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

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

Report of the Secretary-General**

Summary

Pursuant to General Assembly resolution 66/191, the present report provides an annual assessment of the state of implementation of the Monterrey Consensus and the Doha Declaration on Financing for Development. The recent developments are presented under each of six thematic areas: mobilizing domestic financial resources for development; mobilizing international resources for development: foreign direct investment and other private flows; international trade as an engine for development; increasing international financial and technical cooperation for development; external debt; and addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development. Other recent developments related to strengthening of the financing for development intergovernmental follow-up process are presented in a section on “Staying engaged”.

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



I. Mobilizing domestic financial resources for development

1. Economic growth and domestic resource mobilization are intertwined. Thus, the pace, balance and sustainability of global economic recovery will have significant implications for domestic resource mobilization in developing countries. Global growth slowed down markedly in 2011 and is likely to remain below potential in most regions in 2012. World gross product is projected to grow by 2.5 per cent in 2012, following growth of 2.7 per cent in 2011.¹ Faced with weakening external demand and increased global uncertainties, developing countries are projected to see notable growth moderation to 5.3 per cent in 2012.

2. High unemployment remains a constraint for domestic resource mobilization. There remains a deficit of around 50 million jobs in comparison with the pre-crisis situation. Concerted measures are needed to address the existing jobs deficit and provide employment for the over 80 million people expected to enter the labour market in the near future. In particular, youth unemployment rates have increased in about 80 per cent of advanced economies and in two thirds of developing economies.² Many workers in developing countries continue to face social challenges such as unemployment, poor pay, vulnerable job conditions and a lack of access to any form of social security. Globally, there has been little progress in the elimination of gender-based discrimination in the labour market. The labour participation rate stood at 51 per cent in 2010 (52 per cent in 2002) for women, compared with 77 per cent (78 per cent in 2002) for men.

3. The post-crisis recovery of savings and investment rates was mixed among income and regional groups. The average savings rate (gross savings/gross domestic product (GDP)) in low- and middle-income countries, which had dropped to 29 per cent in 2009, has since increased to 30 per cent. In 2010, domestic savings increased significantly in sub-Saharan Africa (from 15.5 per cent in 2009 to 17.3 per cent in 2010), recovered somewhat in Latin America and the Caribbean (from 19.2 per cent in 2009 to 20.8 per cent in 2010) and remained high (46.44 per cent) in East Asia and the Pacific. At the same time, gross capital formation³ has moved to pre-crisis levels in low- and middle-income countries to just over 29 per cent in 2010 from 28 per cent in 2009.⁴ The impact of the crisis was much lower on developing countries than on countries of the Organization for Economic Cooperation and Development (OECD), which show a 3 per cent dip in 2009 and a tepid recovery in 2010 by less than 1 per cent (from 17.3 per cent to 18.1 per cent).

4. Domestic environments that are conducive to private economic activity provide the basis for mobilizing both foreign and local investment. Many developing countries have made progress in this respect, especially in the area of legal and regulatory reform, improving the provision of information, as well as promoting the ease of doing business. For example, in sub-Saharan Africa, where starting and running a business is still costlier and more complex than in any other part of the world, 36 of 46 countries improved their regulatory environment for

¹ *World Economic Situation and Prospects 2012*, midyear update (E/2012/72). The IMF *World Economic Outlook Update* of 16 July 2012 had a slightly higher growth projection for developing countries in 2012 (5.6 per cent).

² International Labour Organization and International Institute for Labour Studies, *World of Work Report 2012: Better Jobs for a Better Economy* (Geneva, 2012).

³ Gross capital formation represents gross domestic investment.

⁴ World Bank, *World Development Indicators 2012* (Washington, D.C., 2012).

domestic businesses in 2010/11 — a record number since 2005. Worldwide, 125 economies implemented 245 reforms making it easier to do business in 2010/11, 13 per cent more than in the previous year.⁵

5. The effects of the world financial and economic crisis on tax revenues are striking. Global tax revenues as a percentage of GDP saw a significant decrease in the period 2007-2009 by more than 2 per cent (from 15.6 per cent in 2007 to 13.5 per cent in 2009). The drop extended to all income groups but was particularly large in high-income countries. Major reasons for drops in tax revenues include the adverse effects of the crisis on economic activity (affecting levels of employment, sales of goods and services, etc.) and developments in tax legislation (affecting tax rates, the tax base, thresholds, exemptions, etc.).⁶ Modernized, equitable, effective and more progressive tax systems can help to increase tax revenue and reduce inequalities.

6. The financial sector has deepened significantly (as measured by the ratio of bank assets to GDP) in most countries over the past decade, despite setbacks in several (mostly developed) economies during the crisis. However, in most low-income countries, bank credit to the private sector has actually decreased in relative terms.⁷ Despite greater resources, banks in low-income countries follow a conservative approach and remain reluctant to lend to the private sector. Challenges remain to mobilize domestic resources for productive investment. Possible avenues include greater diversification of domestic banking sectors, as well as the use of public funds, including donor money, to provide technical assistance and capacity-building to help borrowers develop bankable project proposals and to provide risk mitigating measures for investors in the form of credit enhancements and guarantees.

