[21] But these countries generally lack the capacity to retaliate and the safety nets to assist those affected by such actions.

28. The increase in South-South trade has contributed to the recovery from the crisis. While China has been the main driver of South-South trade expansion, India, Brazil, South Africa and South-East Asian countries have similar potential.[22] However, least developed countries have yet to fully benefit from growing South-South trade. More than 80 per cent of least developed country exports, mainly minerals and fuels, are sent to OECD countries and, to a growing extent, China, Russia, Brazil and India.[23] Evidence suggests that South-bound exports from low-income countries tend to be more sophisticated than those to the North.[24] Thus, larger, more integrated and diverse South-South trade flows could provide commodity-dependent and low-income countries with new export opportunities and much needed cushions in crisis times.

29. The ongoing Doha Round of trade negotiations in the World Trade Organization seeks to establish a universal, rule-based, open, non-discriminatory and equitable multilateral trading system. Following months of impasse, the recently introduced mix of bilateral meetings, small group consultations with the Director-General and multilateral processes, seems to have helped inject new dynamics into the negotiations.[25] However, progress on important trade measures, like reduced agricultural subsidies, greater market access and enhanced special and differential treatment, has been low. Different forms of agricultural subsidies in developed countries continue to represent serious barriers to trade, drive world market prices down and lead to unfair competition with local producers in developing countries. While total support measures to the agricultural sector have declined in OECD

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[20] See Organization for Economic Cooperation and Development, United Nations Conference on Trade and Development, "Report on G20 Trade and Investment measures" (Geneva and Paris, 14 June 2010).

[21] Ibid., 8 March 2010.

[22] See United Nations Conference on Trade and Development, *Development and Globalization: Facts and Figures 2008* (United Nations publication, Sales No. E.07.II.D.20).

[23] See International Trade Centre, "Trade Map Fact sheet: Developing Country Exports Decline in 2009", p. 12.

[24] See United Nations Conference on Trade and Development, "Making South-South trade an engine for inclusive growth", Policy Brief No. 8, November 2009.

[25] See World Trade Organization, Director-General statement to informal meeting of the Trade Negotiations Committee, 27 July 2010.

countries as a percentage of their GDP, they have increased in absolute terms reaching $368 billion in 2008.[26] The conclusion of the Doha Round with a strong development outcome could therefore serve as an important contribution towards the achievement of the Millennium Development Goals.

30. Tariffs imposed by developed countries on key products from developing countries remain relatively high. The goal of the sixth World Trade Organization Ministerial Conference to help the poorest countries expand their participation in international trade through duty-free-quota-free access for their exports has not been fully met. The proportion of imports of developed countries from least developed countries free of duty, arms and oil excluded, has increased by only less than one percentage point from 2004 to 2008. Even high rates of duty-free-quota-free access have often little development impact since key exports from least developed countries remain excluded in certain markets. Non-tariff barriers (such as restrictive "rules of origin" criteria or stringent sanitary and phytosanitary standards) can negate the positive potential effect of progress on duty-free-quota-free access. On the positive side, given their growing share in world trade, increased duty-free-quota-free access to emerging economies holds great potential for least developed country export markets in the future. In this regard, the effective participation of least developed countries in South-South regional trade agreements can play an additional catalytic role in strengthening their supply capacity and export diversification.

31. Coordinated efforts are needed to ensure coherence between trade and climate policies. Greater trade in environmental goods and services can contribute to addressing climate change, generating employment and enabling the transfer of skills and technology. However, the current debate on the scope and the definition of what constitutes environmental goods and services should take developing country concerns into consideration. The extent to which developing countries will stand to benefit depends on their ability to participate in the export of environmental goods and services. In this regard, environmental goods and services market liberalization should occur gradually and carefully. This would allow developing countries to enhance their supply capacity, adjust their regulatory regime and build the necessary infrastructure to capture most potential gains.

