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Coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus

Note by the Secretary-General*

Summary

In its resolution 2006/45, the Economic and Social Council requested the President of the Council, with the support of the Financing for Development Office of the Secretariat, to initiate consultations, including with all major institutional stakeholders, on how to enhance the impact of the special high-level meeting of the Council with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development. The present note provides background information and appends a number of points for reflection to inform discussion at the special high-level meeting of 2007. Under the overall theme of "Coherence, coordination and cooperation in the context of the implementation of the Monterrey Consensus", the following four sub-themes have been chosen for the high-level meeting: (a) good governance at all levels; (b) voice and participation of developing countries in international economic decision-making, including the Bretton Woods institutions; (c) realizing the Doha Development Agenda: effective use of trade and investment policies; and (d) aid effectiveness and innovative financing for development.

The high-level meeting fulfils the mandate set out by the General Assembly in its resolution 61/191, on follow-up to and implementation of the outcome of the International Conference on Financing for Development, in which the Assembly reaffirmed its resolve to continue to make full use of the existing institutional arrangements for reviewing the implementation of the Monterrey Consensus, as set

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

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out in paragraph 69 of the Consensus and in line with its resolution 57/270 B, including the high-level dialogues convened by the Assembly and the spring meetings of the Council with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development, bearing in mind the need to enhance the effectiveness of the follow-up process of the Monterrey Consensus.

I. Good governance at all levels

1. The signatories to the Monterrey Consensus,[1] committed themselves to "sound policies, good governance at all levels and the rule of law" to help to ensure that resources are created and used effectively and that strong, accountable institutions are established at all levels. Historically, economic development has gone hand in hand with the advance in the capacities of social institutions concerned with participation, transparency and accountability. As societies succeed in transforming their economies, so too do governance institutions progress, both as an indispensable element for further development and as an outcome of increased demand from domestic constituencies for such improvements. In fact, in countries that have succeeded, the State has played a key transformative role both in the economic and the socio-political spheres, and any efforts to constrict this transformative role, such as limiting the scope for public regulation of markets to improve their stable operation, slows progress in good governance. Effective and efficient State regulation and supervision are necessary if the private sector is to play a larger role in the economy. In the context of the developmental dimension, we need to caution against frameworks and governance indicators that chiefly associate poor governance with the ineffective operations of governments. International support for the efforts of developing countries to strengthen and improve governance and effective regulation is both necessary and desirable, and indeed the Monterrey Consensus prioritizes the fighting of corruption at all levels, nationally and globally.

2. Developing countries need to determine how much of their limited resources should be expended on the governance agenda. It would be unrealistic to assume that all governance weaknesses in a developing country are of equal significance or can be tackled simultaneously. Sustained progress towards more effective, transparent and equitable governance at the national level can most readily be assured when particular attention is given to those governance capacities that are crucial for accelerating and sustaining growth. Recent research suggests that corruption is often the result of poor fiscal capacity and structurally weak property rights in developing countries. Given the limited administrative capacities of developing countries, it is important for each country to identify and address governance failures that are detrimental to their growth and structural development.

3. Corruption should be recognized as only a part of a complex set of governance challenges. This means that anti-corruption efforts must be understood as one component of longer-term efforts to advance practices of good governance at all levels and as part of the overall development effort in building a variety of other capabilities. Weakness in one area undermines progress in other areas since there are two parties to any bribe, the giver and the receiver.

4. The United Nations system, including the World Bank and other agencies, has called for a multistakeholder approach to combating corruption. Under subsidiarity, the lead responsibility in tackling different areas of corruption should be assigned to the party that has most at stake and has the best ability to address the issue. The active partnership among all stakeholders requires that each one should support such

[1] Monterrey Consensus of the International Conference on Financing for Development (*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.

efforts, and should clearly avoid actions that undercut them. Under such an approach, each country would have the direct and lead responsibility for identifying and addressing domestic corruption, based on a national consensus and consistent with steady progress in strengthening their own political governance institutions, as well as developing domestic capabilities to set standards and to monitor and enforce them. Donor-driven initiatives, especially when perceived as externally imposed conditions, can weaken the legitimacy of domestic efforts to fight corruption. Donors should consistently cooperate to strengthen national efforts, avoiding individualizing their projects and setting up separate project implementation units.

5. Successful anti-corruption strategies should draw on best practices internationally, but these need to be tailored to the specific situation in particular countries. Some tools, such as standards and codes that are publicly available and are adhered to in practice would be part of any successful strategy. Simplification of procedures, transparency and accountability of decision-making, involving enforceable legal entitlements and, as far as possible, the review of procedures appropriate to each country's circumstances are important ways of combating corruption. Since corruption can only be properly addressed by a strategy coming from within each country, it is critical that there be sufficient political and bureaucratic will to address the costs involved. In addition, there is a capacity-building aspect to be addressed, including the need for a civil service that is appointed on merit and is reasonably and regularly paid. Actions to support better and transparent management of public finances, parliamentary oversight, legal, judicial and civil service wage reform and codes of conduct to improve the capacity of local governments to be more responsive and accountable to local communities are important interventions.