7. Financial inclusion, namely, greater access to a wide range of financial services by poor and vulnerable population groups, microenterprises and small- and medium-sized enterprises, is beneficial for development and domestic resource mobilization. Inclusive finance represents a more holistic approach than microcredit and includes savings, payment, insurance and other services tailored specifically to the needs of low-income borrowers and savers. Recently published indicators⁸ show that financial inclusion rises steadily with income. The percentage of people aged 15 and older with an account at a formal financial institution is 24 per cent for low-income, 28 per cent for lower middle-income, 57 per cent for upper middle-income and 89 per cent for high-income countries. Moreover, there are significant disparities along gender lines. Worldwide, 55 per cent of men report having an account at a formal financial institution, while only 47 per cent of women do. The gender gap is largest among lower middle-income economies as well as in South Asia and the Middle East and North Africa.⁸ Policies to advance financial inclusion should therefore remain high on the international agenda.⁹

⁵ World Bank, *Doing business 2012: Doing business in a more transparent world* (Washington, D.C., 2012).

⁶ World Bank, *World Development Indicators 2011* (Washington, D.C., 2011).

⁷ World Bank, Financial structure data set, 2011.

⁸ World Bank, Global Financial Inclusion (Global Findex) database, 2012.

⁹ Special Advocate of the Secretary-General for Inclusive Finance for Development, annual report to the Secretary-General, September 2011.

8. Illicit capital flows continue to drain developing countries of important resources for development. The United Nations Model Double Taxation Convention between Developed and Developing Countries, which was updated by the Committee of Experts on International Cooperation in Tax Matters in 2011, includes important provisions aimed at curtailing cross-border tax evasion and avoidance and capital flight through improved exchange of information (art. 26). Moreover, illicit capital flows are frequently intimately linked to large-scale corruption. It is therefore necessary to continue combating corruption at all levels, including through effective legal instruments such as the United Nations Convention against Corruption,¹⁰ which entered into force in December 2005 and currently has 160 parties.

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

9. Private capital flows to developing countries have exhibited signs of volatility. Following a strong revival in the aftermath of the world financial and economic crisis, net private capital flows to developing countries underwent a downturn during the latter part of 2011. Owing to growing fears among portfolio investors about the sustainability of public finances in Europe, there occurred a general “flight to safety”. In total, net private capital flows to developing countries are estimated to have fallen from about \$447 billion in 2010, to about \$438 billion in 2011.¹¹ Some stability appeared to have returned during the early months of 2012, as risk aversion among investors eased in line with improving prospects for the eurozone and the global economy at large. However, the prospects for private capital flows to developing countries over the coming months are mixed. On the one hand, stronger economic fundamentals in emerging economies, combined with continuing economic problems in many advanced economies, should serve to attract investors. On the other hand, signs of an economic slowdown in some of the leading emerging economies, combined with renewed concerns about the global economy, could lead to a sharp increase in risk aversion in international financial markets, giving rise to large outflows of private capital.

10. Foreign direct investment (FDI) remains a major component of private capital flows to developing countries and is estimated to have amounted to about \$376 billion in 2011. Those flows are concentrated in a few developing countries, although there have been signs of greater diversification. Moreover, there are significant regional differences. The large majority of FDI to developing countries continues to be channelled to Asia and Latin America, while flows to Africa, although higher than a decade ago, remain limited. In recent years, outward FDI from developing and transition economies has become increasingly significant (with a large proportion thereof directed towards other developing and transition economies). However, their share in global FDI outflows declined from 31 per cent in 2010 to 26 per cent in 2011. There was a significant decline in outward FDI from Latin America and the Caribbean, as foreign affiliates of some of their transnational companies repaid loans to their parent firms in the region. Nevertheless, the overall

¹⁰ United Nations, *Treaty Series*, vol. 2349, No. 42146.

¹¹ International Monetary Fund (IMF), *World Economic Outlook* database, April 2012 edition.

levels of FDI flowing from developing and transition economies remained high from a historical perspective.¹²

11. While FDI tends to be more stable than other types of private capital flows into developing countries, there are concerns that its changing composition, owing to a shift from equity to debt components, may be making it more volatile.¹³ Where a significant portion of FDI is intracompany debt, as opposed to green-field direct investments, the parent company can recall this debt on short notice. In this respect, it has been claimed that the proportion of short-term and volatile flows in FDI has increased and that part of the growth in FDI flows during the past two years has been made for the purpose of short-term gains. For instance, some of the intracompany funds received from the parent company can sometimes be invested for speculative purposes and may be easily liquidated. The growing proportion of short-term and volatile flows contained in FDI could reverse more quickly than expected in an uncertain economic and financial climate.

