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Coherence, coordination and cooperation on financing for development

Note by the Secretary-General*

Summary

The present note provides background information and suggested points for reflection to inform discussion on the following selected themes:

(a) Follow-up to the outcome of the 2010 High-level Plenary Meeting of the General Assembly on the Millennium Development Goals at its sixty-fifth session: 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;

(d) Financial support for development efforts of middle-income countries: development cooperation, trade, capital flows, policy space and reserve system.

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I. Follow-up to the outcome of the 2010 High-level Plenary Meeting of the General Assembly on the Millennium Development Goals at its sixty-fifth session: building the global partnership for development, including in response to new challenges and emerging issues

1. In the run-up to the 2010 High-level Plenary Meeting of the General Assembly on the Millennium Development Goals at its sixty-fifth session, the United Nations system, in an inter-agency effort, reviewed the status of progress and identified gaps in the achievement of the Goals. The reports of the United Nations system highlighted the need for collective future actions to promote the attainment of the goals by 2015, including in response to new challenges and emerging issues, such as the recent world financial and economic crisis, and food and energy price spikes, as well as climate change.[1]

2. While globally there have been major successes in reducing extreme poverty, improving school enrolment and child health, reducing child mortality and improving access to prevention and care of a number of infectious and neglected tropical diseases, progress has been uneven across countries and as regards targets of the Millennium Development Goals. For example, there has been slow progress in respect of reaching full and productive employment and decent work for all, in advancing gender equality and, particularly, in improving maternal and reproductive health. On the goal of developing the global partnership for development, the reviews found significant gaps in the delivery of international development cooperation commitments, including in respect of aid levels and effectiveness, conclusion of the Doha Round of multilateral trade negotiations, debt relief and resolution mechanisms, and access to affordable essential medicines and to new technologies.

3. Gains in respect of fighting hunger and malnutrition have been fragile and continue to be vulnerable to volatile food supply and prices. By February 2011, the world food price index of the Food and Agriculture Organization of the United Nations (FAO) had reached its highest level since it had been launched in 1990. The World Bank has estimated that some 44 million people worldwide became impoverished since June 2010 as a result of rising prices for basic foods.[2]

4. The recent food price spike has been driven by multiple factors. Underinvestment in food crop production due to years of neglect of agricultural development has led to declining or stagnant crop yields. Likewise, the reliance on agricultural trade liberalization as a means to achieve food security; the increasing frequency and severity of droughts and floods in important production areas, likely linked to climate change; and the diversion of food production to biofuels and animal feed have contributed to significant imbalances between food supply and demand. Much greater commodity price speculation together with lax monetary policies and the depreciating United States dollar may also have pushed food prices up.

[1] See *The Global Partnership for Development at a Critical Juncture: MDG Gap Task Force Report 2010* (United Nations publication, Sales No. E.10.I.12); and *The Millennium Development Goals Report 2010* (United Nations publication, Sales No. E.10.I.7).

[2] See "Food Price Watch" (World Bank, February 2011).

5. Agricultural subsidies in a number of high-income economies, particularly production subsidies, further aggravate the food security problem, since they insulate producers in developed countries from world price changes, shifting the adjustment burden to developing countries. Moreover, subsidized country exports take significant market shares away from more efficient developing-country exporters and local producers. Other supply-side measures, particularly stockpiling of food and imposition of restrictions on food exports introduced to protect the domestic food supply, including by developing countries, could further exacerbate food price volatility.

6. Actions taken with respect to food price volatility are short- and long-term, with different objectives. Short-term actions should seek to mitigate its harmful effects on poor producers, market agents and consumers. Key examples are targeted safety nets for consumers, pre-positioned small emergency stocks in areas known to be problematic in terms of volatility and poor transport infrastructure, and better and more accessible information, forecasting and risk management tools for producers and market agents. Targeting to the poor and vulnerable and to actual risks is key to the efficiency of short-term response. Long-term responses also need to be started immediately, and to focus on efforts to improve the productivity, resilience and sustainability of agriculture in poor countries faced with tightening supplies of water and land. In addition, action is needed to improve market access, strengthen institutions for better management of risks and promote increased country ownership of evidence-based, strategic and inclusive plans for the provision of agricultural public goods.

7. The outcome of the Doha Round of multilateral trade negotiations could enhance its potential development impact through the reduction of trade-distorting subsidies, the elimination of export subsidies, tightening the disciplines on and use of other export restrictions, and promoting strengthened, non-distorting international agricultural trade markets. At the national level, policies aimed at reducing risks and lowering transaction costs could further stimulate investment in the productive capacities of the economy, particularly in the agricultural sector.

8. In the 1960s and 1970s, the green revolution led to a dramatical increase in crop yields and food production in wheat, maize and rice. It was an achievement that would have been impossible without considerable financial support from Governments, international institutions and philanthropists. Yet, 40 years later, there is a need for a second green revolution for other food crops, especially with respect to water-stressed food agriculture and sustainable management of land, water and forestry. Additional resources to finance the sustainable transformation of agriculture should be part of Governments' strategies to sustain the global economic recovery.

9. In this connection, it is important for Member States to follow through on their pledge to substantially increase the share of official development assistance (ODA) devoted to agriculture and food security based on country-led requests, as agreed at the World Summit on Food Security, held in Rome in November 2009. They should also fulfil their commitment as set out in the L'Aquila Food Security Initiative, including to progress "towards a goal of mobilizing $20 billion over three years" (subsequently increased to $22 billion), which is to be applied under a "coordinated, comprehensive strategy focused on sustainable agriculture development". Yet, to date, only $400 million has been mobilized in delivery on this commitment.

Furthermore, donors have not made clear to what extent these pledges for support to food security are within existing ODA commitments or are additional.

