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INTERNATIONAL CONFERENCE ON THE FINANCING OF DEVELOPMENT

Sources of financing for development

Report of the Secretary-General

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BACKGROUND

At the second regular session of the Economic and Social Council in 1991, the Secretary-General called on the international community to consider the convening of an international conference on development financing. 1/ A major concern at that time was that financial resources seemed inadequate to meet the expected global demand for investment. A special international forum, it was thought, could provide an opportunity for concerted policy initiatives to raise global savings and develop modalities of financing that might better channel those savings to investment, particularly in developing countries.

The concern underlying the proposal had grown out of several developments. On the one hand, major new requirements had been added to the global investment agenda, as several economies embarked on a transition from centrally planned to market economies, while costly bills were foreseen for post-war reconstruction in the Persian Gulf area. On the other hand, the global rate of saving out of current income appeared to have been on a declining trend since the mid-1970s and income itself was growing slowly. The total volume of savings, in other words, was not growing adequately. It thus seemed likely that important investment needs would go unfilled, including a backlog of projects in developing countries where difficult adjustment processes had been under way for much of the 1980s. Many investors, especially in developing countries, would find it difficult to pay the high real interest rates that a global savings shortfall brought about. Over time, global development would be jeopardized and global peace and security threatened.

In response to the Secretary-General's proposal, the Economic and Social Council in its decision 1991/274 of 26 July 1991, decided to refer the matter to the General Assembly at its forty-sixth session for further consideration. The Assembly, in its resolution 46/205 of 20 December 1991, decided by consensus to consider at its forty-seventh session the issue of the convening of such an international conference. To this end, a report (A/47/575) was prepared by the Secretary-General for consideration at the forty-seventh session of the Assembly; that report concluded, *inter alia*, that some of the concerns underlying the original proposal had not been warranted, owing in part to the marked - but most likely temporary - slackening in the growth of the world economy and thus of investment demand in the period 1991-1992. The Assembly, in its decision 47/436 of 18 December 1992, decided to continue exploring the issue of the convening of an international conference on the financing of development in close consultation and cooperation with the World Bank, the International Monetary Fund (IMF), the regional development banks and the United Nations Conference on Trade and Development (UNCTAD), and, to further consider that issue, requested the Secretary-General to submit to the Assembly at its forty-eighth session a report on the situation of the potential sources of financing for development. The present report has been prepared in response to that request.

I. THE SITUATION IN DEVELOPMENT FINANCE

1. Initially, development finance was defined as the financial resources for investment in developing countries. Subsequently, investment was seen as constituting a major part, but not all, of what development finance pays for, as some of what were conventionally thought of as current expenditures were also widely recognized to be crucial components of development expenditure. One example is emergency economic support, such as food aid, which has traditionally been counted as part of development assistance, and thus as part of development finance in a broad sense, as has technical assistance. Today it is common to think of development as the enlargement of the human capacities of developing countries. Teachers' salaries, like investment in a new school building, may thus be considered a part of development expenditures. Although expenditures on human resource development are usually undertaken privately as well as by Governments, the latter have a major responsibility in this realm. Thus, looking at the situation of development finance is here understood to require looking at the situation both of investment finance and of the resources - domestic and foreign - for government current expenditures on human resource development.

A. Domestic resources for development

2. Domestic resources account for the bulk of development finance and the primary determinant of the amount of those resources is the overall trend in per capita income. Comparing the early 1980s and the early 1990s illustrates the point.

3. In the early 1980s, analysts commonly divided the developing countries into two groups. One group comprised a small number of countries whose savings substantially exceeded domestic investment requirements owing to the jump in the price of their petroleum exports, which had caused great leaps in domestic income. Those countries were called the capital-surplus developing countries. The second group consisted of the rest of the developing world. Most domestic investment needs in the latter group of countries were met out of local savings, but foreign capital inflows were also significant. These countries were thus termed the capital-importing developing countries.

4. The next decade was tumultuous for both groups of countries. By the beginning of the 1990s, after five years of comparatively weak international oil prices and protracted war in the Persian Gulf area, the capital-surplus countries as a whole were saving about 23 per cent of gross domestic product (GDP), a figure amounting to less than half the rate of 1980 and representing the same savings rate as that of the capital-importing countries. 2/ The 23 per cent savings rate of the latter group of countries was about the same as in 1980. However, the gross domestic savings rate in capital-importing Asia had risen from 27 per cent of GDP to 31 per cent, essentially owing to the rapid growth of incomes in the region and the tendency to save and invest locally large portions of the increases in income. In Africa and Latin America, however, the aggregate savings rates were lower in 1990 than a decade earlier. 3/

5. The latter results cannot be ascribed to the overt failures in savings policy _per se_. Rather, the countries with the poorest savings performance were generally those with the poorest record of economic growth. The scope for policy to promote savings, whether personal savings or government savings, in a very difficult economic environment is small indeed. For example, average GDP per capita in Côte d'Ivoire in the period 1989-1991 was 29 per cent less in real terms than in the period 1979-1981. In this environment, irrespective of policy reforms and economic adjustment efforts, gross domestic savings averaged 15 per cent of GDP in the later period compared with 22 per cent of GDP a decade earlier; there was therefore a drop of 7 percentage points. 4/

6. The relationship holds as well at higher per capita income levels. In Venezuela, for example, real GDP per capita fell 18 per cent between the period 1979-1981 (a time of relatively high international oil prices and easy access to international credit) and 1989-1991 (one of debt crisis-cum-adjustment). Over the decade, the share of GDP saved fell almost 6 percentage points, from 32 to less than 27 per cent. The relationship between savings and economic growth also holds in the case of strong economic performance. In Thailand, for example, GDP per capita in the period 1989-1991 was 75 per cent above that in 1979-1981; its savings rate in the later period was 10 percentage points higher (30 per cent of GDP versus 20 per cent).