12. While portfolio flows to developing countries rebounded earlier this year, there exists the possibility of a renewed slowdown. Adverse developments in the global economy could affect both equity and bond flows. Furthermore, some developing economies may be particularly vulnerable to adverse market sentiment, owing to concerns that include decelerating growth rates, high fiscal and external deficits and, in some instances, political instability. Adding to these concerns, the earlier surge in capital flows to developing countries that took place between 2009 and 2011 is argued to have increased the amount of potential hot money in emerging markets that may depart suddenly. Moreover, the strong flows into corporate debt markets during the recent years have been accompanied by a rapid expansion in private credit in some developing economies, thereby heightening their vulnerability to rapid deleveraging or a sudden reversal in capital flows.¹⁴

13. In a similar vein, the gradual recovery in commercial bank lending to developing countries is also susceptible to the fragility in economic and financial conditions. Recent figures from the Bank for International Settlements suggest a decline in cross-border claims on emerging market economies from banks located in other countries during the latter part of 2011.¹⁵ As this was only the second such decline in almost three years, it may be indicative of deleveraging by commercial banks and is likely to continue in the near future. While the impact on cross-border bank flows is likely to be greatest in emerging Europe and central Asia, which have the most direct exposures to distressed European banks,¹⁶ there is nevertheless a risk that the deleveraging process could become disorderly and lead to a more generalized cutback in credit that would affect a wider range of developing countries. Such a development may in turn trigger significant portfolio outflows from emerging economies, affecting the stability of their currencies and capital markets. A tightening in lending standards by international banks may also serve to

¹² United Nations Conference on Trade and Development (UNCTAD), *Global Investment Trends Monitor*, No. 8 (24 January 2012).

¹³ *World Investment Report 2011: Non-Equity Modes of International Production and Development* (United Nations publication, Sales No. E.11.II.D.2).

¹⁴ IMF, *Global Financial Stability Report: The Quest for Lasting Stability* (Washington, D.C., April 2012).

¹⁵ Bank for International Settlements, "International banking and financial market developments", *Quarterly Review* (June 2012).

¹⁶ World Bank, *Global Economic Prospects: Uncertainties and Vulnerabilities* (January 2012).

affect trade finance, which in many instances, comprises a large share of short-term debt. There are signs that commercial banks have been cutting trade finance exposures and/or reducing their provision of trade finance for smaller markets. There is a risk that a sharp downturn in the global economy could lead to a freeze in trade finance.¹⁶

14. The increasing volatility of private capital flows and their vulnerability to changing sentiments have rendered it increasingly important for countries to have the scope to employ measures to effectively manage volatile short-term capital flows. The policy instruments that may be employed by countries to manage international capital flows include macroeconomic policies, macroprudential measures, and other forms of capital account regulations, including capital controls. There has been renewed interest in capital account regulations and discussion of the conditions under which they would be effective. During the past few years, a number of countries (including Brazil, Indonesia, Peru, Thailand and the Republic of Korea) introduced capital account regulatory measures to manage volatile short-term capital flows. The effectiveness of capital account regulations would ultimately depend upon the specific circumstances of a country, including its economic situation, the quality of the existing regulatory framework, the structure and persistence of inflows and the design and implementation of capital account regulations.

15. Officially recorded remittances to developing countries are estimated to have totalled \$372 billion in 2011, representing a year-on-year increase of about 12 per cent. The leading recipients of remittances among developing countries were India, China, Mexico and the Philippines. Moreover, remittances make up a larger share of GDP in small- and low-income countries. For instance, in 2010, they amounted to 31 per cent of GDP in Tajikistan, 29 per cent of GDP in Lesotho, and over 20 per cent of GDP in a number of other countries, including Moldova, Nepal and Samoa.¹⁷ Given the important role that remittances play in the economies of a number of developing countries, it is important that source and destination countries collaborate to reduce the transaction costs of remittances and, where possible, to relax legal and funding barriers to remittances and other financial flows by migrants.

III. International trade as an engine for development

16. International trade has experienced marked volatility since the onset of the world financial and economic crisis. After dropping by 9.9 per cent in 2009,¹⁸ global trade expanded by 13.1 per cent in 2010. In 2011, high-income economies experienced a marked deceleration, in which GDP growth halved from 3 per cent in 2010 to 1.6 in 2011. The corresponding decrease in global demand translated into a 6.6 per cent global trade rate of growth in 2011.¹⁸ Trade in developing countries and the member countries of the Commonwealth of Independent States fell (-7.4 per cent), relative to trade in developed economies (-15.1 per cent) in 2009 and recovered faster.¹⁹ Consequently, their share of global exports rose from 39 per cent

¹⁷ World Bank, *Migration and Development Brief*, No. 18 (23 April 2012).

¹⁸ *World Economic Situation and Prospects 2012* (United Nations publication, Sales No. 12.II.C.2), table 1.1.

¹⁹ World Trade Organization (WTO), "Trade growth to slow in 2012 after strong deceleration in 2011", *World Trade 2011, Prospects for 2012*, table 1, p. 5. Press release, PRESS/658/Rev.1 May 10 2012.

in 2008 to 47 per cent in 2011, in contrast with previous global crises, where developing economies had proved to be particularly vulnerable to external shocks.

17. Uncertainties associated with the European sovereign debt crisis, as well as volatile commodity prices and unstable capital flows, imply the possibility of further deceleration in trade growth for 2012. In addition, despite the pledge from G20 members to resist protectionism, to restrain from new measures until 2014, and to roll back measures taken, only 18 per cent of all the measures introduced since the beginning of the crisis have been removed.²⁰ A successful conclusion to the World Trade Organization (WTO) Doha Round of multilateral trade negotiations with an ambitious, balanced and development-oriented outcome would help to restrain these protectionist trends and ensure a faster recovery of the global economy.