6. Attention needs to be paid to good governance and efforts to fight corruption at the international level. The success of efforts to combat global crime and corrupt practices is critical to the promotion of a well-functioning world economy. In the Monterrey Consensus, all States were urged to ratify the United Nations Convention against Transnational Organized Crime. Developed countries have been slower in ratifying the United Nations Convention against Corruption than developing countries. There should be more rigorous enforcement of the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and developing countries could consider either becoming signatories to the Convention or setting up a parallel agreement. Expanded international cooperation in tax matters, a key component of the ongoing Monterrey process, should improve the global monitoring of illicit international transactions, reduce incentives for tax evasion and the concealment of income and strengthen domestic fiscal systems through the establishment of more stable tax bases. The *Global Monitoring Report 2006*, published by the World Bank and the International Monetary Fund (IMF), documents the efforts of those institutions to provide technical support for the efforts of developing countries to combat money-laundering and the financing of terrorism.

7. The responsibility of the private sector in general, and international corporations, institutional and individual investors and banks in particular, in strengthening governance at all levels through self-regulation and compliance is increasingly critical in the highly financialized global economy of today. Good governance in the private sector is an indispensable element of good governance at

all levels. The United Nations Global Compact, the Global Corporate Citizenship Initiative of the World Economic Forum and the general focus on good corporate citizenship represent commendable progress. Corporate bankruptcies and scandals in recent years have been socially costly, not only in monetary terms but also in terms of the credibility of information flows that underpin private markets. In the past such problems arose from the continuing tension between personal gain, structuring incentives for corporate managers, the duty to maximize shareholder profits and the commercial advantages to be obtained from withholding or falsifying information or in engaging in bribery. Public sector oversight and the rigorous application of accounting standards are indispensable to the integrity and healthy functioning of markets.

8. Because the international financial institutions, the United Nations and other intergovernmental and multilateral bodies play a decisive role in the public policies suggested to developing countries and occupy a position of leadership in the donor community, good governance within these organizations is critical. Not only are these organizations and agencies significant sources of finance, their actions provide signals to other donors and external private parties. Importantly, they are also significant suppliers of ideas about national development strategies and are influential arbiters of policies in developing countries. Within their specific mandates, they must tread a fine line in balancing the integrity and technical validity of research and policy analysis against their roles and their need to cater to varied constituencies or beneficiaries. As a result, policy advice emanating from different international public bodies is not necessarily uniform, or always coherent, even with respect to issues of mutual concern. Independent expert review of research work is a sine qua non of good knowledge governance, as epitomized in the recent report, “An Evaluation of World Bank Research, 1998-2005”. The report identified the positive role of research in policy formulation, but it also noted that policy positions sometimes have to be developed before analysis has resolved all uncertainties. The report also noted that the World Bank placed too much weight on preliminary or flawed work to support existing policy positions in areas such as globalization and governance. Similarly, the work of the High-level Panel on United Nations System-wide Coherence highlighted that even within the United Nations system, an apparent overlap in the mandates, functions and policy interventions of different agencies at the global or national levels risked dissipating the effectiveness of the assistance provided through them to developing countries.

9. Democratic accountability is a basic principle of good governance. Ultimately, strong and effective governance in all global institutions must be built on the accountability of their management and governing boards. The hiring and promotion practices at these global institutions should be consistent with basic governance principles, emphasizing qualifications, merit and performance. Efforts to strengthen the voice and the effective participation of developing countries in these institutions must be accelerated. Access to participation in decision-making on global issues has to be widened to take in a larger set of stakeholders and inequities among affected parties must be eliminated. The expansion of peer review processes, such as those now in place in the New Partnership for Africa’s Development (NEPAD), also hold great promise for the promotion of good governance practices. As an example of the potential of this process, the first peer review report (on Rwanda completed in September 2006) incorporated a candid and clear review of the country’s governance and accountability processes.

1.1. What practical steps can be taken to further encourage and assist strengthening governance capacities at all levels, including fighting corruption, in particular as a participatory process between donors and international institutions, the public sector, the business sector and civil society?

1.2. Can more be done to draw lessons from the experience of countries that have been success stories in improving governance and to support private sector initiatives to combat corruption, enhance transparency and adopt good corporate governance practices?

1.3. What kinds of practices and modalities are needed to ensure that national Governments maintain a clear leadership role in designing and prioritizing their governance programmes? How can processes and instruments for international cooperation, such as those in the area of cooperation in tax administration, be fully implemented to strengthen good governance at all levels?

II. Voice and participation of developing countries in international economic decision-making, including the Bretton Woods institutions

10. The signatories to the Monterrey Consensus called for "the full and effective participation of developing countries and countries with economies in transition to help them respond effectively" to the challenges and opportunities presented by globalization. Developing countries represent 79 per cent of the world's population and contribute 45 per cent of the world's gross domestic product (GDP), a proportion that is increasing.