10. There is growing agreement that climate change has increased and intensified unpredictable weather patterns. Floods and droughts have reduced agricultural production and contributed to the sharp rises in food prices. The mitigation of climate change through a reduction in carbon emissions and the promotion of renewable energy must remain high in the global agenda. Developing countries can shift to lower-carbon paths while promoting development and reducing poverty, but this depends on financial and technical assistance from high-income countries. In this connection, Millennium Development Goal 8 calls for greater access for developing countries to new technologies at affordable cost. The chance to leapfrog to higher levels of technology could allow them to save resources and even facilitate activities that would otherwise not be possible without the supporting infrastructure.

11. The members of the international community should come together to better provide other key technologies to developing countries, such as those needed for coping with the adverse effects of climate change and reducing greenhouse gas emissions. The United Nations Framework Convention on Climate Change[3] enshrines commitments by developed countries to "take all practicable steps to promote, facilitate and finance, as appropriate, the transfer of, or access to, environmentally sound technologies and know-how to other Parties, particularly developing-country Parties" (article 4, para. 5). Furthermore, in order to make stakeholders more accountable and make these commitments more coherent with others, the "additionality" of the funds should be made explicit.

12. In early 2009, the Secretary-General proposed a Global Green New Deal to accelerate economic recovery and job creation while addressing sustainable development, climate change and food security challenges, by front-loading massive multilaterally cross-subsidized public investments in developing countries in renewable energy and smallholder food agriculture so as to induce complementary private investments. Following years of easy credit and overinvestment before the crisis, the world now faces underutilized over-capacity in most profitable economic sectors. In this situation, well-coordinated cross-border public investments can fund needed green public goods and induce complementary private investments, for example, through public-private partnerships, in order to address these global challenges. Besides contributing to sustained economic recovery, such investments would also enhance climate change mitigation while advancing developing countries' developmental aspirations and ensuring affordable food security.

13. The world financial and economic crisis has adversely affected development gains and slowed or reversed progress in economic and social development in many countries. Although a deeper and prolonged recession seems to have been averted with unprecedented coordinated actions by major developed and emerging economies, the recovery is still tepid, fragile and uneven.

14. At the High-level Plenary Meeting of the General Assembly on the Millennium Development Goals at its sixty-fifth session, heads of State and Government committed themselves to making every effort to achieve the Millennium Development Goals by 2015 based on an action agenda adopted towards this end.[4]

[3] United Nations, *Treaty Series*, vol. 1771, No. 30822.

[4] See General Assembly resolution 65/1.

They paid due attention to the particular needs of the most vulnerable countries — the least developed countries, landlocked developing countries and small island developing States — as well as to the development challenges faced by middle-income countries. They underlined the importance of Goal 8 (Develop a global partnership for development) in achieving all other Goals and committed themselves to accelerating efforts to implement existing commitments related to Goal 8. They also emphasized the need for mutual accountability in meeting commitments made by developing and developed countries in the context of the global development partnership.

15. Accelerating progress in achieving Millennium Development Goal 8 involves meeting development partnership commitments made in the Monterrey Consensus of the International Conference on Financing for Development[5] and the Doha Declaration on Financing for Development: outcome document of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus[6] and all other relevant outcomes of United Nations conferences and summits aimed at enhancing all aspects of financing for development: domestic resource mobilization of developing countries, foreign direct investment (FDI) in these countries, international trade, international development cooperation, external debt and systemic issues. In order to implement this global partnership, developed and developing countries should be mutually accountable in their efforts towards achieving the internationally agreed development goals, including the Millennium Development Goals.

16. Improving human welfare and eradicating poverty must remain the ultimate objectives of national development strategies. These strategies will need to be supported: by stable aid flows, especially for low-income countries with limited access to other sources of financing; by a fair multilateral trading regime, supported by steady Aid-for-Trade flows that help in building domestic production capacity and pursuing sustainable development goals; and by stable and predictable international financial markets.

17. The outcome document of the High-level Plenary Meeting called for efforts at all levels to enhance policy coherence for development, noting that accelerated progress in achieving the Millennium Development Goals required mutually supportive and integrated policies across economic, social and environmental issues for sustainable development. More effective coordination of policies at the national, regional and global levels will help engender outcomes consistent with objectives of global financial stability, shared prosperity and sustainability of the world's natural environment. Closer global cooperation is needed to tackle a wide range of global challenges, including greater access by developing countries to technology needed to address climate change and the need for a global framework for managing international migration. Moreover, developed and developing economies should come together to coordinate counter-cyclical macroeconomic policies, particularly in times of crises, work towards international financial regulation, and control harmful regulatory and tax competition.

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[5] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

[6] General Assembly resolution 63/239, annex.

Some questions for discussion

1. **What actions can be taken at the global level to respond more quickly and effectively to new challenges and emerging issues?**

2. **What constitute effective ways to facilitate the flow of international private capital, particularly long-term investment, to developing countries?**

3. **How can the conclusion of the Doha Round of multilateral trade negotiations be expedited and the potential benefits of the Doha Development Agenda (see A/C.2/56/7, annex) be realized?**

4. **How can international cooperation be more effective in ensuring debt sustainability of developing countries and fostering consideration of enhanced and fair approaches to sovereign debt restructuring mechanisms?**

5. **How can the international community ensure that commitments in respect of ODA levels and effectiveness are met? How can complementary sources of development cooperation financing be mobilized?**