32. Aid for trade can help developing countries build their trade-related infrastructure and productive capacity. Preliminary analysis shows that aid for trade grew 37 per cent in real terms between 2007 and 2008. Total aid for trade reached $41.7 billion in 2008, an increase of 62 per cent from the 2002-2005 baseline.[27] The G-20 leaders, at the Toronto Summit, committed themselves to maintain momentum for aid for trade and called on international agencies to enhance their capacity and support for trade facilitation.[28] Donor funds are most effective where they target the trade-related needs and priorities of the recipient country. Future support should therefore promote greater country ownership and integration of trade in national

[26] See Organization for Economic Cooperation and Development, "Agricultural Policies in OECD Countries: Monitoring and Evaluation 2009", July 2009.

[27] See Organization for Economic Cooperation and Development, "Overview of Aid for Trade reported in 2008", presented during World Trade Organization workshop on "Aid for Trade and Development Finance", Paris, 27 May 2010.

[28] See the G-20 Toronto Summit Declaration, Toronto, 26-27 June 2010, para. 39, available from http://g20.gc.ca.

development strategies. This implies the need for sufficient policy space in developing countries to enhance necessary production and trading capacities.

IV. Increasing international financial and technical cooperation for development

33. Despite increases in the volume of official development assistance (ODA), aid delivery does not match the pledges made at the 2005 Group of Eight (G-8) Summit at Gleneagles, Scotland, which implied lifting the 2004 ODA from about $80 billion to nearly $130 billion (in 2004 prices) in 2010 or 0.36 per cent of combined gross national income (GNI). According to OECD, a projected shortfall for 2010 will be $18 billion (in 2004 prices) against the Gleneagles target, leading to a further reduction of ODA to Africa, which is projected to be less than a half of the pledged $25 billion in 2010.[29] The ODA/GNI ratios of only five countries (Denmark, Luxembourg, the Netherlands, Norway and Sweden) have exceeded the United Nations aid target of 0.7 per cent. However, OECD/Development Assistance Committee donors, as a whole, are not on a path to meet the 2010 aid targets. Total net ODA from 23 Development Assistance Committee members was $120 billion in 2009, a decline of 2.2 per cent in nominal terms.[30]

34. Considerable uncertainty surrounds the future volume of ODA flows as the risk of a double-dip recession in the advanced economies remains.[31] ODA flows are also likely to be hit by fiscal consolidation in donor countries. Some donors have already trimmed their budget lines for foreign aid.

35. Country programmable aid captures aid flows at the recipient country level. From 2004 to 2008, global country programmable aid grew at a real rate of 5 per cent a year. For all bilateral Development Assistance Committee donors, on average, bilateral country programmable aid represents a little over 50 per cent of their gross bilateral ODA, while the share of multilateral country programmable aid in multilateral ODA is about 90 per cent. Global bilateral and multilateral country programmable aid increased from $75 billion in 2007 to $85 billion in 2008, of which about three quarters was bilateral country programmable aid.[32] In real terms, however, it was a modest gain of 3 per cent, compared to the increase in net ODA of 10 per cent.[33] To meet the 2010 aid targets, substantial annual increases in country programmable aid are needed.

36. Despite the Millennium Development Goals funding gaps in many developing countries, most donors continue to allocate bilateral aid based on their political and economic interests, with a tendency to concentrate on a few countries and rely on performance-based, rather than needs-based, allocation tools. As a result, least

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[29] See Organization for Economic Cooperation and Development, "Development aid rose in 2009 and most donors will meet 2010 aid targets", 14 April 2010.

[30] Excluding the Republic of Korea, which joined the Organization for Economic Cooperation and Development/Development Assistance Committee effective 1 January 2010.

[31] See UN, *World Economic Situation and Prospects, 2010*.

[32] See Organization for Economic Cooperation and Development, *2009 Report on Division of Labour: Addressing Fragmentation and Concentration of Aid across Countries* (Paris, 2009); these figures include the country programmable aid of the Republic of Korea.