11. With regard to the existing institutions of global decision-making, vast changes have taken place since the majority of them were created immediately after the Second World War. Since that time, there has been an enormous increase in the number of developing countries and the economic role of emerging economies has markedly expanded. Middle income countries, in particular, play critical roles in the global economy as well as in the economy of their own regions. Many countries with economies in transition that are not members of the European Union have become key participants in international markets in trade and finance. It is recognized that the effectiveness and legitimacy of the existing institutions in pursuing their assigned objectives can be obtained only if their agenda and decisions better reflect the needs and issues of the majority of countries affected by their operations. Although most efforts to improve voice and representation have been centred on IMF and the World Bank, there are other international rule- and standard-making bodies at the global level in which developing country representation is less significant, and in some cases non-existent. It is for this reason that the Monterrey Consensus addresses forums beyond the Bretton Woods institutions, highlighting the need to extend the discussion of the voice of developing countries and their participation to other policymaking bodies.

12. Even relatively newly created institutions do not adequately incorporate developing country participation. For example, developing countries and countries with economies in transition are not represented at all in the Financial Stability

Forum, although non-members attend its regional meetings. Since the mid-1990s, while there has been a steady growth in the membership of these countries in the Bank for International Settlements, they have no representation on the four Basel committees of the Bank (the Banking Supervision, Global Financial System, Payment and Settlement Systems and Markets Committees). The Committees do liaise and, increasingly, consult with developing countries and countries with economies on transition, including them in their working groups. However, as is the case with the regional meetings of the Financial Stability Forum, consultations and technical discussions are no substitute for having a seat at the decision-making table. A broader representation in these bodies could result not only in better recognition of the specific needs of developing countries but also in fairer, more widely accepted and truly universal regulation, which could contribute to a more stable financial system with welfare-enhancing effects for all.

13. Private international associations, such as the International Chamber of Commerce, have begun playing a powerful role in setting standards and arbitral decisions. Because such activities have a significant economic impact on developing countries, it is important to promote increased participation by the nationals of developing countries in these bodies.

14. In other areas, the reform of decision-making processes is critical for expanding the voice and the participation of developing countries. In the context of the World Trade Organization, developing countries, which represent over two thirds of the membership, are now much more active in the current Doha Development Round, a fact that is consistent with their deeper integration into the multilateral trading system. There are now several groups, including the Group of Twenty, the Group of Thirty-three, the group of developing countries known as the "NAMA 11" and the "Least Developed Countries Group", each one reflecting the interests, sensitive sectors and strategies of the countries active in the negotiations. This is especially true in agriculture, the issue at the core of the current Doha Round. The main work is no longer being carried out just by the "Quad Group" (European Union, the United States, Canada and Japan). There is a new Group of Four, the United States of America, the European Community, India and Brazil; and the Group of Six, including Australia and Japan. In recent years there has been a greater commitment from all members of the World Trade Organization towards inclusiveness and transparency, both of which are necessary in building consensus among all members in order to advance negotiations. The recent vigour of these subgroupings in the World Trade Organization among countries with shared negotiating interests has enhanced the voice of the developing countries and their participation within the overall international framework. The flowering of these "caucuses" among developing countries in other policy areas can also strengthen global governance.

15. While the need for decision-making reform in the broader global institutional context was highlighted in the Monterrey Consensus, the question of strengthening the representation of developing countries is also now clearly on the agenda of the Bretton Woods institutions. In September 2006, the IMF Board of Governors adopted a resolution on quota and voice reform. The two main goals of the reform are to ensure that the distribution of quotas reflects the economic weight and role of member States in the global economy as well as to enhance the voice of low-income countries. There is general agreement that the reform of IMF governance is of utmost importance since the issue of voice and representation is at the heart of the

Fund's credibility and legitimacy as an international institution overseeing the stability of the global economy.

16. As a first step, an ad hoc quota increase was approved for China, Mexico, the Republic of Korea and Turkey, four clearly underrepresented members. A two-year plan of action for more fundamental reforms has been outlined, including an agreement on a simpler and more transparent quota formula that will provide the basis for a second round of ad hoc quota increases and future increases. The plan also calls for, at a minimum, the doubling of basic votes for all members and the protection of the existing voting share of low-income countries as a group, as well as for the proportion of basic votes in the total voting weight to remain constant going forward. Current reform efforts need to attend to the substantial decline in the share of basic votes prior to the present effort, which has fallen from the level of 11 per cent when IMF was founded to approximately two per cent at this time. In addition, the plan envisages an increase in the staffing resources available to Executive Directors who represent a large number of members.

17. Reaching an agreement on quota and voice reform will be a challenge, involving conceptual, technical and political complexities. It will be critical to engage in a wide-ranging consultation process to build a broad consensus. As an arrangement directed towards mutual assistance and responsibility, IMF was configured as a cooperative as opposed to a corporatist agency. Alleviating the perceived democratic deficit in the allocation of quotas is necessary to reinvigorate IMF credibility, inter alia, in providing policy advice; undertaking surveillance; designing and monitoring conditionality; and in the eyes of the private markets, whose resources now greatly exceed those of the Fund. It is therefore important that the sought-after quota formula incorporate certain basic principles that respond to those challenges, namely, they should inform the choice of indicators; the manner in which they are measured; and their weights in the sought-after formula.