7. Of course, the relationship between savings and economic growth is not one-to-one, but these three examples, albeit dramatic, are representative of the general picture. Figure I illustrates this for a sample of 68 countries for which adequate data were available. Each square in the figure represents one country's total growth in GDP per capita in the 10-year period covered (horizontal axis) and the 10-year change in percentage of GDP saved (vertical axis). All the countries in region I of the figure had rising per capita GDP and rising savings shares. All those in region III had falling per capita GDP and falling savings shares. Although there were 17 countries in the area comprising regions II and IV of the figure, 51 countries (three quarters of the total) fell into the area comprising regions I and III.

8. At the heart of the difficulties of the countries in region III was the necessity from the early 1980s of their undertaking macroeconomic stabilization and structural adjustment programmes at a time when many of the economic and financial supports on which those countries had relied - such as remunerative prices for commodity exports, low real interest rates on external debt, access to new flows of external finance, and rising demand in export markets - were being removed. The international community extended financial assistance to support adjustment programmes in the affected countries, but it was far from being in a position to make up for the aforesaid deterioration in the international environment. Moreover, in several developing countries, domestic or regional conflicts raged and pushed development completely off the policy agenda.

9. While domestic saving as a whole suffered owing to the income constraint, many Governments faced particular difficulties in applying adequate resources to budgetary development programmes. On the one hand, weak tax systems and commitments to subsidize particular sectors, which may have been inefficient but functional when income was growing, became an insupportable burden when

economies declined. On the other hand, control of certain rising expenditures was beyond government discretion.

10. One example has involved the rise in government interest payments, both as foreign debt (and thus debt servicing) grew and as the policy of moving to sound monetary policies in several countries raised domestic interest rates to very high levels. 5/ In a sample of 39 developing countries, interest payments rose on average from 6.6 per cent of central government expenditures in 1980 to 12.8 per cent a decade later. 6/ In a sample of 9 heavily indebted countries, interest payments reached almost 19 per cent of expenditures, and even in a sample of 11 low-income countries, almost 14 per cent of expenditures were for interest payments. In sub-Saharan Africa, the level of government expenditures after correcting for inflation and deducting interest payments was lower, in 14 out of 29 countries analysed, at the end of the 1980s than at the beginning.

11. Military expenditures have also continued to absorb large amounts of public resources in many developing countries. Here, however, there was an encouraging trend, namely, out of 58 countries for which data were available, 40 reduced the share of central government expenditure allocated to defence over a 10-year period ending in 1990-1991. Nevertheless, the range of the share of defence in total expenditure indicates that there was still large scope for reductions in military expenditures, as some countries reported spending under 2 per cent of their budgets for defence (for example Barbados, Costa Rica and Mauritius), while many others spent 25 per cent or more. 7/ Indeed, a major objective of the Agenda for Peace 8/ is to reduce conflict and tensions around the world and allow Governments to relax their military security concerns.

12. Given that most countries have been faced with the realities of expenditures on interest and defence and the necessity of reducing government budget deficits, in many countries government development expenditures have experienced tight constraints. Governments have sought to protect spending on human development services, but with mixed success. In sub-Saharan Africa, in particular, although real expenditures on health and education grew in the 1980s, the population grew even faster, especially in low-income countries. More generally, Governments sought to restrain their expenditures by limiting replenishment of supplies, postponing investment and lowering their wage bills. The last was accomplished, especially in Africa and Latin America, more through reductions in real wages, as nominal wage increases did not keep pace with inflation, than through outright staff cuts. This harmed the quality of the services that were provided, as better-qualified staff left for the private sector or went abroad and most had to spend increasing amounts of time supplementing their income in other activities.

13. That such a situation is untenable has been increasingly recognized and, as noted below, there are now broadly agreed policies to strengthen public sector finances and better direct resources where they are most needed. There is also a greater appreciation of the distortions of investment and the waste of resources that an inadequate domestic financial sector causes, and of the directions for policy and institutional reform. 9/ However, it is essential that the amount of resources to be allocated also grows and the key to generating domestically those resources - public resources as well as private savings - remains the recharging of economic growth.

B. International resources for development

14. The international community has long recognized that appropriate levels of domestic investment exceed what most developing countries can finance out of their own saving, and thus net transfers of financial resources are warranted to fill the gap. Only after long periods of rising per capita incomes do savings in developing countries rise enough to close the resource gap.

15. In this regard, certain important developments in international financial flows have recently occurred. Adding together all the financial transfers to and from the capital-importing developing countries - capital flows minus profit, interest or other income on such flows - gives the total of the net transfer of financial resources, as defined on a financial basis. 10/ As may be seen in figure II, that measure of the net transfer had been negative during most of the 1980s, but it turned strongly positive in the 1990s. Those resources are used to raise imports of goods and a broad range of services above what could be afforded out of export earnings and to add to official foreign reserves. In the past few years, most of the positive transfers were indeed added to reserves, but significant increases also took place in import levels, especially in Latin America. In fact, 1992 was the first year in a decade in which Latin America enjoyed an import surplus financed by a net transfer of resources.

16. Nevertheless, much of the surge in net financial transfers in 1991 and 1992 that is as depicted in figure II was the result of increases in the residual category of financing, which groups together movements of short-term funds and changes in assets held abroad by residents of developing countries. It appears that much of that inflow was attracted by short-term domestic interest rates that were significantly higher than internationally available rates. Indeed, the fear of high international interest rates that prompted the initial call for an official conference on finance has been far from justified, as international interest rates have been falling and a significant reallocation of world savings to some developing countries has been taking place. However, given the volatile nature of so many of the inflows and their international context, they could just as quickly again move abroad, if for example, interest differentials became less attractive. Also, most countries have not even tapped into this supply. A large part of the new inflows is thus not a reliable source of development finance.