II. Role of the United Nations system in global economic governance

18. The term "global economic governance" commonly refers to the role of multilateral institutions and processes in shaping global economic policies, rules and regulations. While global economic governance may refer to existing multilateral approaches to managing global economic challenges, it may also point towards the concept of a more ambitious international framework for global economic cooperation. In this connection, the General Assembly has highlighted the need for more inclusive, transparent and effective multilateral approaches to managing global challenges and reaffirmed the central role of the United Nations in ongoing efforts to find common solutions to such challenges.[7]

19. The current global governance structure in the economic field is highly decentralized and lacks an effective formal mechanism for economic policy coordination. Large numbers of intergovernmental organizations with varied compositions, structures and purposes exist. Within the United Nations system, many of the organizations, even formally specialized United Nations organizations like the Bretton Woods institutions, report to their own executive boards and operate independently of governing bodies of the United Nations, such as the General Assembly and the Economic and Social Council. As a result, self-selected informal groupings, like the Group of Twenty (G20), and the Group of Seven/Group of Eight (G7/8), have taken the lead in formulating and implementing coordinated economic policies which have far-reaching impact beyond their limited membership.

20. The rules of the United Nations system were shaped, for the most part, more than 60 years ago, at the time of the founding of the United Nations. While the United Nations remains the only truly universal and inclusive forum for dialogue, it urgently needs to adapt its structures so as to increase its effectiveness in responding to current global challenges. As a result of slow decision-making processes and lack

[7] See General Assembly resolution 65/94 of 8 December 2010.

of political support and follow-up, United Nations bodies, particularly the Economic and Social Council, have found it challenging to fulfil their roles as defined in the Charter of the United Nations and move beyond serving as just forums for dialogue on global economic challenges. Consequently, most of the actual global economic and development policy formulation and implementation within the formal institutional structures of the United Nations have become the responsibility of agencies that are part of the wider United Nations system but operate under their own governance structures. However, those governance structures need to undergo significant reforms if they are to reflect the realities of the twenty-first century.

21. In this connection, the International Monetary Fund (IMF) and the World Bank have taken initial steps to redress imbalances in voice and representation and to move towards a more representative, responsive and accountable governance. On 15 December 2010, the IMF Board of Governors approved governance reforms under the Fourteenth General Review of Quotas. The reforms double current quotas, which will result in roughly a 6-percentage-point shift in quota share within the membership so as to increase the share of emerging market countries. The reforms maintain the voting shares of the poorest members and provide for a more representative and fully elected Executive Board. However, the reformed governance structure still gives one country veto power over the majority threshold of 85 per cent needed for major Executive Board decisions. Likewise, the World Bank Governors, at their 2010 Spring Meeting, decided to introduce a second phase of global governance reform, which will lead to a shift in voting power to developing and transition economy countries. Yet, according to many members, particularly from developing countries, these measures do not suffice, as the current governance structure of the Bretton Woods institutions falls short of the objective of achieving more adequate and legitimate representation.

22. The World Trade Organization is different from the World Bank and IMF in that the decision-making authority is not delegated to a board of directors or the Organization's head. All major decisions are made by the membership as a whole and are taken by consensus. In order to advance the negotiations and facilitate the decision-making process, chairpersons of negotiating groups often hold bilateral or small group consultations with delegations. These as well as other meetings, to which representatives of different groups of countries are invited, can be an important tool for building consensus. Yet, the meetings, as conducted, must be careful to allay concerns among delegations about the transparency and inclusiveness of the process.

23. Such informal arrangements may enhance the capacity of these institutions to arrive at decisions in a timely manner. However, given the complexities and interdependencies of the global economy, consultative, transparent and inclusive processes are fundamental for the effective implementation of policy decisions on a global scale. They ensure that policy agreements take into account both immediate and longer-term issues as well as the concerns of the most vulnerable and marginalized countries. Hence, legitimacy and effectiveness should not be seen as mutually exclusive.

24. In this regard, the emergence of the G20 as the self-proclaimed major forum for global discussions and decision-making on international economic cooperation has received mixed responses from States Members of the United Nations. Some feel that the G20 succeeded in averting a global depression and managed to put the

world economy on the path of recovery; others point out that, although the G20 was able to respond to the crisis relatively quickly, the consensus that made the quick response possible has already faded, which means that a sustainable long-term form of global governance is still lacking. Whereas most of the smaller countries may have limited systemic importance for the world economy, issues under discussion at the G20, such as responses to the recent financial and economic crises, financial stability and banking supervision, global imbalances, inclusive and innovative finances, food security and commodity price stabilization, as well as the broader development agenda, will have profound implications for their economies.

25. In addition to challenges in respect of the governance structures of multilateral bodies, the overall system of global economic governance suffers from a deficit of coherence, coordination and cooperation, as was already recognized in the 2002 Monterrey Consensus of the International Conference on Financing for Development. Decisions and actions taken by Governments and institutions alike in different parts of the system in relation to growth, stability, trade and sustainable development are not always consistent with one another or complementary. Moreover, this deficit is also reflected in the weak accountability for, and weak enforceability of, decisions and internationally agreed commitments made in United Nations processes and forums. Creation of a more effective United Nations framework for coordination, coherence and cooperation should therefore be at the forefront of efforts to reform the existing system of global economic governance.

26. Over the last decade, States Members, have strongly and consistently reaffirmed the role of the Economic and Social Council in promoting the overall coherence, coordination and cooperation of United Nations system activities in economic, social and related areas. The Monterrey Consensus (para. 69 (b)) encouraged “the United Nations, the World Bank and the International Monetary Fund, with the World Trade Organization, to address issues of coherence, coordination and cooperation, as a follow-up to the Conference, at the spring meeting between the Economic and Social Council and the Bretton Woods institutions. The 2005 World Summit Outcome[8] led to the strengthening of the Council’s functions as a forum for policy debate and consensus-building through the introduction of the annual ministerial review and the biennial Development Cooperation Forum. Despite this, internal coordination and cooperation have been difficult owing to the decentralized structure of the United Nations system. Moreover, notwithstanding many efforts, the Council’s deliberations have not been able to attract the same degree of participation by senior officials from finance, trade and economic ministries as have corresponding events held by the Bretton Woods institutions and the World Trade Organization, nor has the Council been able to ensure effective accountability and implementation of commitments made in United Nations processes.