18. At its meeting in September 2006, the Joint Ministerial Committee of the Boards of International Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, acknowledged the measures already taken by the World Bank to enhance capacity in Executive Directors' offices and capitals of developing and transition economies, asked the Bank to work with its shareholders to consider promoting the voice of developing countries and their participation in the governance of the institution. This call was supported by the Ministers of Finance of the Group of Twenty and by the Governors of central banks. Renewed debate on World Bank governance is welcome and timely.

19. The reallocation of voting power now under way in existing global institutions will be a complex experience, requiring both goodwill and political will among States and other stakeholders. The long-term viability of the existing institutions depends on progress in this regard.

20. Building effective regional institutions would also be a key step forward in expanding the voice and participation of developing countries in addressing global problems. In addition, the strengthening of the independence and competence of regional and global institutions would serve to broaden governance on critical international issues, rather than maintaining over-reliance on a narrow set of countries.

2.1. What kind of political processes would be most effective in advancing efforts to increase the voice and participation of developing countries and countries with economies in transition in global economic decision-making?

2.2. What principles governing the allocation of votes in the Bretton Woods and other international institutions will ensure their relevance and effective operation?

2.3. What measures are necessary to further strengthen the ability of developing countries and countries with economies in transition to participate effectively in international economic decision-making?

III. Realizing the Doha Development Agenda: effective use of trade and investment policies

21. Increasingly, domestic economies are becoming part of the global economic system. In both the Monterrey Consensus and the 2005 World Summit Outcome, the effective use of trade, investment and technological promotion were recognized as being critical to the development effort and in fighting poverty. For example, in order for the Millennium Development Goals to be achieved, specifically Goal 1, to reduce poverty by one half by 2015, the economies of many developing countries will have to grow at a much faster rate than they have done over the past 25 years. More proactive policies in support of capital accumulation and productivity enhancement are needed for successful participation in the international economy and for sustained improvements in the welfare of all sectors of the population. Moreover, if trade is to be an engine of growth, national development efforts need to be supported by an enabling international economic environment. The proper configuration is a virtuous relationship between trade and investment: investment creates the production capacity to increase trade and successful trade activities validate the risk of investment.

22. After the suspension of talks in 2006, renewed efforts to conclude the Doha Development Round are needed and welcome. But while continued progress is important in order to deter protectionist pressures, it is equally important that all parties to the negotiations keep their goals in mind and not conclude negotiations simply for the sake of concluding the Doha Round. The ultimate success of the Doha process will be evaluated in the light of the Doha Development Agenda, including the intention, stated in the Doha Declaration, that the needs and interests of developing countries should be placed at the heart of its work programme.

23. In deciding to designate the Doha Round as a development round in 2001, the members of the World Trade Organization recognized that the current multilateral trading system puts developing countries at a disadvantage, and that it must be corrected. The objective, therefore, is to improve the multilateral disciplines and the commitments by all members of the Organization, to establish a more level playing field and to provide developing countries with better conditions to enable them to reap the benefits that accrue from opening barriers to trade.

24. With regard to industrial tariffs, through the reduction formula under discussion at the Doha Round, members can, for the first time, address the subject of tariff peaks, high tariffs and tariff escalation still in use in developed countries.

Very often, the highest import tariffs are applied on products control over which developing countries have a comparative advantage.

25. In agriculture, members have agreed that the Doha Round must deliver "effective cuts" in trade-distorting agriculture subsidies in developed countries in order to rebalance the multilateral trading system in favour of developing countries. The most damaging type of subsidies will also be eliminated, namely: export subsidies by 2013, with a substantial part of them gone by 2010. The negotiations should improve market access, including on South-South trade, through the reduction of tariffs and the removal of quantitative restrictions, especially on products where developing countries have a comparative advantage. At the same time, members of the World Trade Organization have recognized the right of developing countries to protect a number of special products for reasons of food security, livelihood security and rural development and to use a special safeguard mechanism to protect themselves against import surges. On the above subjects agreement has already been reached; now the question is "how much". The continued merit of the rules governing the world trading system hinges on the speed at which world agricultural trade can be brought under multilateral disciplines.

26. Concerning the least developed countries, there is agreement to provide duty-free and quota-free access to 97 per cent of all their products on a lasting basis, with a view to eventually extending this treatment to 100 per cent of their products. Because of the narrow range of manufactured products exported by the least developed countries, the 3 per cent exception clause could obviate most benefits to market access.