[33] See Organization for Economic Cooperation and Development, *2009 DAC Report on Aid Predictability: Survey on Donors' Forward Spending Plans 2009-2011*, p. 15 (Paris, 2009).

developed countries and other vulnerable countries have not been the highest priorities of the Development Assistance Committee donors.[34] In 2008, the top 10 ODA recipients accounted for 38 per cent of total ODA, compared to 12 per cent in 2000. Thus, the donor community has increased the concentration of assistance on a limited number of countries, creating so-called “donor darlings” and “donor orphans”.

37. Since 1990, ODA allocations have seen a dramatic shift from the economic to the social sector. In 1990, economic infrastructure accounted for the largest share (around 25 per cent in a three-year average), followed by general programme aid, production (including agriculture, forestry, fishing and tourism) and social sectors (less than 20 per cent in a three-year average). In 2008, the largest share of bilateral ODA commitments was allocated to the social sectors (40 per cent), followed by economic infrastructure (17 per cent). Bilateral ODA commitments to agriculture, forestry and fishery accounted for only 5 per cent in 2008, compared to about 17 per cent in 1990.[35] The food crisis brought to the forefront the decline of investments in agriculture.

38. OECD reports a mixed picture of progress in improving aid effectiveness, with considerable variations across indicators and countries. Slow progress towards the targets of the 2005 Paris Declaration on Aid Effectiveness is especially visible in countries receiving lower levels of aid, fragile States and least developed countries where distortions of aid allocation have been exacerbated. The 2008 Accra Agenda for Action stressed the need for strengthening country ownership, building more effective partnerships, and delivering and accounting for development results. Further agreements have been reached to improve the quality of aid to fragile States (Dili Declaration, April 2010) and the quality of development assistance by middle-income countries, civil society organizations and NGOs (Bogota Statement, March 2010). The next high-level forum on aid effectiveness will take place in the Republic of Korea in November 2011, with a view to setting the aid quality framework by the Millennium Development Goals target date of 2015.[36]

39. The 2010 Economic and Social Council Development Cooperation Forum highlighted that predictability of aid had improved in some programme countries, but more flexibility is essential to fund changing priorities and counter exogenous shocks. Durability, stability and flexibility need to be further improved if aid is to be made more effective. Policy conditionality continues to remain a key cause of some of the above difficulties.

40. Progress on mutual accountability remains limited. As at the end of 2009, only seven recipient countries had established fully functioning mutual accountability mechanisms, and the change in donors’ behaviour was uneven.[37] At the international level, a complex range of mechanisms exist, including official peer review processes. There are also many independently managed assessments that call

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[34] Ethiopia and Afghanistan, the second and third highest aid recipient since 2008, are the exceptions.

[35] See “Development aid at a glance: statistics by region”, table 1.3.3 (p. 11) and chart 1.3.7 (p. 13), available from http://www.oecd.org/dataoecd/59/5/42139479.pdf.

[36] See Organization for Economic Cooperation and Development, “Aid effectiveness and accountability: G8 support is key for progress”, 10 June 2010.

[37] United Nations, *MDG Gap Task Force Report 2010*, Department of Economic and Social Affairs.

for building more equal and inclusive partnerships. Moreover, systematic focus on gender issues has not been placed at any level of mutual accountability mechanisms. Effective monitoring of mutual accountability requires international coordination to streamline existing peer review mechanisms.

41. More efforts are needed to streamline conditionality, monitor indicators and ensure country ownership. Ownership is closely linked to representation of recipient countries in the governance of aid architecture. The G-8 Summit at Muskoka, Canada, endorsed an action plan to enhance efforts towards development-related commitments, including commitments to untie aid and to disburse aid in a timely and predictable manner through partner country systems.[38]

42. South-South cooperation increased by 63 per cent during the period 2006-2008, providing an important contribution towards achieving the Millennium Development Goals. According to OECD, South-South cooperation accounts for approximately 10 per cent of total aid flows. At the regional level, economic downturns have somewhat stalled integration efforts in Latin America owing to lack of resources and external support, while, in most cases, regional and subregional cooperation have gained further momentum. About 90 per cent of South-South development cooperation continues to come in the form of project finance and technical assistance. In addition, there is an increasing focus on humanitarian assistance, infrastructure development, health and agriculture.[39]