27. While there is widespread consensus on the need to strengthen coherence, coordination and cooperation within the United Nations system, an important consideration is whether these efforts should be pursued in the framework of existing structures or warrant the creation of new mechanisms. Suggestions have been put forward to strengthen the standing, impact and working methods of the Economic and Social Council within that framework. For example, one proposal envisages increasing the influence of the Council’s decisions and recommendations

[8] See General Assembly resolution 60/1.

through summit-level meetings on issues related to global economic governance, and ministerial-level meetings on specific sector-related issues. A more ambitious proposal relates to establishing a global economic coordination council, at a level equivalent that of the General Assembly and the Security Council, which "would promote development, secure consistency and coherence in the policy goals of the major international organizations and support consensus-building among Governments on efficient and effective solutions for issues of global economic governance". Representation in the council would be based on a constituency system and would be designed to ensure that all continents and all major economies are represented, with relevant global institutions participating in its work.[9]

28. It is also important that there be agreement on ways to enhance the efficiency of the United Nations system and, in particular, to ensure that its subsidiary machinery responds to global economic issues and development challenges in a timely, coherent and coordinated fashion. The degree of coherence, coordination and cooperation of global economic governance through the existing multilateral framework has been tested by informal groupings of Member States and, most recently, by the increasing prominence of the G20. Attention is therefore being given to enhancing the engagement of the United Nations with the G20, the United Nations being the essential forum in which Governments' actions can be held accountable. For example, some 27 non-G20 nations have joined in an informal coalition known as the Global Governance Group or "3G".[10] 3G made several recommendations on how to improve the engagement between the G20 and the United Nations. First, the G20 should undertake consultations as widely as possible, through regular and predictable channels, with non-G20 members before the G20 summits. The hosts of the G20 summits should also provide the rest of the United Nations membership with an update after the meetings. Second, the participation of the United Nations Secretary-General and the United Nations "Sherpa" at the G20 summits and preparatory meetings, respectively, should be formalized. Third, the participation of regional organizations in G20 summits should be regularized. Fourth, the G20 decision-making process should take on a "variable geometry" configuration so as to allow non-G20 States to participate in ministerial gatherings and other working groups involving senior officials and experts on specialized issues (see document A/64/706, annex).

29. The topic of global economic governance has featured strongly in the deliberations of Member States in both the Economic and Social Council and the General Assembly, particularly in the context of the financing for development follow-up process. The Ad Hoc Open-ended Working Group of the 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[11] convened a meeting on the issue of "Strengthening the role of the United Nations in global economic governance". The Council, during its 2010 substantive session, hosted a panel discussion on the subject. The discussions highlighted the pressing need to

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[9] See para. 24 of the recommendations contained in A/63/838.

[10] The 3G comprises the following States Members of the United Nations: Bahamas, Bahrain, Barbados, Botswana, Brunei Darussalam, Chile, Costa Rica, Guatemala, Jamaica, Kuwait, Liechtenstein, Malaysia, Monaco, New Zealand, Panama, Peru, Philippines, Qatar, Rwanda, San Marino, Senegal, Singapore, Slovenia, Switzerland, United Arab Emirates, Uruguay and Viet Nam.

[11] General Assembly resolution 63/303, annex.

strengthen the representation of developing countries in several key international decision-making bodies; the importance of considering ways of enhancing the engagement between the G20 and the wider United Nations membership; the need to strengthen the role of the United Nations in global economic governance; and the importance of having new, effective multilateral frameworks that deal with critical issues such as international financial regulation, international migration and sovereign debt workouts.

30. Finally, well-coordinated regional and subregional cooperation mechanisms can play an important role in strengthening the role of the United Nations system. Regional cooperation can complement the work of international organizations through better identifying and responding to specific regional needs and demands and ensuring better representation for smaller and poorer countries, providing a source of counter-cyclical finance and other actions. Moreover, cooperation between countries in a region can help them to fill financing gaps and benefit from economies of scale. In particular, Governments can join forces to better mobilize resources, reduce costs and enhance stability through, inter alia, risk pooling, trade integration and harmonization of policies and institutions to deepen regional markets.

Some questions for discussion

1. **Nine years after the Monterrey conference, how can the United Nations, the Bretton Woods institutions and the World Trade Organization learn from past experiences and efforts to more effectively coordinate their actions so as to increase the coherence and consistency of the international monetary, financial and trading systems in support of development?**

2. **What should be the modalities of engagement between the United Nations and informal groups of limited composition such as the G20?**

3. **Which are the most effective ways to strengthen the role of the United Nations in global economic governance? Are new structures the answer, or should the focus be on improving the standing and impact of the Economic and Social Council and its coordination functions?**

4. **What can be done to ensure that the United Nations and its subsidiary machinery will arrive at and implement decisions on global economic issues in a timely fashion?**

5. **In what ways can regional cooperation mechanisms complement global economic governance?**

III. Financial support for development efforts of least developed countries: development finance, including innovative mechanisms, Aid for Trade and debt relief

31. The least developed countries have a higher level of vulnerability which constrains their capacity to mobilize domestic resources and absorb external shocks. Their limited access to private capital makes ODA the most vital source of development finance for achieving the Millennium Development Goals and other

development goals. The Brussels Programme of Action for the Least Developed Countries for the Decade 2001-2010[12] calls for an effective partnership between least developed countries and developed countries towards mobilizing financial resources for development. ODA directed towards key productive sectors with large spillovers helps crowd in private investment and trigger large supply responses. Consequently, development finance that is well targeted and efficiently used can build the capacities of least developed countries to mobilize domestic sources.