17. In other words, any contribution to the net financial transfer to a developing country adds to potential imports and can finance additional investment. In practice, however, the link to development is more certain in the various categories of medium-term and long-term financial flows and grants. Policy thus still needs to focus on international resources for development, although less on the question of the supply of savings available for investment in developing countries and more on that of the allocation of investment resources to countries and the financial composition of the flows.

18. Recent evidence suggests that the supplies of medium-term and long-term private finance are quite abundant and available to qualifying developing countries in an increasing variety of forms and on an increasing variety of terms. Yet, too few countries are seen as qualifying at this time. Indeed, some low-income countries with low debt-servicing capacity will need to draw

mainly on concessional official flows for the foreseeable future. Most developing countries will need to draw on some measure of official finance for many years to come. The key question is whether the funds - public and private - will be available in adequate amounts.

1. Private sources of finance

19. With respect to the various sources of private, external finance for development, the most encouraging trend in recent years has been in direct investment, as can be seen from figure II. Yet the distribution of that investment has been very uneven. Sixty-five per cent of the total went to 10 developing countries in 1992, and this amount represented virtually the same concentration as had been manifested since 1981 (albeit with different countries among the top 10). 11/ More than half of gross direct investment in developing countries in 1991 and 1992 went to countries of the Asian and Pacific region, whereas in the early 1980s they had accounted for about a third. In the earlier period, Latin America and the Caribbean had received larger investment flows than Asia, but even though there was a surge in investment in Latin America beginning in 1991, about one third more investment was attracted to the Asian and Pacific region. Africa, moreover, has not participated at all in the growth of direct investment: while flows to other regions increased substantially over the years, those to Africa remained in the range of $2 billion to $3 billion a year and now account for only 5 per cent of the gross flows to developing countries.

20. The attraction exerted by Asia on direct investors is fundamentally the same as that exerted by the region on its own domestic investors: the attraction is connected with relatively stable macroeconomic and political conditions, sustainable external accounts with an outward orientation of policy-making, and surging growth of real income. Flows to certain countries of Latin America are stimulated by similar phenomena, or the expectation that such conditions are on the horizon. However, a substantial proportion of the recent flows to Latin America has derived from the privatization of state enterprises. Although additional enterprises are set for privatization, this involves one-time phenomena and continuing inflows over the long run will depend mainly on a spreading positive perception of general business conditions. Indeed, the lack of such a perception with respect to many African countries explains much of the difficulty Africa has had in attracting direct investors.

21. In choosing investment locations, direct investors also look for complementary productive resources in the form of infrastructure, a trained workforce, local banking and commercial services, suppliers and subcontractors. Again, these factors are crucial to domestic investors as well. Where they do not exist, they must be created if dynamic growth is to take place, and generally only a part of the task will be undertaken by the private sector itself. Governments are expected to assume the leading role in providing the rest of these resources.

22. In the industrialized countries, major government investments are usually financed by bond issues sold to the public at home and abroad. The access of developing-country Governments to international bond markets for such financing dates back to the nineteenth century (although access was, of course,

interrupted at various points in time). This is a source that is again being cultivated by certain countries in Latin America, as well as by several Asian economies. In 1992, Latin America (mostly Argentina, Brazil and Mexico) raised almost $12 billion from bonds sold on these markets, coupled with bonds issued by private and state enterprises. This amounted to more than twice what was borrowed by Asian countries (mainly China and the Republic of Korea). Three years before, Latin America had raised virtually no funds through this mechanism. Most developing countries and virtually all of Africa still do not raise funds in this way. 12/

23. The more common mechanism for raising substantial amounts of private international credit for developing countries in the 1970s and early 1980s had been syndicated international bank lending. International bond markets had been quite cautious, requiring considerable familiarity with a borrower, and only a small number of developing countries enjoyed access. Bank lending required that a group of bankers much smaller in number than that comprising individual or institutional bond holders be familiar with the potential borrower. Thus, one bank or a group of banks - often including those banks that operated in the developing country and thus had a continuing relationship with it - would arrange and manage a large loan using funds provided by many other banks (sometimes hundreds). Except for developing countries that escaped the debt crisis, this channel of funds largely dried up during the 1980s.

24. Thus, Asian economies now account for over 70 per cent of the medium-term and long-term international bank lending directed to developing countries (over 80 per cent in 1991 and 1992, when Kuwait and Saudi Arabia tapped this market). Bank lending to Latin America, despite the return to the bond markets noted above, remains small. Bank lending is especially limited for Africa, where several countries once borrowed significantly and grew to become substantial debtors.

25. The large commercial banks in many industrialized countries and offshore centres overextended themselves in speculative lending in such areas as real estate and the financing of corporate mergers, not to mention developing-country debt, and have had to retrench and rebuild their capital base. They are still in the process of reducing their claims on debt-crisis countries through negotiated agreements and buy-backs. 13/ They are not looking to resume lending to the same countries quickly. Meanwhile, the bond markets have become more sophisticated and more room has been made for speculative-grade lending through bonds.

26. Indeed, advances in international communications have so improved the general state of information about the developing world in international financial markets that developing-country corporations are increasingly able to float their own equity issues in industrialized countries. In 1991, such companies issued almost $5 billion in new shares internationally and in 1992 over $7 billion, albeit shares from privatization activities in Mexico bulked large in the total. 14/

27. All in all, recent developments thus seem to point to an increasing ability of developing countries to draw on international private finance in the form of direct or portfolio investment and to continue to tap international bank lending largely where it is already available. The supply of funds available for

investment projects that have reasonable profit prospects seems quite abundant. Even in countries with fragile balance-of-payments conditions, projects can attract credit if prospective foreign exchange earnings are earmarked for debt service.