18. At the Eighth WTO Ministerial Conference, held in December 2011, ministers recognized that multilateral trade negotiations were at an impasse and that there was a need to more fully explore different negotiating approaches, compatible with the principles of inclusiveness and transparency. Lately, negotiations in WTO have centred on a possible “early harvest” of issues of importance to developing countries and least developed countries, such as facilitating accession of least developed countries, full implementation of the 2005 WTO decision on providing duty-free, quota-free market access for least developed countries, operationalization of the Least Developed Country Services Waiver, extension of Agreement on Trade-Related Aspects of Property Rights (TRIPS) flexibilities and eliminating export subsidies and trade, distorting domestic support to cotton production in developed countries.

19. Several issues that have emerged as being important for a more balanced and effective multilateral trading system are not a part of the Doha Agenda, such as the governance of global supply chains, commodity price volatility and trade-related aspects of climate change. Market transparency has to be enhanced to mitigate excessive price volatility in commodity markets, which can have particularly adverse effects on developing countries heavily dependent on commodity exports. Likewise, measures should be taken to curb risks to food security in food-importing countries. The proliferation of bilateral and regional trade agreements could be made more compatible and coherent with the multilateral system, perhaps through plurilateral agreements under WTO auspices.²¹

20. Even though the share of least developed countries in global trade increased to 1.14 per cent in 2011, more needs to be done to enhance their integration into the global economy. The share of the value of exports from developing countries and least developed countries imported free of duty in developed markets reached 80 per cent in 2004²² and has remained at that level since then.²³ To boost the participation of least developed countries in world trade, developed countries should focus on the full implementation of commitments contained in the 2005 WTO decision to provide duty-free, quota-free market access to least developed country products, along with simplified rules of origin, lower administrative costs and elimination of non-tariff barriers affecting least developed country exports. South-South trade

²⁰ WTO, “Report on G-20 trade measures”, 31 May 2012.

²¹ IMF, “The WTO Doha trade round — unlocking the negotiations and beyond”, November 2011.

²² Excluding arms and oil.

²³ Millennium Development Goals Gap Task Force Report 2012 (to be issued).

expanded by 32 per cent in 2010, absorbing 49 per cent of developing countries' exports, suggesting a potential dynamic market for least developed countries, including further duty-free, quota-free access.

21. Although preferential market access is still an important factor of developing countries enterprises' competitiveness, trade policies are no longer sufficient because of the current nature of the global supply chains business model. In effect, competitiveness in these chains is determined by a wide range of factors, especially by the quality of policies influencing the overall business environment. Least developed countries and other low-income countries are often confronted with substantial disadvantages, as implementing these policies would require substantial resources that are often lacking.²⁴ Accordingly, national policies to support businesses, as well as to generate incentives for technology transfer and assimilation, are required to allow least developed countries and low-income countries to participate at higher value-added levels, and thus contribute more to their development.

22. Aid for Trade is one of the instruments that should be boosted to improve trade infrastructure, diversify export capacity and support an increase in the technological content of exports. Aid for Trade commitments reached \$45.3 billion in 2010, despite the fiscal and economic difficulties in many OECD countries. This amount represents a further increase of 12 per cent over 2009 levels. The outlook for Aid for Trade, however, is bound to be affected by the continuing tight government budgets in OECD countries, which in turn will put pressure on aid levels in the coming years. Aid for Trade to least developed countries reached \$13.7 billion in 2010, up 14 per cent from 2009 levels. Least developed countries now account for 30 per cent of total Aid for Trade. However, disbursements amounted to just \$9 billion.

23. Existing trade finance programmes need to be expanded to reach all low-income countries and ensure that trade finance is offered at an affordable cost. The Basel III framework introduced additional requirements that effectively classify trade finance among risky assets, even though data show that trade finance is a safe, low-risk financial activity. WTO and the World Bank raised the issue of the "potential unintended consequences of the Basel frameworks of prudential regulation for the finance industry on the availability of trade finance, in particular for low-income countries" with the Basel Committee.²⁵ In turn, the Basel Committee introduced some flexibilities to address these issues, but contingent trade finance exposures are still treated in the same way as lending, which adversely affects small businesses, small countries and small banks, especially in Africa.

24. Trade-related aspects of climate change are one of the key issues for developing countries. A greening global economy can open new markets with trade opportunities for all countries, which could generate employment. Particularly in rural areas, a green economy, together with information and communications technologies, has the unique power to connect people to global markets. Yet, this usually requires improved production processes, investment in new technology and

²⁴ Alessandro Nicita, and others, *Global Supply Chains: Trade and Economic Policies for Developing Countries*, Advance Unedited Version, *Policy Issues in International Trade and Commodities Study Series* (UNCTAD, Geneva 2011).

²⁵ WTO, press release, "Lamy outlines benefits of changes to Basel framework for trade finance", 26 October 2011.

efficient trade infrastructure, all of which are often more costly to implement in developing countries.