27. In other countries, the development dimension involves preserving tariff revenue, trade preferences, special and differential treatment and less than full reciprocity, special products and special safeguard mechanisms in agriculture, commodities, implementation-related issues, the concerns of small and vulnerable economies and policy flexibility. The negotiating outcome on all of these issues will determine the extent of the policy space[2] developing countries will have to ensure that trade can be harnessed as an engine of development. Some flexibility has been introduced in agriculture, NAMA and services negotiations, as well as trade facilitation for developing countries, in particular for least developed countries. What is more important in the long run is the incorporation of the development dimension into the architecture of the World Trade Organization, and making it fully operational. In that regard, it is important to note the new provisions on access to medicines, which have already been agreed upon, allowing for compulsory licenses by poor countries that do not have manufacturing facilities. This provision can make an important difference in saving people's lives and in ensuring that more people can afford minimum medical treatment. The policy space created in this way can be utilized by developing countries, in particular those with manufacturing facilities, to develop their manufacturing and technological capabilities.

28. If development is to be the objective of the global trade system, market access alone is not enough. Developing countries need to upgrade their capacity to supply goods in the international market both in quantitative and qualitative terms. A recent report of the United Nations Conference on Trade and Development (UNCTAD)

[2] According to the South Centre, "policy space" provides developing countries with the freedom to choose the best mix of policies possible for achieving sustainable and equitable economic development.

contends that building “supply side” capabilities should be thought of as developing “productive capacity”. Productive capacity, in turn, results from the interaction of three core elements: productive resources (production factors); entrepreneurial capabilities (the ability to innovate and manage scarce resources efficiently, especially through the use of new technology); and production linkages (backward and forward linkages between sectors and between enterprises). There are three central processes in building productive capacity: capital accumulation, which requires substantial investment; technological progress, which involves genuine and viable transfers of appropriate technology; and structural change, which requires an enabling environment for innovation, production and trade. Deliberate, as opposed to haphazard, import liberalization to build competitive export capability in order to take advantage of intermediate inputs and technology from global production chains has been a component of successful trade policies.

29. The provision of services accounts for over 60 per cent of the world’s output. While the share of services in global trade at present is only about 20 per cent, since 1980 trade in services has grown faster than trade in goods. With the advent of faster transmission technologies and transport, the rate of growth of “trade in services” is expected to increase. The General Agreement on Trade in Services of the World Trade Organization, which entered into force in 1995, set out the framework of rules that govern the liberalization of services trade. There are significant potential gains to developing countries in increased trade in services, including the area of mode 4 (movement of natural persons) of the General Agreement. However, it is clear that there are still significant political obstacles to liberalizing the movement of labour in the industrialized world.

30. Trade in services encompasses a broad range of activities, including tourism, education, health, financial and legal services. Because of their enormous potential for employment generation, export earnings and upgrading human resources, developing countries should incorporate into their national strategies deliberate interventions for services sector development that take into account and take advantage of increased trade possibilities. Logistics services, for example, are an increasingly critical underpinning to international competitiveness in goods trade. The service sector is an arena where both developed and developing countries seek to develop their international competitiveness. As in other areas concerning development, countries can exploit the positive benefits from trade in services. They must also ensure that such trade does not undermine their potential to establish and grow their own competitive services sectors or their macroeconomic stability, and that it is consistent with basic social objectives.

31. A more open system of trade can be politically and economically sustainable only if it is complemented by attendant policies that simultaneously address capacity problems, whether human, bureaucratic or structural, and the challenges of distributing the benefits created by freer trade. The “Aid for Trade” initiative is one response to this challenge, which, if properly configured and not burdened by the introduction of conditionality, could empower developing countries to benefit from trade. The initiative can promote development of the private sector, helping entrepreneurs, traders and investors to seize export opportunities, but it requires greater international cooperation and coherence, both between the World Trade Organization, the World Bank, IMF, and the United Nations at the global level, and between trade, finance and development ministries at the national level. While it cannot be a substitute for expanded, fair and stable market access, “Aid for Trade”

is part of the much larger challenge presented by the Doha Round, which is to ensure that trade is not just an end in itself, but that it works to raise living standards and to reduce poverty. The initiative seeks to ensure that the opening up of markets translates into real benefits for the people by helping to put in place the necessary conditions to bring about such gains.

32. Effective trade policy requires effective investment policy. Analysis from the Bretton Woods institutions in recent years has highlighted the fact that insufficient public investment in infrastructure in the pursuit of macroeconomic stability in many developing countries is undermining their medium-term growth prospects. There is a glaring lack of infrastructure in many developing countries in areas such as power, transport and telecommunications, as well as in basic services such as water, education and health. The original faith in the private sector as a substitute for the public sector in the provision of infrastructure has proven to be misplaced. The public sector and multilateral development banks need to remain active in financing projects in sectors where private considerations cannot adequately pursue the needs of society at large (in areas such as roads and water for example) and in low-income countries where private financing is insufficient to begin with. In other sectors, such as power, and in middle-income countries that have received greater levels of private financing, there is a need for the public sector to leverage private finance to a greater extent through the strengthening of complementary services and risk mitigation instruments.