28. This attractiveness notwithstanding, access is still quite limited and many creditors consider their lending largely speculative. Sovereign-risk lending to Governments that have been trapped in debt crises can be difficult to arrange. Indeed, certain classes of institutional investors in industrialized countries are restricted to purchasing mainly debt that is rated investment-grade by one of the private rating agencies. As of mid-1993, such a rating has been given to the foreign-currency bonds of only eight developing countries (Chile, China, Colombia, Indonesia, the Republic of Korea, Malaysia, Thailand and Turkey). 15/ Furthermore, even though the secondary-market prices on the outstanding bank debt or successor bonds of heavily indebted countries have risen in the past few years, in every case but two the debt still trades at more than a 10 per cent discount from face value. 16/ As of June 1993, the average bid on Latin American debt was only 55 per cent of face value.

2. Non-concessional sources of official finance

29. Sometimes, official financial flows complement or galvanize the mobilization of private sector funding and sometimes official providers are the only practical source of international financial support. Few developing countries, no matter how deep their access to private sources of funds, are willing to forgo all funding from official sources. Even for higher-income countries, there are advantages in being able to draw on project appraisal and technical assistance from multilateral institutions and reduced costs of borrowing using officially supported export credits, not to mention IMF resources during adjustment periods. For some lower-income countries, there are no private sector alternatives to much of the financing they need and they can only afford the part of official finance that is supplied on a highly concessional or grant basis. The prospects are quite uncertain for the availability of these latter funds, as will be discussed below; but the prospects are also uncertain for some forms of higher-cost official finance.

30. Export-credit agencies (ECAs) are a case in point. The fundamental aim of ECAs is to promote the exports of their home countries, frequently capital goods that require medium-term to long-term financing. Usually, ECAs reduce costs to the buyers by insuring loans made by banks for a purchase or suppliers’ credits directly offered by exporters. They reduce the lenders’ risks and thus the interest rates charged. Sometimes the ECAs themselves also lend.

31. ECAs are meant to cover their costs from fees and charges, although because of the debt crisis of developing countries and economies in transition, export-credit agencies have had to pay out claims well in excess of their premium income. Governments cover the losses and as a result the "guardian authorities" have pressured the ECAs to be more cautious in underwriting exports than in the past. 17/ This means some projects that might have been accepted for export-credit financing in an earlier time may not go forward or that the financing terms will be less attractive.

32. The natural tendency of ECAs is to compete against each other through offers of increasingly subsidized credit, but this has long been held in check through a periodically updated agreement negotiated in the Organisation for Economic Cooperation and Development (OECD), formally called the Arrangement on Guidelines for Officially Supported Export Credits. Under the new pressures, interest-rate subsidies have largely been phased out of the OECD Arrangement, although countries can still provide subsidies indirectly by using official development assistance (ODA) to cover part of the cost of the exported goods. However, efforts have also been made to limit the use of these "mixed credits". In OECD discussions, emphasis has been placed on seeing that ODA used in mixed credits does not lose its "aid" character or substitute for potentially available commercial finance. 18/

33. The terms of export credits have also been toughened in another sense. Some ECAs have adopted new arrangements to reduce the risk to lenders that seem to compromise the nature of export-credit finance. One example involves requiring the establishment of offshore escrow accounts to hold foreign currency earnings from a project that is to use the capital goods financed by the export credit. Such an arrangement is similar to what a commercial bank without export insurance might devise, and offers very little in the way of enhancement, from the borrower’s perspective, of a loan arranged without official support. With factors such as these, as well as the continuing low rate of investment and thus of capital goods imports in many developing countries, it is perhaps not surprising that the dollar value of medium-term and long-term export credits in the period 1991-1992 averaged only $2.8 billion, a figure representing about the same amount as in 1970. 19/ Indeed, the problem of reducing the overhang of the mainly export-credit debt of developing countries that slipped into debt crisis seems to have advanced to a solution more slowly than that of the treatment of commercial bank debt, especially as concerns the low-income countries. 20/

34. The regular lending "windows" of the international financial institutions are now the major source of unsubsidized official credit for developing countries. In the case of the World Bank and the other multilateral development banks, the borrower benefits from paying an interest rate that is only a small margin above the very-low-risk rate at which the institution itself can borrow in the international bond markets. The institution borrows on very attractive terms both because its portfolio of developing country loans is highly diversified and because the institutions’s own debt servicing is effectively guaranteed by the industrialized and other financially strong member countries of the institution. Maturities are also longer than those that can usually be obtained in a direct approach to the financial markets. 21/

35. IMF is a special type of multilateral financial institution. Its lending is meant for temporary balance-of-payments support during economic adjustment and thus is mainly shorter-term than development lending *per se* and not project-related. Regular loans from IMF have to be repaid in five years, but countries can borrow on longer term with maturities up to 10 years (compared with 20 years at the World Bank). Otherwise, IMF lending terms are similarly a margin above the borrowing costs of the institution, although in its regular operations the Fund is more simply seen as a pool of currencies, with the Fund paying interest to countries whose currency deposits in the Fund have been lent to the borrowing

countries. The main financial difference from development banks is that IMF obtains resources only from Governments, not from financial markets.