32. Despite considerable progress in the last decade in aid delivery, ODA continues to fall short of commitments made at major United Nations conferences and summits. For example, net ODA disbursements from Organization for Economic Cooperation and Development-Development Assistance Committee (OECD-DAC) donors to least developed countries increased from less than $14 billion in 2001 to $37 billion in 2009. During the same period, the share of aid flows to least developed countries rose from 17 to 30 per cent of aggregated ODA compared with 17 per cent in 2001. However, OECD-DAC donors spent only 0.10 per cent of their aggregated gross national income (GNI) on ODA to least developed countries,[13] which remained well below the United Nations target of 0.15-0.20 per cent of GNI, as set in the Brussels Programme of Action. The shortfall has led to an estimated delivery gap of $23 billion-$43 billion.[14] At the individual donor level, 14 OECD-DAC donors out of 23 failed to meet the 0.15 per cent target.

33. Moreover, ODA allocation has been highly skewed.[15] The distribution of aid across countries and sectors remains uneven, with the tendency being to allocate a rising share of aid in a few countries and in the social infrastructure and social services (such as health and education), while reducing aid to production sectors, especially food agriculture and infrastructure. Yet, structural vulnerabilities leave least developed countries highly susceptible to the adverse impacts of external shocks and can lower their repayment capacity over time. Well-coordinated development aid that addresses structural vulnerabilities and promotes the productive capacities of least developed countries could reduce output volatility in these countries and help to mitigate shocks. The donor community should thus include some measure of vulnerability to external shocks as a determinant in ODA allocation. Current measures to enhance the productive capacity and reduce the vulnerability of least developed countries, including the trade-oriented Enhanced Integrated Framework for least developed countries, need to be integrated into a more systematic effort by donors and relevant multilateral institutions.[16] The Fourth United Nations Conference on the Least Developed Countries, to be held in Istanbul in May 2011, will provide a crucial opportunity to address these gaps and work towards more coherent, consistent and effective ODA for least developed countries.

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[12] A/CONF.191/13, chap. II.

[13] Based on updated figures (23 December 2010) presented in table 31, Statistical Annex of the Organization for Economic Cooperation and Development (OECD) Development Co-operation Report 2010. Available from http://www.oecd.org/document/9/0,3746,en_2649_34447_1893129_1_1_1_1,00.html.

[14] See OECD, "Development aid rose in 2009 and most donors will meet 2010 aid targets", 14 April 2010. Numbers are estimated in 2009 exchange rates and prices.

[15] *The Global Partnership for Development at a Critical Juncture*.

[16] Department of Economic and Social Affairs, Committee for Development Policy, Strengthening International Support Measures for the Least Developed Countries, policy note (United Nations publication, Sales No. E.10.II.A.4).

34. Innovative sources of finance have grown in number and size over recent years and provide important development resources for least developed countries. However, the large majority of donors continue to include these flows in their traditional budgetary accounts for ODA, which makes it difficult to gauge how far these flows are additional to present ODA commitments, as contained in the Monterrey Consensus and the Doha Declaration on Financing for Development. Based on an OECD study on innovative finance,[17] the revenues raised by the major existing mechanisms from 2003 to 2010 are estimated at about $5 billion.

35. Better-targeted and less volatile ODA would increase aid quality and effectiveness, as envisaged in the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action.[18] With low domestic revenue generation and limited access to global capital markets, least developed countries rely on ODA as a major source of funding for government development spending. Consequently, their budgetary processes are directly affected by the delivery, timing and composition of aid. Yet, aid disbursements remain unstable, as outlined in *The Least Developed Countries Report 2010*.[19] Moreover, since the timing of aid flows tends to be pro-cyclical, many least developed countries do not receive financing when it is most needed for the implementation of counter-cyclical economic policies.[19] In this connection, Heads of State and Government, in the outcome document of the High-level Plenary Meeting, encouraged "all donors to establish ... rolling indicative timetables that illustrate how they aim to reach their goals, in accordance with their respective budget allocation process" (para. 78 (f)).

36. Concerted efforts are needed to conclude the Doha Round of multilateral trade negotiations with a strong development outcome. In this connection, the outcome document called for "implementing duty-free and quota-free market access for all least developed countries in conformity with the Hong Kong Ministerial Declaration adopted by the World Trade Organization in 2005" (para. 78 (m)). Aid for Trade can play an important role in helping countries develop the necessary infrastructure, institutions and technical capacity to harness the benefits and minimize the risks of trade liberalization. Aid-for-Trade commitments to least developed countries reached almost US$ 12 billion in 2009, representing a growth of 13.8 per cent as compared with 2008. These commitments represent 32.5 per cent of the total Aid for Trade for developing countries, as compared with 28.6 per cent in 2008.[20] Developed countries should build on these efforts and further increase Aid for Trade to least developed countries in support of their efforts to reduce the adjustment costs of trade liberalization.

37. A growing share of Aid-for-Trade commitments for least developed countries (63 per cent in 2009, compared with 46 per cent in 2006) flows towards trade-related infrastructure projects in the transport, energy and communication sectors. Commitments for agriculture, industry and mining decreased to 27.7 per cent in 2007-2008 but recovered to previous levels, of about 32 per cent, in 2009. Consistent

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[17] Elisabeth Sandor, Simon Scott and Julia Benn, "Innovative financing to fund development: progress and prospects", DCD Issues Brief (Paris, OECD, November 2009).