25. However, some policies to support a green economy can restrict access to markets, distort international competitiveness and, in some cases, be incompatible with multilateral trade rules. Accordingly, a better understanding of the rules and potential impacts of green economy policies would be needed.

IV. Increasing international financial and technical cooperation for development

26. In 2011, members of the Development Assistance Committee of OECD provided \$133.5 billion of net official development assistance (ODA), representing 0.31 per cent of their combined gross national income. This marks a decrease of 2.7 per cent compared with 2010 and was the first fall in global ODA since 1997, if one excludes the years of exceptional debt relief.²⁶ Within total net ODA, aid for core bilateral projects and programmes (i.e., excluding debt relief grants and humanitarian aid) fell by 4.5 per cent in real terms.²⁷ There were reductions in ODA budgets of 16 Development Assistance Committee donors, including the largest ones such as the United States of America, the European Union, France and the United Kingdom of Great Britain and Northern Ireland. Countries such as Austria, Belgium, Greece, Japan and Spain saw double-digit cuts in their ODA in 2011. Looking ahead, prolonged recessions in several Development Assistance Committee donors may further squeeze aid budgets and pressure may mount on other donors in the coming years.²⁸

27. Donors renewed their commitment to provide at least 0.15 to 0.20 per cent of their gross national income as aid to least developed countries in the Istanbul Programme of Action for the Least Developed Countries for the Decade 2011-2020,²⁹ adopted at the Fourth United Nations Conference on the Least Developed Countries, held in Istanbul, in May 2011. The Programme called on all donors to achieve the 0.15 per cent target by 2015. However, only nine donors have thus far reached the target of 0.15 per cent. Moreover, having amounted to \$27.7 billion in 2011, ODA to least developed countries was almost 9 per cent lower than in 2010. Similarly, the commitments made at the Group of Eight (G8) 2005 summit in Gleneagles to increase aid to Africa by \$25 billion were not met in the target year of 2010. Whereas bilateral aid to sub-Saharan Africa was \$28.0 billion in 2011, representing a fall of 0.9 per cent in real terms compared with 2010, aid to the African continent increased by 0.9 per cent to \$31.4 billion, as donors provided more aid to North Africa following the political upheavals in the region.

²⁶ OECD, "Development: aid to developing countries falls because of global recession", 4 April 2012.

²⁷ ODA data from the OECD-Development Assistance Committee website.

²⁸ OECD-Development Assistance Committee, "Outlook on Aid: Survey on Donors' Forward Spending Plans 2012-2015", preliminary findings.

²⁹ *Report of the Fourth United Nations Conference on the Least Developed Countries, Istanbul, Turkey, 9-13 May 2011* (United Nations publication, Sales No. E.11.A.1, chap. II).

28. Following these shortfalls, the Council of the European Union reaffirmed its commitment to achieve all their development aid targets, including the collective 0.7 per cent ODA to gross national income target, by 2015.³⁰ Furthermore, the European Union has reiterated its commitment to policy coherence for development and has identified its key strategic priorities. The European Union will focus on governance and inclusive sustainable growth as the two overarching pillars of development cooperation, follow a more differentiated approach to countries at varying levels of development and concentrate on a maximum of three sectors per country. The mix and level of aid will be adapted according to the needs, capacity, impact, and progress in commitments to and the record on human rights, democracy and the rule of law, and according to the ability to conduct reforms and to meet the needs of the people.

29. Leaders at the Fourth Conference on the Least Developed Countries made a renewed call for support for agriculture, along with building productive capacity in developing countries. The sector received \$5.4 billion, equivalent to 6.1 per cent of sector-allocable aid in 2010, up from 5.1 per cent in 2009. Food aid and food security assistance is a separate category of aid, which totalled \$1.4 billion in 2010. According to the G8 Deauville Accountability Report, \$22.5 billion was pledged in total for the L'Aquila Initiative, some of which should focus on sustainable agricultural development. The report highlighted that 22 per cent had already been disbursed and 26 per cent was firmly on track to be disbursed, as at May 2011.³¹

30. Progress on the implementation of the Paris Declaration on Aid Effectiveness, reinforced in the Accra Agenda for Action, set for 2010 has been slow, with only 1 of 13 targets (coordinated technical cooperation) met. Some progress has been made on individual indicators, especially those related to the obligation of recipient countries. Moreover, findings shared with the Development Cooperation Forum,³² underscore that the establishment of mutual accountability mechanisms has so far been the indicator with the least progress, and further emphasize that aid is becoming more fragmented. Therefore, the lessons from the Fourth High-level Forum on Aid Effectiveness (29 November-1 December 2011, Busan, Republic of Korea) and the Development Assistance Committee's own recommendations on good pledging practices should be fully implemented. The endorsement of the Busan Partnership for Effective Development Cooperation represents the willingness of countries to deal with development in a more holistic way. In the Busan outcome document, leaders further recognized the importance of complementary United Nations processes and invited the Development Cooperation Forum to play a role in consulting on the implementation of agreements reached in Busan.