36. The two largest multilateral institutions, IMF and the World Bank, are generally thought to have adequate capacity to meet the expected demand for non-concessional lending over the next few years. IMF raised its ability to make non-concessional loans by increasing its resources by 50 per cent in 1992, when it implemented the Ninth General Review of Quotas. As it stands, however, the Fund is currently receiving more from developing countries in repayments of past credits than it disburses in new loans. 22/

37. The World Bank last undertook a general capital increase in 1988, which raised its non-concessional lending capacity by $75 billion. If the rate of lending grew as expected at that time, the Bank would now be in need of additional resources. However, the Bank is understood to currently enjoy adequate "headroom" for prospective new lending, albeit this is owing to the difficulties and delays that many developing countries have had in arranging projects and programmes in an environment of slow economic growth, the sometimes difficult negotiations over the policies entailed in loan packages, and low government investment. 23/

38. Regional development banks, in contrast, are seeking to increase their lending capacity, in particular, the Asian Development Bank and the InterAmerican Development Bank. The African Development Bank has a different problem in that only a small number of member countries from the region can currently afford the near-commercial terms of its regular lending arrangements. Lending by its highly concessional arm, the African Development Fund (ADF), however, is highly constrained at this time by resource limitations, and a replenishment and expansion of these resources are to be negotiated.

3. Concessional sources of official finance

39. Besides their regular programmes, all the multilateral banks and IMF lend on highly concessional terms to low-income developing countries through special facilities such as the International Development Association (IDA) at the World Bank, ADF and other comparable facilities at the regional banks, the International Fund for Agricultural Development and the Enhanced Structural Adjustment Facility (ESAF) at IMF. Coupled with the grants for technical assistance and food aid by the operational organizations of the United Nations (namely, the United Nations Development Programme (UNDP), the United Nations Population Fund (UNFPA), the United Nations Children's Fund (UNICEF) and the World Food Programme (WFP)), these facilities make up most of what is generally classified as multilateral ODA. Twenty years ago, multilateral ODA accounted for about half of the total of multilateral resource arrangements. In recent years, it has accounted for less than a third (see figure III).

40. Multilateral ODA has suffered from the same difficulty as ODA in general in attracting the political support that translates into adequately growing budget appropriations. Unlike the official financing of the multilateral banks *per se*, where only a small fraction of a capital increase is paid in and the rest is "callable" - and thus far it has never been called - funds for the concessional lending programmes come entirely from the budgets of donor countries.

41. Moreover, because the arrangements for equitable cost sharing among donor countries fix the proportion contributed by each to multilateral replenishments, a large country that wishes to make a relatively small contribution may be able to restrict the size of the total increase. It depends on the ability of the Governments that wish to make a larger replenishment to convince the reluctant partner to increase its proposed contributions. This mechanism restricted the size of the recent tenth replenishment of IDA (IDA-10), which is providing the resources for IDA lending from 1 July 1993 to 30 June 1996. Under this replenishment, 34 donor countries are to contribute $18 billion which, coupled with $4 billion in expected repayments of earlier IDA loans, will provide the same resources in real terms as IDA-9. The World Bank had sought a larger replenishment, especially in the light of the new commitment of the international community to support programmes for environmentally sustainable development, as set forth in the Rio Declaration on Environment and Development 24/ and in Agenda 21. 25/ In addition, the funds will have to be spread among a larger number of countries, as several countries in transition from centrally planned to market economies have recently joined the World Bank and become eligible to draw from IDA. 26/

42. The United Nations raises funds for its operational activities, which are provided on a grant basis, through annual voluntary pledges without a formal burden-sharing arrangement. Nevertheless, here too recent experience has been disappointing and has been quickly reflected in programme activities. Thus, total commitments for operational activities decreased from $4 billion in 1991 to $3.6 billion in 1992, about half of the decline having taken place in UNDP, the biggest programme. 27/ As to the future, some donors have expressed the view that additional resources require changes in oversight and coordination of operational activities.

43. Although ODA disbursed through multilateral channels is a particularly desirable means of achieving international cooperation, it accounts for less than 30 per cent of ODA received by developing countries. The rest is contributed on a bilateral basis, with donors concentrating their programmes of assistance on countries with which they have relatively strong political or economic relations and making relatively greater use of modalities in which they have an abundant capacity, such as food aid.

44. Adding together bilateral ODA and contributions to multilateral concessional operations gives total ODA as viewed from the budget process of the donor country and from the perspective of ODA commitments made in the United Nations and elsewhere. While donor Governments stand by those commitments, total ODA receipts in real terms have essentially stagnated since the mid-1980s, at roughly $55 billion in 1991 prices. 28/ Aid from the member countries of the Development Assistance Committee (DAC) of OECD has grown in this period at about 2.5 per cent per year in real terms; but other donors have cut back their ODA, in particular oil-exporting donor countries and the former centrally planned economies of Eastern Europe and the Union of Soviet Socialist Republics. Neither group of countries could sustain its earlier aid efforts, which for Arab donors among the oil exporters had totalled 1.3 per cent of their gross national product (GNP) in 1985. Arab aid in 1992, estimated at $1 billion, had fallen to less than one third of the 1985 dollar amount, while the other group of countries has lost virtually all aid-giving capacity at this time.

45. The growth of ODA from DAC countries thus prevented the aggregate amount of aid from falling, but Development Assistance Committee ODA grew only at about the rate of growth of aggregate GNP. That rate of growth maintained an overall DAC ratio of ODA to GNP of 0.33 per cent, but with this figure amounting to a little less than half the United Nations target of 0.7 per cent of GNP, it represented no progress towards meeting the target on an aggregate level. Although the ratio of ODA to GNP was higher in 1992 than in the mid-1980s for Austria, Denmark, Finland, France, Luxembourg, Norway, Portugal, Spain, Sweden and Switzerland, the total ODA of these countries accounted for less than 30 per cent of the DAC total. Only four countries met or exceeded the target in 1992 (Denmark, the Netherlands, Norway and Sweden) and they accounted for only 13 per cent of Development Assistance Committee ODA.