33. Recent multi-stakeholder consultations, such as those organized by the Department of Economic and Social Affairs Financing for Development Office, have examined the issue of how development finance institutions can help bridge the infrastructure financing gap in developing countries. The consultations on "financing access to basic utilities for all" explored the long-term funding possibilities for water and electricity projects and emphasized that policymakers need to identify the appropriate combination of tariff regimes, subsidies and tax policies that would allow these services to be universally provided, affordable to the poor and financially sustainable. In other consultations on infrastructure carried out by the Department of Economic and Social Affairs, the critical bottleneck impeding investment finance in some countries by the shortage of good projects was highlighted and the official sector was called upon to provide technical and financial assistance to strengthen project development capacities in developing countries.

34. Foreign direct investment policies need to be in line with the identified development priorities of each country and should form part of a broader strategy to raise productive investment and the development of skills and technology. The experience of the most successful late-industrializing countries has shown that well-conceived national support policies can strengthen the creative forces of markets and related domestic capital formation. Foreign direct investment flows will have a beneficial effect only if these policies ensure that such investments support clear development goals, maximizing the potential benefits of in flows and minimizing the negative effects such as the crowding out of domestic firms and the abuse of market power. In practice, however, the impact of foreign direct investment on development is likely to depend on the motivation and strategy of the foreign corporation and the policies and characteristics of the recipient country. For instance, some countries have expressed the view that foreign direct investment in new plant equipment is more likely to add to productive capacity than that arising from mergers and acquisitions. Host country regulations should be directed at

influencing the creation of linkages between foreign affiliates and local firms and expanding the potential for foreign direct investment to be a channel for diffusing skills, knowledge and technology. Linkage promotion policies have already been adopted in a number of countries and should be combined with broader measures to strengthen the quality of entrepreneurship in the local economy since the availability, costs and quality of domestic suppliers are all key factors in inducing foreign companies to invest their capital.

35. In designing public policy to attract foreign direct investment, care must be taken to ensure that policies are country-specific in design. Small, landlocked least developed countries in particular have special circumstances that cannot be ignored in policy design. Nor may foreign direct investment policy be considered in isolation from the broader development strategy or without reference to the need for coherence with overall government policies, including policies on trade, domestic investment and other policy areas (fiscal, tax, inflation, public services, education, health, labour market, science and technology, institutional development, etc.). Both domestic investment (public and private) and foreign direct investment can contribute to development by generating growth and employment and improving skills, technology and infrastructure. In this regard, the creation of linkages between foreign and domestic investment is extremely helpful. Success in structural transformation and poverty reduction requires that institutions and institutional capacity be strengthened to enhance their ability to design and effectively implement investment and other policies.

36. Recently, developing countries (especially from East and South Asia) have become increasingly important sources of foreign direct investment. This trend has been driven by both corporate factors and government policies aimed at ensuring access to strategic resources, such as minerals. These South-South investment flows have begun to comprise a significant proportion of foreign direct investment inflows to some developing countries. The most recent *World Investment Report* includes indications that investment from developing countries is likely to have a stronger effect in improving productive capacity since transnational corporations from developing countries tend to invest in new plant equipment, rather than undertaking mergers and acquisitions, as a mode of entry. Moreover, given the generally greater labour intensity of corporations in developing countries, their potential for generating employment also tends to be higher. These and related benefits have led many developing host countries to adopt specific strategies to attract such investment. Moreover, there has also been an increase in South-South investment cooperation through international investment agreements that may facilitate foreign direct investment flows among developing countries. At the same time, there is a need for greater understanding at all levels about the factors driving these flows, their implications and the possibilities for maximizing their impact. Multilateral organizations can play an important role by providing the requisite analysis, technical assistance and forums where policymakers could share experiences and discuss methods of further cooperation.

3.1. What scope is there in the renewed effort to conclude the Doha Development Round for advancing a developmental agenda in world trade? How can progress in multilateral trade negotiations and in setting multilateral rules and regulations be reconciled with the need for sufficient space for national policies in support of structural change and growth in developing countries?

3.2. How can foreign direct investment policies be more successfully integrated in a coherent manner with policies on trade, domestic investment and other government policies to achieve development objectives?

3.3. How can relevant multilateral, regional and national institutions develop functions and tools that allow them to better mitigate the risks facing private foreign investors involved in infrastructure projects in developing countries?

IV. Aid effectiveness and innovative financing for development

37. In the Monterrey Consensus, the signatories asserted that effective partnerships among donors and recipients were based on the recognition of national leadership and ownership of development plans and, within that framework, that sound policies and good governance at all levels are necessary to ensure that official development assistance (ODA) produced desired results. The 2005 Paris Declaration on Aid Effectiveness was a milestone in setting out the principles and launching a process to achieve that mandate. Ongoing efforts should be intensified and lessons learned, including those to be gathered from the outcome of the September 2008 High-level Forum on Aid Effectiveness, to be held in Accra, which should serve as key inputs to the follow on conference on financing for development to be held in Doha later in 2008. Deliberations at the meeting of the development cooperation forum in July 2007 and in the third quarter of 2008 and the High-level Dialogue on Financing for Development in the fourth quarter of 2007 would also be of crucial importance in advancing the aid effectiveness agenda.