31. The volume of South-South cooperation had risen sharply from \$8.6 billion, or 6.9 per cent of global aid flows, in 2006 to \$15 billion, or 9.5 per cent, in 2008 and was estimated to have reached \$20 billion in 2010. Most of the resources come in the form of bilateral programmes of project funding. This form of cooperation lays

³⁰ Council of the European Union, Council conclusions, "Increasing the impact of EU development policy: an agenda for change", 3166th meeting of the Foreign Affairs Council, Brussels, 14 May 2012.

³¹ G8 Deauville Accountability Report, "G8 commitments on health and food security: state of delivery and results".

³² Based on surveys in 105 countries by the Department of Economic and Social Affairs/United Nations Development Programme in 2010 and 2011 for the Development Cooperation Forum.

emphasis on national sovereignty, common interests, the motives of solidarity and partnership rather than compassion, except in cases of emergency assistance, and embraces a broader concept of development effectiveness. A distinctive characteristic of South-South development cooperation is an integrated approach that packages commercial transactions in trade, investment and loans with unidirectional support, for example, in education, health and infrastructural aid programmes, which is guided by domestic growth experiences.

32. Progress has been made in promoting innovative financing mechanisms to raise additional resources for development. It is estimated that such mechanisms have generated from \$37 billion to \$60 billion for development assistance in the period 2002-2011, depending on which mechanisms are deemed to be innovative financing (see A/66/334, para. 9). There are no standardized reporting systems to monitor flows raised through innovative financing. Some of these mechanisms tend to involve more effective use of aid rather than additional resources mobilization, such as frontloading ODA, which may reduce ODA in the future at the expense of other development needs. Also, resources thus raised are mostly used to prioritize financing global public goods rather than domestic development needs and have been rather insignificant relative to the overall external financing, even in the poorest countries. There is some evidence that global health funds have drained human resources out of national health services and increased administrative burdens. In addition, they may have contributed to further fragmentation of the aid architecture by adding new players and delivery mechanisms. For instance, earmarking for specific purposes, as is done by vertical funds in the health sector, can limit the domestic policy space for using the resources for nationally defined priorities such as strengthening domestic health services.³³

33. An array of potentially large innovative sources of development financing have been proposed, but not been agreed upon by the international community. Important ones include taxes on financial and currency transactions and on greenhouse gas emissions, as well as issuance of special drawing rights for developmental use. Any resources raised through new mechanisms should be aligned to recipient countries' development strategies and priorities.

V. External debt

34. At present, sovereign debt vulnerability has become a global phenomenon, threatening global recovery, with intensifying strains in the euro area and fragilities in the global financial system. This time, the debt situation in emerging and developing countries does not portend a systemic problem, as was the case in earlier episodes of debt distress, default and contagion, but the epicentre of the problem is located in some countries in Europe. Bailouts of sovereign States and banks by the public sector so far in this debt crisis, and in the aftermath of the world financial and economic crisis, have reached unprecedented historical highs, putting a strain on public funds. Yet, the outcomes remain uncertain.

35. The dollar value of total external debt of developing countries increased by 11 per cent between 2010 and 2011: in upper middle-income countries, total debt

³³ *World Economic and Social Survey 2012: In Search of New Development Finance* (United Nations publication, Sales No. E.12.II.C.1).

stock increased by 12 per cent, while in low-income and lower middle-income countries total external debt increased by 10 and 8 per cent, respectively. In 2011, the ratio of external debt service to exports increased slightly in the aggregate for developing countries, led by the increase in lower middle-income countries, for which debt service increased by 34 per cent, while exports increased by only 20 per cent.

36. In low-income countries, debt relief initiatives, through Heavily Indebted Poor Countries initiatives (HIPC) and the Multilateral Debt Relief Initiative, further reduced low-income countries' ratio of debt service to exports to 4.8 per cent in 2011. Thirty-six out of 39 HIPC have reached the decision point, 33 of which have reached the completion point, receiving almost 35 per cent of their 2010 GDP in debt relief. Yet, the full participation of all creditors, particularly a number of smaller multilateral, non-Paris Club bilateral and private creditors, remains to be secured. In December 2011, an end-2010 indebtedness criterion was added for eligibility for assistance under the HIPC Initiative.

37. Although the debt ratios of developing countries do not reveal a generalized problem, vulnerabilities remain in some regions and countries, notably the Caribbean region, where eight countries had external public debt to GDP higher than 65 per cent in 2011, two of which were classified as in high risk of debt distress, and five were in moderate risk of debt distress as at 3 May 2012.³⁴ Eight low-income countries that benefited from the HIPC Initiative and the Multilateral Debt Relief Initiative, and six non-HIPCs, are also in high risk of debt distress. Of the four countries in debt distress, two are interim between decision and completion point, one is at pre-decision point and one is non-HIPC.