43. Innovative mechanisms of development finance provide increasingly important contributions to complement ODA. It is estimated that innovative fund-raising generated $57.1 billion in official flows between 2000 and 2008.[40] While a range of schemes has developed, the most successful ones focus on addressing the health-related development agenda. Other proposals under discussion at various forums include an international financial/currency transactions tax, carbon taxes, special drawing rights (SDRs) allocations for development, illicit capital flow repatriation and facilitation of remittances. Expectations of identifying practical innovative financing mechanisms to tackle climate change are particularly high.

44. Debt sustainability is crucial for financing development. In many vulnerable economies, grant financing is needed to meet the shortfalls in revenue and foreign exchange. The proportion of grants in net ODA from Development Assistance Committee members fell from 89 per cent in 2005 to 66 per cent in 2009. Multilateral lenders, however, continued to provide large shares of grants to the most indebted countries. In response to the crisis, IMF introduced a set of new financial instruments for concessional lending to eligible low-income countries. The World Bank also responded with changes in its lending facilities.

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[38] See Group of Eight, *Muskoka Accountability Report: Assessing action and results against development-related commitments*, available from http://g8.gc.ca/g8-summit/accountability/ (accessed on 1 July 2010).

[39] See E/2010/93.

[40] See Navin Girishankar, "Innovating development finance: from financing sources to financial solutions", World Bank Policy Research Working Paper, No. WPS 5111 (1 November 2009).

V. External debt

45. The impact of the global financial and economic crisis has been eroding progress made in reducing the debt burden of developing countries. The debt situation of many developing countries has deteriorated owing to the slowdown of the global economy, the resulting fall in trade and fiscal revenues, remittances and capital flows, and increased volatility of commodity prices. Moreover, many developing countries had to take recourse to internal and external borrowing, thus raising their public debt levels.

46. The crisis severely impacted international liquidity, leading to a sharp decline in international capital flows. In response, new international lending from official sources was initiated at the G-20 Summits. Gross IMF lending commitments, which stood at $1 billion in 2007, went up to $49 billion in 2008 and $120 billion in 2009.[41] IMF concessional lending commitments in 2007 amounted to $0.2 billion, and rose to $1.2 billion in 2008 and $3.8 billion in 2009. The number of low-income countries that sought IMF financial support increased from 8 in 2007 to 22 in 2008. Other multilateral financial institutions also sharply increased their lending levels. The World Bank increased its gross commitments from $36.5 billion in 2007 to $65 billion in 2009. The main regional development banks together increased their lending from $30 billion to $50 billion over the same period.[41]

47. The total external debt (public and private) of developing countries as a share of GDP rose to 24.8 per cent in 2009, an increase of 2.2 per cent over the previous year. Prior to the crisis, the debt service to exports showed a downward trajectory reflecting the improved capacity of developing countries to service debt and the increase in exports of goods and services, which nearly doubled between 2003 and 2007. The damaging impact of the crisis on the real economy resulted in a decline in exports by 22 per cent in 2009. The resultant fall in foreign exchange earnings led to an increase of debt service to exports by 5 per cent in the same year.[42] Every region of the developing world was affected, albeit to different degrees, owing to policy choices, borrowing opportunities and available fiscal space.

48. Many post-completion point highly indebted poor countries (HIPC) have debt above thresholds utilized for their debt write-offs. Other low-income countries and many small middle-income countries, including those with structural vulnerabilities, are in a difficult debt situation. In a majority of cases, debt owed to Paris Club creditors is less than 25 per cent of total external debt, so that solutions for some countries also need to focus on resolving multilateral debt and debt owed to private creditors and non-Paris Club official creditors.