[18] A/63/539, annex.

[19] United Nations Conference on Trade and Development, *The Least Developed Countries Report 2010: Towards a New International Development Architecture for LDCs* (United Nations publication, Sales No. E.10.II.D.5).

[20] Data from OECD Query Wizard for International Development Statistics (QWIDS). Final Aid-for-Trade data for 2009 will be available in April 2011.

with the structure of least developed countries' economies, agriculture received the highest commitments among these three sectors, averaging 22.6 per cent in 2002-2009.[21] In addition to promoting trade infrastructure and the productive capacity of the domestic economy, Aid for Trade can also enhance development through capacity-building in trade negotiations.

38. Spending priorities within Aid-for-Trade projects should be properly aligned with national development strategies. Donor funds are most effective where they target the trade-related needs and priorities of the recipient country. Aid for Trade should therefore promote greater country ownership and integration of trade into national development strategies. This implies the need for sufficient policy space in developing countries for enhancing necessary production and trading capacities. Moreover, given the low revenue generation, limited repayment capacity and economic vulnerability, as well as the extreme aid dependence of least developed countries, Aid for Trade should be predictable, sustainable and effective and remain additional to existing ODA commitments.

39. Since the implementation of the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), debt ratios in many least developed countries had shown a marked improvement. For the least developed countries as a group, external debt stocks as a share of gross domestic product (GDP) decreased from 75 per cent in 2002 to 33 per cent in 2007.[22] However, the world financial and economic crisis has adversely affected debt indicators in many least developed countries. Since 2007, the external debt stocks of least developed countries as a group increased by 12 per cent, reaching 160.9 billion in 2009. The ratio of external debt service to exports also increased by 2 per cent, reaching 5.7 per cent in 2009. The present value of debt to exports, in 11 countries surpasses 150 per cent, the threshold for HIPC debt relief. Owing to the severity of the crisis, falling fiscal revenues, export earnings and income affected all countries and many experienced rising public debt-to-GDP ratios. A prompt and sustained recovery of the world economy could substantially improve the position of many countries. In the current global environment, oil prices are rising and risks remain high.

40. Of the 40 countries eligible or potentially eligible for debt relief under the HIPC Initiative (of which 30 are least developed countries), 36 (including 27 least developed countries) have qualified for HIPC Initiative assistance, of which 32 (including 25 least developed countries) have reached the completion point and were thus granted the full relief programmed and also qualified for additional relief from remaining multilateral obligations owed to participating institutions under the MDRI, while 4 countries (including 1 least developed country) have received interim relief. Based on the analysis carried out on the Debt Sustainability Framework for Low-Income Countries,[23] three pre-decision-point least developed countries are characterized as being in debt distress. As of 15 December 2010, nine least

[21] Ibid.

[22] Calculations derived from the World Bank Global Development Finance database (accessed 18 February 2010).

[23] International Development Association (IDA) and International Monetary Fund (IMF), "Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI): status of implementation", staff paper, 14 September 2010.

developed countries out of 32 post-completion-point HIPCs are considered at high risk of debt distress.[24]

41. New debt restructuring mechanisms might have to be considered for some least developed countries, especially if global economic recovery remains slow and fragile. There are currently no formal international mechanisms that effectively deal with official debt restructuring and help tackle commercial debt. Outside the HIPC Initiative, official debt relief is provided through the informal Paris Club, which consists of 19, mostly large, creditor economies. Eligibility for debt relief is assessed on a case-by-case basis by Paris Club creditors, taking into account the track record of the debtor country with the Paris Club and IMF and various other criteria like per-capita income, level of indebtedness and debt service. However, since the Paris Club creditor's share of debt is now smaller than that due to other official and non-official creditors,[25] a more inclusive, transparent and legitimate internationally agreed mechanism could fill an important gap in the current international financial architecture.

42. The delay in resolution of high debt burdens among some low- and middle-income countries and the surge of sovereign debt distress among a number of developed countries point to the urgent need for setting up an international sovereign debt workout mechanism which would allow countries to restructure their debt in a timely and comprehensive manner, as outlined in the Monterrey Consensus. More efforts are needed through international debt resolution mechanisms to guarantee equivalent treatment of all creditors, just treatment of creditors and debtors, and legal predictability, as stated in the Doha Declaration on Financing for Development and reiterated in the outcome document of the High-level Plenary Meeting of the General Assembly on the Millennium Development Goals. In addition, there are limits to the resources available for official sector financing in bailing out countries in debt distress. The right balance between official sector financing, debt standstills and debt restructuring and debt write-offs has to be determined on a case-by-case basis.

Some questions for discussion

1. **Should structural vulnerabilities be the basis for allocation of grants to least developed countries and assessments of their ability to repay debt?**

2. **How should the methods for aid allocation be reviewed to ensure aid flows to the neediest countries and finance investments in productive capacity?**

3. **How can additionality, stability and sustainability of innovative financing and aid-for-trade flows be ensured?**

4. **What are the possible options for new modalities for providing debt relief to least developed countries?**

5. **How can policy coherence be ensured between development finance, aid for trade, and debt relief?**

[24] IMF, "List of LIC DSAs for PRGT-eligible countries", as of 15 December 2010.
[25] See note 24, p. 33 of the database.

IV. Financial support for development efforts of middle-income countries: development cooperation, trade, capital flows, policy space and reserve system

43. With sustained rapid growth in a number of emerging economies over the past decade, the contribution of middle-income countries to global growth has increased steadily, reshaping the regional composition of the global economy. Middle-income countries as a group account for two thirds of the world population and almost 40 per cent of world gross product. They have also become an engine of growth driving the global economic recovery from the financial crisis. Yet, despite notable reductions in extreme poverty, middle-income countries are still home to 64 per cent of the world population that lives on less than $1.25 per day.