38. Emerging and developing economies, as well as many developed economies, remain at risk from the fallout of the eurozone crisis. The outlook for the global economy is tepid. Food and commodity prices are likely to continue to show high instability. The increase in money supply in developed countries, especially in the United States of America and the eurozone, owing to quantitative easing in recent years, has already generated major spillover effects on developing countries that saw highly volatile capital inflows, exchange rates and asset prices over the past two years.³⁵

39. Reserve accumulation has been at the core of the ability of upper middle-income countries to weather recent crises. Yet, this success has to be balanced with the important opportunity costs of holding high levels of resources as reserves.³⁶ In 2011, developing countries' international reserves increased to \$1.1 trillion,³⁷ bringing the buffer against contagion to 13.6 months of imports. In contrast, the growth of imports in low-income countries was faster than reserve accumulation and thus the precautionary cushion fell to 3.8 months of reserves in 2011. For developing countries, in 2011, the ratio of short-term debt as a percentage of reserves was around 20 per cent, with low-income countries at a lower 9 per cent. To maintain sustainable sovereign debt ratios and weather the effects of impending

³⁴ IMF, List of low-income countries debt sustainability analyses for Poverty Reduction Growth Trust-eligible countries, as of 3 May 2012.

³⁵ IMF, *World Economic Outlook*, April 2012, executive summary, p. xvii.

³⁶ The vast majority of reserves are invested in United States Treasuries and other low-yielding sovereign papers.

³⁷ *World Economic Situation and Prospects 2012*, p. xi.

global risks in economic growth, many emerging and developing economies would need to ensure that macroeconomic policies are part of a transparent countercyclical framework combined with strengthened macroprudential financial and capital-account regulation to mitigate the impact of volatile commodity prices and capital inflows.

40. Large provisions of financial resources, including country provisions, are needed to sustain solvency and liquidity backstop to prevent a run on the financial system and on sovereign debt. In the current setting, the International Monetary Fund (IMF) acts as a quasi-lender of last resort to address liquidity problems (not insolvency), often in concert with the multilateral development banks and other official creditors. The new IMF instruments, such as the Flexible Credit Line and Precautionary Credit Line, have moved the Fund to be more like a lender of last resort. Yet, there is tension in this role, as the distinction between liquidity and solvency, while clear in theory, is often very opaque in practice. Moreover, concerns remain that liquidity support can lead to both debtor and creditor moral hazard, as debtors defer needed adjustments, hoping for an improvement in economic conditions, and lenders do not correctly price in risk. Banks may postpone recognizing losses on their balance sheets, since the infusion of public funds may temporarily reduce the volume of assets to be declared as impaired assets. Consequently, the size of the “haircut”, that is, the debt write-off granted to the sovereign debtor country, can turn out lower than would have been otherwise possible.

41. The present crisis situation shows again the complexities that the Fund faces when it contemplates the right time for an exit from a country where the sustainability of the debt burden remains a challenge. Sometimes the lack of an acceptable alternative in terms of an orderly exit gives IMF little choice but to forbear. For the debtor Government, it is often politically not feasible to announce that they will restructure their debt, so that incentives are present to gamble for resurrection.

42. Legally binding standstills could give the domestic and international official sector breathing space to find a solution and prevent the mass exodus to the exit that triggers a “rollover” crisis and/or a rush to the courthouse. Standstills could be included in bond contracts to set out the contractual terms for non-payment of interest and suspension of payments.³⁸ This would prioritize financial stability, prevent cross-border default and acceleration and bring creditors together. However, it remains open whether a fixed time limit on a standstill would help or hurt the sovereign attempt to restructure. Another option would be a statutory approach with a possible amendment of the IMF Articles of Agreement.

43. The financial architecture should aim at improving the efficiency of global capital markets by reducing losses faced by creditors, sovereign borrowers and others adversely affected by the uncertainty surrounding potentially disruptive debt scenarios. IMF has a critical role as lender of last resort but, absent a better framework for the timely, orderly restructuring of sovereign debt, it is less effective in assisting its members to strike a judicious balance between financing and

³⁸ Currently, the contractual terms in most sovereign bonds have a grace period of 3-13 days, which are not meant to operate as a standstill but to resolve any technical difficulties in making payments, and certainly not to facilitate a restructuring.

adjustment. Consequently, a timely reform of the architecture for debt restructuring is needed.³⁹

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

44. The international community has continued its efforts to reform the international monetary and financial system and architecture in the key areas of macroeconomic policy coordination, financial regulation, multilateral surveillance, sovereign debt, global financial safety net and governance structures at the Bretton Woods institutions (see A/67/187). The reform is geared towards improving the functioning, stability and resilience of the international monetary and financial system and to enable the international community to respond to global risks in a more coherent, effective and cooperative fashion. However, serious systemic shortcomings persist, which, among other factors, have a bearing on the capacity of developing countries to mobilize resources for development. It is crucial to continue and reinforce efforts at enhancing the coherence and consistency of international monetary, financial and trading systems in support of development.