49. Managing the impact of the crisis turned around the overall fiscal balance of developing countries from 0.48 per cent of GDP in 2007 to -4.85 per cent of GDP in 2009. In many countries, the ratio of public debt to GDP is even higher than the Maastricht criteria of 60 per cent in the euro zone. Given the weaker position of developing country financial markers vis-à-vis the advanced economies, the acceptable levels for sustainable public debt of developing countries are arguably lower and need a case-by-case assessment. Evidence shows that public debt of many

[41] Some acceleration in official lending had already begun in response to the food, fuel and financial crisis in mid-2008 before the G-20 Summit.

[42] Based on the International Monetary Fund World Economic Outlook online database, April 2010.

developing countries is above 40 per cent, including that of those countries that benefited from the Highly Indebted Poor Countries Initiative, indicating the limits to their further borrowing space.

50. In many developing countries, high public debt ratios coexist with current account deficits above the generally acceptable level of 5 per cent of GDP and with international reserve levels covering less than three months of import. Thus, those countries face fiscal space constraints in servicing a rising stock of debt and still stepping up efforts towards the achievement of the Millennium Development Goals. Recovery of their GDP, exports and fiscal revenues may not be strong and rapid enough to ensure that their debt remain manageable.

51. Grant financing would impose no additional limits to future fiscal space. It would also enable the better performing recipients to envisage a wider range of financing options for the much needed investments in productive capacity. In principle, new external resources should not be used to pay off debt. To the extent debt servicing is a problem, traditional forms of debt relief, as well as debt standstills and debt write-offs can be employed, based on judgements on the future growth prospects and economic performance of affected countries, both as tools of crisis prevention and management.

52. According to IMF, post-crisis debt sustainability analyses for 39 countries (including 10 middle-income non-HIPC) show a significant increase in the level of debt and debt-service ratios.[43] As of April 2010, the distribution of 27 countries in debt distress and at high risk confirms higher vulnerabilities of highly indebted poor countries, as well as some non-highly indebted poor countries.[44] The IMF study concludes that systemic debt difficulties are unlikely in the sample of countries. In about half of these countries, including all those in debt distress, debt vulnerabilities are expected to be reduced substantially through HIPC/Multilateral Debt Relief Initiative (MDRI) relief or will require similar relief. In the other half, concerted efforts would address debt vulnerabilities through: (a) improved policies and institutions; (b) better fiscal positions; and (c) more favourable financing terms provided by creditors.

53. By 1 July 2010, out of the 40 countries that were eligible or potentially eligible for debt relief under the HIPC Initiative, 30 reached their completion point and qualified for irrevocable debt relief from the HIPC Initiative and MDRI. Six countries were between “decision” and “completion” points, wherein they received interim relief, making a total of 36 countries receiving debt relief under the Initiative.

54. After the fourth extension of the sunset clause, which expired at end-December 2006, no further extension has been considered in the light of the crisis. This means that, no matter how unsustainable their debt levels may be, developing countries that did not meet the HIPC-eligible criterion in 2006 will not be able to enjoy the benefits from the HIPC/MDRI debt relief despite debt vulnerability and debt distress.

[43] International Monetary Fund and World Bank, “Preserving Debt Sustainability in Low-income Countries in the Wake of the Global Crisis”, 1 April 2010.

[44] A country, with current debt and debt-service ratios in significant or sustained breach of thresholds in addition to actual or impending debt restructuring negotiations or the existence of arrears.

55. The 2009 review of the joint World Bank-IMF debt sustainability framework for low-income countries resulted in a number of improvements.[45] However, some concerns about country policy and institutional assessments still remain.[46] While institutions matter for long-term development, thresholds for debt carrying capacity defined in the short- and medium-term based on institutional quality give greater weight to institutional and governance factors, without recognizing that improving institutions and governance also requires fiscal capacity. Therefore, a needs-based assessment for the allocation of grants to invest in the Millennium Development Goals and other development goals is needed, so that development gains lead to improved institutional governance and debt carrying capacity. Further work is needed to provide the technical basis for the balance between new resources, standstills and debt relief.