46. For several years, the growing concern has been growing that far from rising to the level of the United Nations target, aid levels might become increasingly inadequate in terms of meeting the world's needs. As the Chairman of DAC noted almost a year ago,

> "The trend lines in ODA availability are especially worrisome given the growing demand and opportunities in today's rapidly changing world. New recipient countries and new sectoral priorities such as environment will create even greater competition for scarce ODA resources in the next few years...". 29/

He went on to call for greater effectiveness in aid use, which would be important even if aid resources were more abundant, and suggested that recipient countries might find themselves competing increasingly for limited aid resources. The analysis of the World Bank was more blunt in its assessment of aid trends:

> "... For recipient developing countries the stark message is: show a capacity to use aid effectively - through both sound economic policy and effective governance - or risk losing it." 30/

47. Prospects for aid flows have lately become if anything of even more concern. Italy, the fourth largest DAC donor, had to cut its 1993 aid budget by 40 per cent and in the United States of America, which rivals Japan as the largest donor, the Administration and Congress are considering across-the-board changes in foreign assistance, including budget levels. Japan, on the other hand, has recently adopted a new five-year target for the growth of its aid programme, which would raise Japanese ODA by 40-50 per cent in the period 1993-1997 compared with the previous five-year period.

II. CURRENT ISSUES FOR POLICY DISCUSSION

48. The international community has adopted several texts in recent years that together represent the consensus on development objectives and the role of international cooperation in achieving those objectives, including, in particular, finance for development. Primary texts at the United Nations are the Declaration on International Economic Cooperation, in particular the Revitalization of Economic Growth and Development of the Developing Countries (as contained in General Assembly resolution S-18/3 of 1 May 1990, annex) and

the International Development Strategy for the Fourth United Nations Development Decade (as contained in Assembly resolution 45/199 of 21 December 1990, annex). Finance for development was also an important feature of two major international meetings in 1992, namely the eighth session of the United Nations Conference on Trade and Development, which adopted the Cartagena Commitment 31/ and the United Nations Conference on Environment and Development, which adopted Agenda 21. 25/ Most recently, the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (the Development Committee) took up the question of finance for development at its autumn 1992 and spring 1993 meetings. 32/ The aforementioned texts share a common core of principles and concerns, albeit with different emphases. If an international conference on the financing of development was to be organized, these would represent its starting-point, although certain additional points, as noted below, might also be reviewed.

A. Domestic dimensions of policy

49. The broadest international agreement concludes that the developing countries themselves must be the primary source of their financial resources for development. Likewise, the importance for development of sustainable macroeconomic policies and flexible economic structures, guided largely by market signals, is virtually uncontested. A suitable legal and institutional framework where the obligations and protections of enterprise are clear-cut is equally necessary if potential investment is to become actual capital formation. It is also widely appreciated that relatively large increments to savings may be generated out of increases in income per person in poor countries, but it would be quite unusual to raise savings significantly from a reallocation of spending on consumption when incomes are stagnant.

50. These principles can be tied together by viewing the solution to the problem of raising domestic saving in slowly growing countries as including economic adjustment and growth, each being both necessary and reciprocally supportive. Adjustment is to be pursued by a reorientation of policies and, if necessary, by institutional reforms. Growth in a stagnant economy is generally stimulated by an expenditure increase, as from improved export performance or new investment, usually with a significant component of foreign financing. The policy challenge, in other words, is to revitalize economic growth where it is stagnant while also implementing a policy package that inspires the confidence of domestic economic actors. 33/ If the policy is successful, the people experiencing rising incomes are likely to generate considerable additional savings that could be mobilized domestically and then invested in the domestic economy.

51. The importance of a well-functioning and increasingly flexible domestic financial sector for efficient intermediation between savings and investment is also widely appreciated today. Financial sector policy efforts thus emphasize institution-building, including capital-market development, along with liberalization of administrative controls. The latter needs to be coupled, however, with appropriate prudential regulation and supervision of financial institutions. Many countries are now tackling the problems of financial institutions that became insolvent as a result of bad loans. Equally important

are measures to facilitate the access to credit of small entrepreneurs and farmers.

52. Another dimension of success entails a broadly based and equitable tax system that raises adequate revenue from growing incomes to support essential government services, some of which are necessary complements of private investment. Adequate public financing of human resource development is seen today as an especially critical ingredient of development efforts. The need to strengthen the administrative capacity of the tax authorities is also being increasingly recognized. Moreover, many countries have rethought the question of providing public assistance through subsidized activities available to all compared with targeting assistance directly on vulnerable groups. There has thus been a tendency to seek better recovery of the cost of government services and a phasing out of subsidies to public sector enterprises.

B. International dimensions of policy

53. It is also universally recognized that the developing countries are heavily dependent on the international economic environment and that while domestic policy needs to increase the ability of those countries to take advantage of the opportunities provided by the international environment, they are also in need of a capacity to withstand that environment’s adverse developments. Countries can adequately develop such a capacity on their own only at a late stage of development. Moreover, there is a virtually universal presumption, which is embedded in all the basic internationally negotiated texts, that countries in the early and middle passages of the development process should have access to net transfers of financial resources from abroad.

54. The international community thus accepts the need to support the development efforts of developing countries, especially in the early stages of development and when economic adjustment and policy reform efforts are initiated. The support should include financial assistance, foreign debt restructuring where needed, and maintenance of an open international trading environment.

55. In the area of trade, the frequently stated international commitment to roll back protectionism in industrialized countries contrasts dramatically with actual practice in some countries and with the degree of trade liberalization that is occurring in developing countries. At present, no measure appears more important for reinvigorating international confidence in industrialized country trade liberalization than a successful conclusion of the multilateral negotiations under the General Agreement on Tariffs and Trade.

56. In the treatment of the debt of countries in debt crisis, international policy has evolved very considerably, particularly as regards commercial bank debt. Much remains to be done, however, especially for low-income countries owing substantial amounts to official creditors, as discussed in a report of the Secretary-General (A/48/345) on the international debt strategy as of mid-1993.