44. Priority areas of development cooperation for middle-income countries as a group should be in poverty eradication and reduction of economic and social inequality, strengthened governance, production diversification, increased resilience to external financial and trade shocks, external debt sustainability and strengthened financial and technological capacity for climate change adaptation and mitigation. Strengthened cooperation of the United Nations system with middle-income countries needs to be based on better alignment of development programmes with country priorities and development strategies. This should be complemented by strengthening South-South cooperation. In addition, voice and representation of middle-income countries in the international financial institutions and other international decision-making groups or bodies should be commensurate with their importance in the global economy.

45. At the Doha Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, Member States agreed to strengthen and support efforts of middle-income countries to ensure that results in achieving development goals, including the Millennium Development Goals, are sustained. Member States also acknowledged that official financing remained essential for some of these countries in targeted areas of need, specific to individual countries' circumstances. The General Assembly, in paragraph 7 of its resolution 64/208, invited the international community to further strengthen its support to the development efforts of middle-income countries through targeted technical assistance, provision of resources, technology transfer and capacity-building; and underscored the need for sustained efforts towards achieving debt sustainability in middle-income countries in order to avert a debt crisis, and encouraged further efforts by international financial institutions to enhance facilities for them (para. 9).

46. Middle-income countries have led the recovery in international trade following the recent world financial and economic crisis. Their impressive performance follows important efforts undertaken to diversify their exports in manufacturing and services and gain higher market shares for high-technology goods. Looking ahead, middle-income countries should build on these reforms and improve external competitiveness through product differentiation, and more active international marketing, as well as through moving into more dynamic areas of specialization with a higher technological content and greater value added.

47. Moreover, increased ties among developing countries through global value chains have helped many smaller middle-income countries to benefit from international trade. However, despite important reforms and strengthened trade ties,

especially through components trade,[26] middle-income countries remain highly dependent on demand for exports in developed countries. The Doha Round could help ensure greater and less volatile future demand for goods and services from middle-income countries through reducing high levels of tariff protection and market distortions created by subsidies and other protectionist measures.

48. In the aftermath of the financial crisis, capital inflows to middle-income countries have taken centre stage in the policy debate on global and domestic economic and financial stability. As noted in *World Economic Situation and Prospects 2011*,[27] counteracting damaging international spillover effects in the form of increased currency tensions and volatile short-term capital flows represents one of the major policy challenges.

49. After declining markedly during the crisis, private capital flows to these countries recovered strongly in 2009-2010. Low interest rates and improved liquidity conditions in developed countries, the result of monetary policy measures undertaken to strengthen economic recovery from the crisis, have led to surges of capital flows to middle-income countries with comparatively higher interest rates and stronger growth prospects.

50. The recovery in private capital flows has important benefits for developing countries in terms of providing financing for productive investments and facilitating financial development. However, large capital inflows pose risks and policy dilemmas when they are largely in excess of the economy's absorptive capacity and/or highly speculative in nature. In this case, capital flows can lead to exchange-rate overshooting, credit booms, asset price bubbles and financial instability. There are also clear risks of abrupt stops or reversals in those flows. Capital flows are essentially pro-cyclical: they surge during economic booms, but reverse during economic slowdowns. A case in point was the abrupt and massive outflow of capital after the eruption of the global financial crisis. Consequently, middle-income countries experienced severe turbulence in financial markets, even though they were not at the epicentre of the crisis.

51. There is no one-size-fits-all solution to problems associated with volatile capital flows. Governments have a variety of policy tools with which to help stabilize financial flows. Faced with the threat of excessive currency appreciation, many central banks in middle-income countries have intervened in the foreign-exchange market. The result has been accumulation of foreign-exchange reserves. Although this serves the purpose of self-protection in case of capital outflow, accumulating and holding reserves are seen as not costless in terms of forgone productive investment and social spending.[28]

52. The recent initiatives to strengthen the global financial safety net are unlikely to radically change countries' incentives to accumulate reserves, which remain their first line of defence against potential shocks. Reserve accumulation has been an effective option for middle-income countries. Central banks in many emerging and

[26] See Prema-Chandra Athukorala and Jayant Menon, "Global production sharing, trade patterns, and determinants of trade flows in East Asia", ADB Working Paper Series on Regional Economic Integration, No. 41 (Manila, Asian Development Bank, 27 January 2010).

[27] United Nations publication, Sales No. E.11.II.C.2.

[28] Some have argued that a reformed exchange-rate system based on rules to adjust nominal rates in line with differentials in the rate of inflation or interest could reduce speculative capital and help avert the need for government intervention that leads to reserve accumulation.

some developed countries used part of their reserves to ease domestic tensions created by dollar liquidity shortages in the recent financial crisis. It is hardly possible that, in the foreseeable future, countries will have automatic access to a sufficient quantity of foreign-currency funding to cope with a major crisis. Consequently, countries will continue to hold some reserves of their own, and there are strong indications that reserve accumulation will persist and grow in the aftermath of the crisis. The practice of relying, to varying degrees, on a mix of complementary self-insurance and bilateral and multilateral agreements will therefore likely continue unless there are changes made to the global financial architecture.

53. There have also been suggestions that emerging economies should adjust macroeconomic policies by raising interest rates and tightening fiscal policy in light of rising inflationary pressures. However, this policy mix is likely to induce more capital inflows and jeopardize the nascent recovery which, in many countries, is led by domestic demand. Moreover, fiscal consolidation is not likely to address financial fragility concerns promptly. In many countries, macroeconomic policies were supplemented by additional macroprudential measures. In some cases, direct capital controls, aimed at stemming large inflows of short-term and volatile capital, were introduced. In this regard, it has been recognized that, along with macroeconomic and prudential policy measures, and depending on the circumstances, the imposition of capital controls may be an appropriate response.[29] Capital controls may also reduce the need to accumulate foreign reserves, as they could help to reduce the risk of sudden capital flow reversal.