56. Despite signs of global recovery, considerable volatility remains in international financial markets and uncertainty surrounds global economic outlook. The recent evidence and indications of further debt problems in the advanced countries can trigger instability and negatively impact developing countries. As illustrated by the unfolding situation in Europe, the lack of instruments and institutional mechanisms to deal with debt distress has high costs not only for developing countries, but also the developed world. Fresh efforts are needed to design instruments and mechanisms to restructure debt and deal comprehensively and speedily with debt distress.

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

57. The worst financial crisis since the 1930s revealed weaknesses in financial intermediation and underscored the lack of a proper institutional framework to manage development and rapid economic and financial globalization. In response, the international community has initiated a set of reforms to build a more resilient financial system. The issue of stability of the international financial system has increasingly been viewed in the broader context of global economic governance, including quota and voice reform at the international financial institutions and the role of the United Nations.

58. In 2008-2010, both IMF and the World Bank took several steps to redress imbalances in voice and representation. The governing bodies of both institutions decided on two-step quota realignments in favour of developing and transition economies and reiterated the commitment to protect the voting shares of the poorest members. Other governance reforms under way at both institutions include consideration of greater ministerial involvement in the strategic oversight of policies and operations; the effectiveness of the Executive Boards and re-examining their voting procedures; reforming the selection criteria for senior management; and enhancing staff diversity. Despite consensus on the quota and voice reform agenda,

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[45] See International Development Association and International Monetary Fund, “Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries”, 22 January 2010.

[46] See A/65/130, para. 59 and A/64/884.

many issues still need to be resolved, requiring political will and strong support of the entire membership. Indeed, the very modest 2008 IMF quota and voice reform, which will basically lead to a quota redistribution among the group of emerging market and developing countries, has not yet gone into effect.

59. It is recognized that to promote global stability, the IMF in its surveillance activities needs to pay more attention to financial sector issues and to policy spillovers, especially those emanating from systemically important countries. Assessing international policy coherence and promoting coordination among national policies should become a central objective of multilateral cooperation. Most members support a greater direct role of the Fund, but the specifics have not been well defined. Hence, it could be useful to clarify what is expected, including key modalities, procedures and outcomes.

60. Thus far, the major attempt at the highest political level to take account of multilateral dimensions when setting national policies has been made outside of the IMF surveillance process. At the G-20 Summit held in Pittsburgh in September 2009, G-20 leaders announced the Framework for Strong, Sustainable and Balanced Growth and committed themselves to submitting their policies to peer review through the mutual assessment process. The first stage of the mutual assessment process was completed before the G-20 Summit held in Toronto in June 2010.

61. The substitution of the G-20 for the G-8 as the major forum for international economic cooperation is a welcome development. However, the majority of United Nations Member States are still excluded. It is therefore necessary for the G-20 process to develop greater legitimacy, including through forging stronger institutional linkages with other States and developing constructive dialogue with the United Nations, to ensure that the views and concerns of all countries, especially the poorest, be taken into account.

62. Achieving more sustainable and balanced global growth will also require close coordination of macroeconomic policy decisions with other areas of global governance, including those related to the multilateral trading system, aid architecture, poverty eradication and sustainable development agenda and climate change. While progress has been made in enhancing coherence, coordination and cooperation among multilateral organizations, in particular in response to the fall-out of multiple international crises,[47] no specific mechanism to promote coherent policy responses to the interdependent development issues exists at present. There have been proposals that place a strengthened United Nations framework for enhancing coordination and complementarity at the centre of efforts to bridge this gap.[48]

63. A major step in the financial regulation and supervision reform process is the modification of the Basel II framework for capital and liquidity regulation, whose gradual implementation is expected to start at the end of 2012. The modified framework envisages the rise in the level, quality, consistency and transparency of the bank capital; the introduction of counter-cyclical capital buffers; and the

[47] See World Bank, "Coherence, Coordination and Cooperation among Multilateral Organizations: 2009 Progress Report".

[48] See, for example, Report of the Commission of Experts of the President of the United Nations General Assembly on *Reforms of the International Monetary and Financial System* (2009), available from www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf.

establishment of mandatory leverage ratio; that is, a cap on the amount of assets a bank can have in relation to its equity. Moreover, a global liquidity standard, including higher liquidity cushions and constraints against maturity mismatches, will be implemented. There have been, however, some concerns that the final version of international bank standards will be based on the lowest common denominator.