57. In the area of financial flows, much attention has been focused on building the capacity to capture increasing amounts of the large potential supply of international private flows. The factors needed for providing an appropriate

environment for attracting long-run private flows are in all essentials the same ones needed for stimulating high rates of saving and investment in the developing country economy itself: above all a certain measure of economic growth along with economic stability and a suitable legal and institutional framework. Recent experiences show that foreign investment flows to countries where economic adjustment has already progressed to a degree and become associated with significant economic growth and a relatively stable balance-of-payments situation, in particular one that is not encumbered by a foreign debt "overhang". Such considerations are at the centre of the investment decision; the host of special incentives, tax holidays, credit subsidies and so on with which developing countries often seek to compete in attracting potential investors are at the periphery.

58. What holds for direct investment holds as well for portfolio and medium-term and long-term credit flows. Yet, the international community can play an important role in increasing the access of developing countries to various sources of such funds through technical and financial assistance in the approaching of financial markets and in the removing of excessive regulatory obstacles in industrialized countries to the placement of funds in developing ones. In addition, private flows to developing countries can be augmented by official financial assistance. Sometimes official financial flows are at the centre of a package including private flows that would not otherwise participate in a project, as in formal "cofinancing" arrangements.

59. The capacity of the major sources of official flows not only to play this catalytic role, but also to engage in their regular lending programmes remains indispensable. Although some of the multilateral institutions may have adequate headroom at this time, as discussed above, others such as the Asian and Inter-American development banks are entering into important negotiations to increase their capital base. These arrangements need to be completed in a timely fashion, as must the still-pending negotiations on several concessional facilities, notably those at IMF concerning the successor arrangement to the ESAF (targeted for completion in November 1993) and the review and the replenishment of the Global Environment Facility (targeted for December 1993), as well as the replenishment of the African Development Fund, mentioned previously.

60. The final issue confronting the international community in the arena of cooperation for development, and perhaps the most burning one, is the unsatisfactory recent record of and outlook for ODA as a whole. Some countries that were major donors in the past no longer have the same capacity. In other countries, ODA is being forced to compete more and more strenuously with other claims on limited budget resources.

61. In some donor countries, ODA has fallen victim to the budgetary consequences of economic recession or slow-down. Indeed, acceleration of economic growth in those countries would contribute to the solution of their own economic and social difficulties, and thereby reduce the competition for budget resources; and such a course could help ease the constraints on the growth of ODA. (This emphasizes the wide ramifications of inadequate economic growth in today’s global agenda.)

62. However, the political priority of ODA is also being reconsidered in some donor countries. ODA has served a variety of functions for donors, and only some of those functions pertain to economic and social development. As the discussion of export credits and "mixed credits" suggested, some motives for the offering of aid are commercial ones. By receiving aid based on such a motive, a developing country with long-running deterioration of its economic situation and growing poverty would become a less promising market and would thus be a less substantial ODA recipient just when its aid needs were greatest.

63. Other aid motives of donor countries have pertained to the building of political alliances, in particular within the context of the cold war, a factor that is no longer relevant. The humanitarian impulse remains a strong motive, but the different standards that countries maintain with respect to human rights and political participation, not to mention military spending, can challenge the political constituencies for ODA in donor countries. In addition, in the political arena of donor countries, ODA suffers from the fact that it has been extended for well over 30 years and per capita incomes of a substantial number of recipient countries are lower today than they were when ODA began. That a large number of generally small countries have become heavily dependent on ODA resources is a concern of donors and recipients alike. 34/

64. In many cases, too much may have been expected from a relatively small amount of assistance. However, the shared donor-recipient responsibility for improving the effectiveness of ODA has been an important concern of the aid community for many years. Recently, the Development Assistance Committee of OECD has codified its work on appropriate aid practices in a handbook for donors. 35/ This is also a constant concern of the meetings of the consultative groups and round-table arrangements of donors and individual recipient countries.

65. A significant and related recent trend is the rising role of non-governmental organizations in international cooperation for development. Non-governmental organization offer an important alternative outlet for ODA to the humanitarian impulse of people around the world, one that tends to reduce government intervention at donor and recipient ends of the aid spectrum. On the other hand, non-governmental organizations mobilize financial resources on a much smaller scale than government agencies, although in donor countries they often play an important role in lobbying for more effective and larger-scale official assistance.

66. Indeed, there are reasons to seek to deepen the ODA commitment. One is the increasing recognition of the global nature of several sectoral and environmental problems, including reducing carbon dioxide emissions to combat global warming, rebuilding the productivity of ocean fisheries, giving low-income farmers an alternative that can compete with illicit drug crops, and cementing national and regional peace and building security through post-conflict economic development assistance.

67. As always, however, the primary case for ODA is that the world can ill afford to have any significant part of itself remain perpetually outside the portion where incomes grow significantly and the security of life improves. ODA has been central to international economic cooperation for development and remains so. The desire to strengthen that cooperation is born of the recognized

mutuality of national interests and the need for solidarity in an interdependent world. The commitment of the international community to ODA remains a major test of its commitment to international cooperation for development.

Notes

1/ See Official Records of the General Assembly, Forty-sixth Session, Supplement No. 3 (A/46/3/Rev.1), chap. III, paras. 6-14.

2/ Aggregated estimates are from the Department for Economic and Social Information and Policy Analysis of the United Nations Secretariat, Macroeconomic Data System (MEDS), an analytical database of the Division of Macroeconomic and Social Policy Analysis.

3/ In Africa, aggregate savings fell from 26 per cent of GDP in 1980 to 19 per cent in 1990, while in Latin America savings fell from 23 per cent GDP to 21 per cent over the same period.

4/ Three-year averages are used here to reduce the statistical effects of short-term changes in economic conditions of individual countries; the savings rate is calculated in nominal terms in local currency from national income accounts; real GDP is also based on national currency definitions (data from World Bank, World Tables, 1992 Update, 28 August 1992).