38. The report of the OECD Development Assistance Committee on the baseline for and progress on the Paris Declaration, which is to be issued in April 2007, documents the current wide-ranging monitoring efforts and discussions on implementation. The report confirms that some progress in the implementation of the Paris Declaration is apparent in a growing number of countries. It is clear, however, that more efforts are needed if real and deep changes are to be made in aid effectiveness. According to the report, partner countries are to lead the implementation of the Paris Principles at the country level, making clear the expectation that donors will harmonize their action plans, cooperate in monitoring progress and support improvements in the quality of national public financial management and procurement systems by helping to build and strengthen country capacities and systems for monitoring results. This will require traditional and new donors to alter their practices, consider more effective approaches, such as expanding the use of budget support, and address universally understood problems, such as fragmentation.

39. The current governance of international aid is uneven and recipient countries have an inadequate voice in the process. While the interests and views of the donor countries are well represented in the boards of the multilateral financial institutions (dominated in most cases by the developed economies) and the OECD Development Assistance Committee, there is no permanent forum representing the interests of the recipient countries. The General Assembly has called for the convening of a development cooperation forum, with the participation of developing countries, to build political oversight over aid effectiveness. At the country level, it is critical that

institutions for measuring and monitoring aid effectiveness involve a genuine partnership between donors and recipients, which means that these processes should avoid using donor templates and indicators exclusively. Legislatures and citizens groups from the recipient countries should be adequately represented in the country assessment process. These country level processes should include an assessment of donor performance.

40. The system of providing ODA is expanding, increasingly complex and fragmented and insufficiently coordinated. There is an increasing number of new donors. The international aid system now consists of a loose aggregation of more than 150 multilateral agencies, including agencies of the United Nations system and the global and regional financial institutions; 33 bilateral agencies that are members of the OECD Development Assistance Committee; several Governments that are not members of the Development Assistance Committee that provide significant sums of ODA; and a growing number of special-purpose global funds, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria. As in the case of earmarking, these special funds can distort the balance of national priorities, and it is important that such funds accelerate their commitment to the Paris Principles. Within this system, bilateral aid accounts for approximately 70 per cent, with the multilateral system accounting for the remaining 30 per cent.

41. Under the current system, countries seeking aid, whether provided through the budget or through projects, deal with a variety of aid instruments and associated agreements with a large number of donors. The number of donor missions received by some recipient countries can be so great as to leave little time, space or resources for independent policymaking. For donors, there is a proliferation of indicators to be monitored; indicators that may sometimes be inconsistent among themselves. Aid is the most conditional source of external financing and efforts to streamline conditionality are thus even more pressing in this area.

42. Aid allocations by donors are often characterized by selectivity and instability. From 1980 to 2004, the top 20 aid recipients received more than half of net bilateral ODA and less than 50 per cent of aid recipients received 90 per cent of all aid from the OECD Development Assistance Committee donors, with many poor low-income countries receiving very little assistance. Moreover, some high income and middle income countries are large recipients of ODA, receiving aid for geopolitical reasons rather than for development needs. In some cases, donors provide aid to specific countries and then, in unison, discontinue such assistance, causing surges and reversals and making aid more volatile than fiscal revenues. In the face of such sudden changes, central banks and ministries of finance must make costly changes in policy, including fiscal adjustments in the form of increased taxation and spending cuts, which may reinforce the cyclical impact of declining aid flows, further increase the macroeconomic volatility that characterizes most developing countries and have a detrimental impact on growth and development.

43. Progress towards the goal of aid effectiveness will require political and conceptual agreement on approaches to measuring both the quantity and the quality of assistance. There is increased interest in moving towards outcome-based conditionality, under which disbursements are based on the achievement of results, leaving recipient countries the freedom to determine for themselves the policy content of their programmes. In the case of balance-of-payments support, questions have been raised about whether an outcome-based approach will permit the

disbursement of funds in a timely manner. Outcome-based conditionality requires timely and correct measurement of target variables and a capacity to take into account the impact of purely exogenous shocks in measuring performance. A formulaic application of outcome-based conditionality could reduce the flexibility and adaptability of the programmatic approach. Country experience suggests that outcome-based indicators are an essential tool to measure results but that caution should be used in applying them as conditions for disbursement. The key advantages of outcome-based conditionality are that it enhances ownership and increases the probability of applying the proper instruments to meet agreed goals.

44. As noted in previous reports, the declining trend of ODA was reversed in 2002. ODA rose to $106.5 billion in 2005, or 0.33 per cent of gross national income of developed countries, although a large part of the increase was due to debt relief to a few countries and to tsunami aid. The Group of Eight pledged to double aid to Africa to $50 billion by 2010. Despite this positive trend since 2002, the current and projected levels of ODA for the period 2006-2010 still fall far short of targets. It is now estimated that $150 billion is needed to reach the Millennium Development Goals by 2015, and ODA remains below the 0.5 per cent achieved in the early years of the Development Assistance Committee and below the 0.7 per cent target. The latest simulation of the ODA volumes of Committee members, carried out by the Committee secretariat, shows a fall in aid to 0.30 per cent in 2006.