54. In the wake of the post-crisis resurgence in private capital flows, several middle-income countries have turned to direct capital control measures to limit currency appreciation and financial fragility.[30] These measures include mandatory reserve requirements on foreign currency-denominated debt, taxes on foreign loans aimed at offsetting interest-rate differentials, minimum investment periods and quantitative limits on certain types of cross-border capital transactions. Also, some countries have prohibited financial institutions from holding currency mismatches in their portfolios or lending in foreign currencies to individuals and/or firms that do not have revenues in those currencies. Others have chosen to increase capital requirements for those that have currency mismatches.

55. Free flows of capital may not necessarily be the preferred option for middle-income and other developing countries, as fully open capital accounts can be problematic. The success of development strategies may require dynamic capital-account management to enhance policy space so that there is flexibility to both tighten and loosen controls as and when necessary in order to pursue counter-cyclical macroeconomic policies. IMF is now examining in detail the issue of reducing capital flow and exchange-rate volatility, including whether there is a need for globally agreed "rules of the road" for managing capital flows. The World Bank

[29] See, for instance, Dominique Strauss-Khan (Managing Director, IMF), "The right kind of global recovery", 1 February 2011. Available from www.imf.org.

[30] They include Brazil, Chile, Indonesia, Mexico, Peru, Singapore and Thailand. In the run-up to the Group of Twenty (G20) summit in Seoul, the Economic and Social Commission for Asia and the Pacific (ESCAP) convened a meeting of its over 50 member States to support the use of capital controls.

also considers that temporary capital controls may be appropriate for mitigating the adverse impacts associated with the surge and volatility of capital inflows.[31]

56. However, there will be a limit to how much capital controls imposed by recipient countries can achieve. In an era of financial globalization, it is no longer possible for any individual country to fully manage cross-border risk on its own. Moreover, it is important to take into consideration multilateral dimensions of capital-account management. Consequently, there is a need for some form of global governance of cross-border capital flows which is largely lacking. In this regard, there have been calls for an international code of conduct for regulating international capital flows to be put in the agenda of the G20 and other relevant international forums.[32]

57. In the same vein, the proposal to introduce an internationally coordinated tax on cross-border financial transactions has recently received renewed attention. As suggested, it could be levied each time a unit of capital crossed borders, so that the effective tax burden would be greater, the shorter the time-horizon of the financial transaction, thereby discouraging, in particular, short-term speculative flows.[33] Besides, it has been suggested that a reserve requirement on cross-border capital flows could be agreed upon and made part of the ongoing efforts of the reform of financial regulatory systems.[34]

58. The International Monetary and Financial Committee of the Board of Governors of IMF has identified volatile capital flows as an issue that is critically important for the effective operation of the global economy and the stability of the international monetary system, and asked the Fund to deepen its work in this area, including through in-depth studies to help increase the effectiveness of policies to manage capital flows.[35] To help its members deal with capital flows, and as part of its surveillance activities, the Fund is to expand its work in respect of filling information gaps on cross-border capital flows and exposures and deepening the understanding of capital flows and their interrelationships with other policy areas. This should include providing countries with pragmatic policy advice on how to limit excessive short-term flows. Moreover, on the basis of this analysis, the Fund could provide a much-needed multilateral perspective on the issues by advising both capital-exporting and capital-importing countries on the economic policy choices necessary for ensuring orderly capital flows. Such a multilateral platform for managing capital flows would be an appropriate response to the crisis and its aftermath which, like other events, have underscored the capriciousness of capital flows.

59. Deeper reforms of the international monetary system would still be needed, since the more fundamental factors conducive to volatility are inherent in the

[31] *Global Economic Prospects, 2010: Crisis, Finance, and Growth* (Washington, D.C., World Bank, 2010).

[32] *Financial Times*, 25 January 2011.

[33] *Trade and Development Report, 2009: Responding to the Global Crisis — Climate Change Mitigation and Development* (United Nations publication, Sales No. E.09.II.D.16), p. 119.

[34] *World Economic Situation and Prospects 2011* (United Nations publication, Sales No. E.11.II.C.2), p. 40.

[35] Communiqué of the Twenty-Second Meeting of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, 9 October 2010. Available from www.imf.org.

present system, which overly relies on a single national currency as the world's reserve. The current international reserve system made an important contribution to the absence of a smooth adjustment to imbalances, volatile capital flows and lopsided provision of liquidity. A pragmatic path to reform may be to further enhance the role of existing special drawing rights (SDRs) arrangements which could, over time, evolve into a widely accepted world reserve currency. Along with reducing the inherent instability of the current system, the greater use of SDRs may result in a more democratic control of global liquidity.

Some questions for discussion

1. **How can the United Nations system more effectively promote South-South and triangular development cooperation?**

2. **How can capital-account policies and other policies affecting capital flows be made more effective in responding to capital surges and reversals? What measures are needed to promote financial deepening and structural reforms in middle-income countries that could help deal with volatile capital flows?**

3. **What steps should be taken to strengthen multilateral coordination on policies influencing capital flows?**

4. **What should be the form of the global framework to govern or oversee international capital movements? Should there be global "rules of the game" for cross-border capital flows? Should the issues related to cross-border capital flows be a part of the ongoing reform of financial regulatory systems?**

5. **What path should the reform of the international reserve system take?**