5/ On the relation between foreign debt servicing and the non-interest budget balance, see the report of the Secretary-General (A/45/487) entitled "Net transfer of resources from developing countries", sect. IV and references cited therein.

6/ The statistics in the following paragraphs are based on Report on the World Social Situation, 1993 (United Nations publication, Sales No. E.93.IV.2), chap. VIII.

7/ Including El Salvador, Israel, the Republic of Korea, Myanmar, Oman, Pakistan, the Syrian Arab Republic, Uganda, the United Arab Emirates and Yemen.

8/ See the report of the Secretary-General pursuant to the statement adopted by the Summit Meeting of the Security Council on 31 January 1992 on preventive diplomacy. Peacemaking and peace-keeping (A/47/277-S/24111) entitled "An Agenda for Peace".

9/ See Savings and Credit for Development. Report of the International Conference on Savings and Credit for Development, Klarskovgård, Denmark, 28-31 May 1990 (United Nations publication, Sales No. E.92.II.A.1).

10/ The following is based on World Economic Survey, 1993 (United Nations publication, Sales No. E.93.II.C.1), chap. IV. A formal derivation of the net transfer is given in World Economic Survey, 1986 (United Nations publication, Sales No. E.86.II.C.1), annex III. The net transfer considered as a supplement to domestic savings is formally defined as the net transfer on an expenditure basis and differs from the net transfer on a financial basis described in the present report by the net amount of use or accumulation of official reserves.

11/ The composition of flows is from World Investment Report, 1993 (United Nations publication, Sales No. E.93.II.A.14), p. 45, table II.2.

12/ Data of the International Monetary Fund (IMF) and the World Bank in "Developing country access to private capital flows", Development Issues: Presentations to the 46th Meeting of the Development Committee (Washington, D.C., World Bank, May 1993), p. 55.

13/ See the report of the Secretary-General, (A/48/345), entitled "The international debt strategy as of mid-1993".

14/ The totals included shares issued through depositary receipts, where a bank acted as an intermediary and held the shares originally issued, and "B-shares" issued by Chinese firms (based on IMF and the World Bank, "Developing country access to private capital flows", p. 56).

15/ Ratings by Standard & Poor's as of 5 July 1993, as reported in World Bank, Financial Flows to Developing Countries: Quarterly Review, July 1993, p. 9.

16/ Of the 25 developing countries whose secondary-market prices are tracked by the Secretariat, only Algeria and Chile have attracted bids of 90 per cent of face value or more in the first half of 1993 (based on data provided by Merrill Lynch and Salomon Brothers, New York). A general rise in bids on the market reflects both an improved outlook for the countries concerned and falling interest rates available on other international bonds.

17/ See Malcolm Stephens, "Export finance as a source of funding for developing countries", in Development Issues: Presentations to the 46th Meeting of the Development Committee (Washington, D.C., World Bank, May 1993), pp. 195-200.

18/ This remains an important item on the agenda of the Development Assistance Committee of OECD (see OECD, Development Cooperation, 1992 Report (Paris, OECD, December 1992), pp. 10-11.

19/ Data of OECD, "Financial resources for developing countries: 1992 and recent trends", press release SG/PRESS(93)41 of 29 June 1993.

20/ See document A/48/345.

21/ Some developing countries nevertheless enjoy rather good access to private finance and may be offered quite competitive terms, especially when the exchange-rate risk of the multiple-currency borrowing of the multilaterals is taken into account, not to mention the policy conditionality that is negotiated as part of a multilateral loan agreement.

22/ The Fund received $200 million on a net basis from developing countries in 1992 and over $50 million in the first six months of 1993, despite its making net disbursements of concessional flows of $800 million in both periods (data of IMF, International Financial Statistics).

23/ A related matter is the decline in recent years in the proportion of operations that the World Bank itself considers to have been successful. To address this problem, the President of the Bank commissioned an internal study (the Wapenhans Report, named after a former Bank vice-president who headed it) and then launched a new programme to implement its recommendations. For a description of the latter, see Getting Results: the World Bank's Agenda for Improving Development Effectiveness (Washington, D.C., World Bank, 1993).

24/ See Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992, vol. I, Resolution Adopted by the Conference (United Nations publication, Sales No. E.93.I.8), resolution 1, annex I.

25/ Ibid., annex II.

26/ See the report of the Secretary-General (A/48/331) entitled "Impact of the recent evolution of the economies in transition on the world economy".

27/ See World Economic Survey, 1993 ..., annex, table A.33.

28/ For detailed preliminary aid data for 1992, see OECD, "Financial resources for developing countries: 1992 and recent trends." ... .

29/ OECD, Development Cooperation ... , p. 23.

30/ Global Economic Prospects and the Developing Countries, 1993 (Washington, D.C., World Bank, April 1993), p. 50.

31/ Report of the United Nations Conference on Trade and Development on its Eighth Session, TD/364, part one, sect. A.

32/ See the press communiqués of the Development Committee issued on 22 September 1992 (reprinted in IMF Survey, 12 October 1992, pp. 313-315) and 1 May 1993 (reprinted in IMF Survey, 17 May 1993, pp. 150-152).

33/ Current thinking on such policy packages is reviewed in another report of the Secretary-General (A/48/380), presented to the General Assembly at its forty-eighth session, entitled "Economic stabilization programmes in developing countries".

34/ In the period 1986-1991, the value of ODA receipts exceeded 10 per cent of GNP in more than 30 countries; it exceeded 20 per cent of GNP in 19 countries (based on data of World Development Indicators, World Development Report, 1993 (Washington, D.C.: World Bank, 1993)).

35/ See Development Assistance Manual: DAC Principles for Effective Aid (Paris, OECD, 1992).