45. The gap in financing required to reach the Millennium Development Goals by 2015 confirms the need for additional efforts to increase the flow of financing for development, including through new and innovative mechanisms. At the 2005 World Summit, Heads of State and Government recognized the value of developing innovative financing for development. Building on those grounds, and believing that they can provide for additional, long-term and more stable flows of resources, the consideration of several innovative projects reached implementation phase in 2006. Efforts were initiated in 2004, when more than 100 countries agreed to the New York Declaration on Action against Hunger and Poverty. The declaration on innovative sources of financing for development was subsequently adopted at United Nations Headquarters in New York on 14 September 2005 and endorsed by 79 countries. More recently, a meeting of the Technical Group on Innovative Financing Mechanisms was held in Santiago and the Government of Norway hosted the second meeting of the 46 countries that are part of the Leading Group on Solidarity Levies to Fund Development, which was established in Paris in 2006. It is important that this momentum be maintained and that new initiatives be encouraged in view of the international follow-up conference on financing for development, to be held in Doha in the second half of 2008.

46. The first projects were put into practice in less than two years. First, an air ticket solidarity levy was launched in Paris on 1 March 2006. It is said to be relatively straightforward to implement, with limited collection costs and no effect on competition. To date, 25 Member States, a majority of which are developing countries, have committed themselves to introducing the levy or, in a few cases, to providing a voluntary contribution. It has been agreed to use the proceeds to focus on scaling up access to treatments against HIV/AIDS, tuberculosis and malaria. The pooled proceeds will go to the International Drug Purchase Facility, a funding mechanism launched in New York on 19 September 2006 and hosted by the World Health Organization (WHO), which aims to lower the price of quality drugs and diagnostics and increase the pace at which they are made available. Secondly, the

International Finance Facility for Immunization was launched in London on 7 November 2006, with the first successful pricing of its bonds on capital markets. By investing resources up front and resorting to the bond market, this programme increases current aid flows to ensure reliable and predictable funding flows, up to and including 2015. Funds will be used for health and immunization programmes through the Global Alliance for Vaccines and Immunization. Thirdly, an advanced market commitments pilot programme was launched in Rome on 9 February 2007. The programme combines market-based financing tools with public intervention to provide long-term funding for the development of future vaccines against pneumonococcal disease.

47. Other innovative mechanisms being discussed include: ways to promote microfinance for development; projects that focus on the environment; analysis of a low currency transaction levy of around half a basis point, which countries would introduce on a voluntary basis to fund specific development projects; and discussions on tax havens and tax evasion. On the financial system side, other possible financing mechanisms more directly beneficial to middle income countries include the introduction of new financial instruments (such as gross domestic product (GDP) indexed and commodity linked bonds) and a renewed effort to provide financing for crisis prevention through a proposed Reserve Augmentation Line facility at IMF. The President of Costa Rica recently launched an initiative, the Costa Rica Consensus, to increase social expenditures to be financed by concessional flows to countries that reduce or limit military expenditures. Some of the existing financial mechanisms or a new fund could be used for that purpose.

48. Several broad challenges remain. It is important to be realistic and to recognize that while these initiatives could raise some funds, the amounts are not likely to be very large. There is a general view that the efforts outlined above are additional to the commitment of donor countries in reaching the 0.7 per cent of their gross national income for ODA. Several of these efforts involve earmarking collected funds and can place undue priority on issues when other problems are more pressing, although this weakness must be weighed against the need to build global constituencies in support of development financing. As much as possible, the funds collected should be pooled and disbursed through existing multilateral institutions with good track records in achieving development results: where possible, organizations of the United Nations system should be utilized. In order to mobilize wider support for new funding mechanisms, priority should continue to be given to clearly identifiable programmes with a high degree of visibility. Furthermore, civil society should play a more visible role in participating in the design of projects and in monitoring the use of resources and the private sector should, in cases where it is beneficial, be incorporated into certain project designs. Overall, an important challenge will continue to be building consensus around pilot projects and other implementable ideas.

4.1. How can the aid system be further improved to enhance ownership, governance, effectiveness and predictability? What are the most effective evaluation and signalling mechanisms for aid allocation and delivery? With respect to budget support, what are the conditions required for greater volumes of budget support having greater development impact?

4.2. What are the constraints to gaining the involvement of a greater number of partner countries in the process of improving aid effectiveness?

Which modalities (for example greater donor-recipient coordination, outcome-based conditionality and effective dialogue with others) should be put in place to ensure improved development outcomes? How can we involve newly emerging donor countries in donor coordination and harmonization?

4.3. How can international cooperation under the framework of innovative financing for development be accelerated? To what extent would more universal country participation advance this agenda?