64. Another important focus of reform is the development of legal and policy frameworks for cross-border resolution that should allow institutions of all types and sizes to fail without putting the rest of the financial system or the taxpayers at risk. Some alternative solutions that may gain broader acceptance include placing restrictions on certain business activities, size and structure of the financial firms. It has also been decided to explore options to devise fair and substantial contributions from the financial sector to defray the fiscal costs of financial failure. In addition, work is under way to achieve a single set of global accounting standards and on the internationally consistent implementation of agreed measures to improve transparency and institute regulation and supervision of hedge funds, credit rating agencies, compensation practices and over-the-counter derivatives. Close cooperation and coordination among numerous national and international regulatory and standard-setting bodies is important to ensure coherence and consistency of financial reform measures and to assess costs and benefits of the proposed reforms.

65. An effective global financial safety net is an important backstop for safeguarding global economic and financial stability. The multilateral safety net was strengthened significantly during the crisis through $350 billion in capital increases for the multilateral development banks, reform of the IMF credit facilities, including the introduction of a flexible credit line, and the commitment to triple IMF resources. The Fund role is increasingly seen as a provider of insurance-like crisis prevention facilities amid volatile cross-border capital flows and the risk of contagion.

66. Even after the tripling of IMF resources, their share in global GDP is still smaller than it was when the Fund was created. Besides, the bulk of the increase was in the form of borrowed funds. The outcome of the fourteenth general quota review, scheduled to be completed in January 2011, should restore the central role of general resources through a substantial increase in IMF quotas.

67. Other elements of a broader global financial safety net include bilateral foreign exchange swap arrangements among major central banks, regional reserve pools and self-insurance through appropriately scaled reserve accumulation. It is important to find an appropriate balance and to develop effective coordinating mechanisms between the different elements of public liquidity support.

68. The need to explore options for reform of the international reserve system, currently based on virtually one national currency, is now broadly recognized. It is generally agreed that the long-term issue of moving towards a more diversified, balanced and stable international reserves system, including an enhanced role for SDRs, should be kept under consideration. Reform of the current international reserve system should be part of a broader framework. It is not likely that any feasible change would bring about smooth and automatic balance of payment adjustment. Therefore, along with moving towards a greater variety of reserve options, further progress in dialogue and cooperation aimed at more balanced and sustainable global growth will remain indispensable.

69. The Financing for Development process was early in recognizing the links between taxation and development and remains the only truly global forum for discussing international tax cooperation issues. The increasing recognition of these relationships is manifest, for example, in the recent creation of the OECD informal task force on tax and development. However, resources available to the United Nations to meet its inherent mandate in the tax area, including capacity-building, remain sparse.

70. The Committee of Experts on International Cooperation in Tax Matters has an increasingly important role to play, but the Committee members, while nominated by Governments, act in their personal capacity. The time has come to consider establishing a United Nations intergovernmental commission on tax matters, in order to engage tax authorities of all States in promoting truly global cooperation in tax matters, based on relevant national and international activities. Yet, it would bring much greater focus to the role of tax cooperation in advancing development, including the Millennium Development Goals.

VII. Staying engaged

71. During the reporting year, the Financing for Development process featured several major events, each of which sought to provide a substantive input to the preparatory process of the High-level Plenary Meeting of the General Assembly on the Millennium Development Goals (September 2010).

72. The General Assembly held its fourth High-level Dialogue on Financing for Development on 23 and 24 March 2010, under the overall theme “The Monterrey Consensus and the Doha Declaration on Financing for Development: status of implementation and tasks ahead”. The Dialogue included four interactive discussions on: (a) the reform of the international monetary and financial system and its implications for development; (b) the impact of the current financial and economic crisis on foreign direct investment and other private flows, external debt and international trade; (c) the role of financial and technical development cooperation, including innovative sources of development finance, in leveraging the mobilization of domestic and international financial resources for development; and (d) the link between financing for development and achieving the Millennium Development Goals: the road to the 2010 high-level event. A summary of the Dialogue was given by the President of the General Assembly (see A/65/130).

73. 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 18 and 19 March 2010, on the overall theme “Building on Monterrey and Doha: towards achieving the internationally agreed development goals, including the Millennium Development Goals”. Pursuant to Council resolution 2009/30, the meeting was held five weeks prior to the spring 2010 meetings of the Bretton Woods institutions in Washington, D.C., and its duration was extended to two full days. New interactive modalities were utilized to organize three thematic debates on (a) mobilizing domestic and international resources to fund existing and emerging Millennium Development Goal implementation gaps; (b) supporting rehabilitation, recovery and development efforts of developing countries with special needs and those facing humanitarian emergency situations; and (c) enhancing coherence and consistency of

the international monetary, financial and trading systems in support of development. In follow-up, a summary by the President of the Economic and Social Council (A/65/81-E/2010/83) of the special high-level meeting was issued. The President of the Economic and Social Council was invited to present the outcome of the Council meeting to the joint World Bank/IMF Development Committee on 25 April 2010 in Washington, D.C.

74. The ad hoc open-ended working group of the General Assembly to follow-up on the issues contained in the Outcome of the Conference on the World Financial and Economic Crisis and Its Impact on Development held, from April to June 2010, a series of six substantive meetings on the themes (a) the impact of the crisis on debt sustainability of developing countries; (b) mobilization of additional resources to mitigate the impact of the crisis on the most vulnerable; (c) access to credit and concessionary finance, fiscal space for counter-cyclical policies and the current global reserve system; (d) improved financial regulation and supervision; (e) reform of the international financial and economic system, including voice and participation of developing countries in the Bretton Woods institutions; and (f) strengthening the role of the United Nations in global economic governance. The deliberations were summarized in a progress report of the working group to the General Assembly at its sixty-fourth session (A/64/884).

75. The fifth session of the Committee of Experts on International Cooperation in Tax Matters met in Geneva from 19 to 23 October 2009. The report of the Committee (E/2009/45) contains, inter alia, a draft United Nations code of conduct on cooperation in combating international tax evasion. Other substantive issues on the Committee agenda include definition of permanent establishment; taxation of services and development projects; tax incentives; transfer pricing; and revisions of the United Nations Model Double Taxation Convention between Developed and Developing Countries and the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries. The sixth session of the Committee will be held in Geneva from 18 to 22 October 2010.

76. An informal event on innovative sources of development finance, held in New York on 3 June 2010, consisted of two panel discussions on the themes (a) mechanisms of innovative development financing in operation; and (b) innovative development financing initiatives under development. In addition, the Financing for Development Office of the Department of Economic and Social Affairs of the Untied Nations Secretariat continued to organize, in collaboration with other stakeholders, workshops, multi-stakeholder consultations, panel discussions and other activities aimed at better enabling member countries to implement their commitments as agreed in the Monterrey Consensus and the Doha Declaration on Financing for Development. Information on those activities is posted, on a regular basis, on the website at www.un.org/esa/ffd.

77. In its resolution 64/193, the General Assembly endorsed the recommendations of the Economic and Social Council as contained in Council resolution 2009/30 on a strengthened and more effective intergovernmental inclusive process to carry out the financing for development follow-up, reiterated the need to review the modalities for the financing for development follow-up process, as appropriate, and requested the Secretary-General to include in an annual analytical assessment concrete proposals on the further strengthening of the financing for development follow-up process for consideration by Member States. In this regard, it will be recalled that

the note by the Secretary-General on coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus and the Doha Declaration on Financing for Development (E/2009/48) contained a detailed overview of various follow-up proposals, including those of the Secretary-General, in particular on the establishment of a new mechanism with a representative, multi-stakeholder “Financing for Development Committee” at its centre. Those proposals may continue to serve as a valid point of reference for further consideration by Member States, as appropriate.