45. The coordination of financial and economic policies at the international level is critical to safeguard global financial stability. In the wake of the global crisis, it has been a priority of the Group of 20 (G20) to set up a framework for economic policy coordination. G20 leaders, at their summit in Cannes, France, in November 2011, adopted the Cannes Action Plan for Growth and Jobs, which aims at addressing short-term vulnerabilities in the financial system and strengthening medium-term foundations for growth, such as through fiscal consolidation and boosting domestic demand in countries with large current account surpluses in order to advance global rebalancing. Building on this process, G20 leaders, at their summit in Los Cabos, Mexico, in June 2012, adopted the Los Cabos Growth and Jobs Action Plan. However, it is argued that more comprehensive and decisive international cooperation is necessary to tackle pressing financial and economic challenges.⁴⁰

46. There is a need for a stronger and more inclusive framework of global economic governance. Current institutional arrangements have proved to be inadequate in addressing a range of pressing development issues, including reducing global economic imbalances and advancing a multilateral trade agreement. It is essential that the system of global economic governance become more effective, transparent and legitimate. Consideration should also be given to better incorporating regional arrangements into the governance framework (see A/66/506). The General Assembly recognized the need for an inclusive, transparent and effective multilateral approach to managing global challenges, and reaffirmed the central role of the United Nations in ongoing efforts to find common solutions to such challenges (see General Assembly resolutions 65/94 and 66/256).

³⁹ Report of the Expert Group Meeting on Sovereign Debt Restructuring, available at http://www.un.org/esa/ffd/msc/2012Egm_debt/index.htm.

⁴⁰ *World Economic Situation and Prospects 2012*, midyear update (E/2012/72).

47. In view of the accumulation of significant amounts of foreign reserves by some developing countries, including, in part, for the purpose of self-insurance against crises, there have been suggestions to strengthen the role of special drawing rights of IMF within the global reserve system. The issue of broadening the special drawing right currency basket remains under consideration,⁴¹ which might eventually increase the acceptance of special drawing rights and help to strengthen their role as an international reserve asset.

48. Steps have been taken to further strengthen financial regulation and oversight in response to weaknesses exposed by the global financial crisis. The focus at the international level is on implementing the Basel III framework, strengthening the regulation of large financial institutions and expanding the regulatory perimeter to the shadow banking system and certain financial innovations. The success of international financial regulatory reform depends on the timely, comprehensive and consistent implementation of these policies. Moreover, measures in a number of regulatory areas remain work in progress and require further detailing. Emerging markets and developing countries have expressed concerns about the complexity of Basel III, which would pose challenges to their capacity to implement the new regulations, monitor implementation and address potential unintended consequences for their financial systems.⁴² Furthermore, there are concerns over the impact of new rules on development, e.g., with regard to possible adverse effects of Basel III on trade finance.

49. Efforts have continued to strengthen the capacity of multilateral surveillance to identify risks to global financial and economic stability in a timely and comprehensive manner. A priority in this process has been to attach more importance to cross-border and cross-sectoral linkages. IMF has taken a number of steps to strengthen the quality and coverage of its surveillance activities, including through novel spillover reports. These reports stressed the importance of financial channels for transmitting global shocks and, hence, the positive effect of policies tackling financial stress.⁴³ IMF also cooperates closely with the G20 countries in their Mutual Assessment Process on whether their policies support balanced and sustainable global growth. In addition, work is under way at the Fund to further reform and broaden its surveillance approach, as suggested by the IMF 2011 Triennial Surveillance Review and the related Managing Director's Action Plan. The International Monetary and Financial Committee, at its meeting held in April 2012, welcomed recent initiatives on Fund surveillance, and agreed that the current surveillance framework should be significantly enhanced.⁴⁴

50. Financial instabilities arising from the sovereign debt crisis, in particular in the eurozone, might further spread to other parts of the world economy and tarnish the prospects of developing countries. Various policy interventions at the national and regional level have been taken to reduce public debt, albeit with mixed results. Fiscal austerity measures are projected to reduce budget deficits in some advanced economies; however, premature fiscal austerity measures can slow down economic

⁴¹ IMF, "Criteria for broadening the SDR currency basket", 23 September 2011.

⁴² Financial Stability Board, "Identifying the effects of regulatory reforms on emerging market and developing economies: a review of potential unintended consequences", 19 June 2012.

⁴³ IMF, "Consolidated spillover report, implications from the analysis of the systemic-5", July 2011.

⁴⁴ International Monetary and Financial Committee, communiqué of the twenty-fifth meeting, 21 April 2012.

growth to a degree that may worsen public debt. As a structural measure, international financial stability could further improve through the establishment of international statutory mechanisms to both facilitate timely debt restructuring and to provide greater clarity of the rules by which sovereign debt restructuring will occur. Moreover, current vulnerabilities have yet again shaken the confidence in credit rating agencies, which are subject to a number of regulatory initiatives to improve their transparency, risk assessment and oversight.

51. Amid continuing financial instabilities, steps have been taken to strengthen the global financial safety net. In 2012, a number of countries committed to provide an additional \$456 billion to IMF for crisis prevention and resolution. The Fund also continued to reform its liquidity and emergency lending facilities, such as by introducing the Precautionary and Liquidity Line. The international financial safety net has continued to evolve towards a multilayered structure comprising global, regional and bilateral components. The overall size of the collective safety net, however, remains small in comparison with reserves accumulated by national central banks. Efforts to further strengthen crisis lending facilities should therefore focus on enhancing the different layers of the financial safety net, strengthening the cooperation of IMF with regional arrangements and key central banks, and increasing coordination among these various mechanisms.

52. Both IMF and the World Bank have taken important steps to enhance their governance structures and to increase the voting power of emerging market and developing countries. The Fund approved quota and governance reforms in 2010. The reforms will not come into force until three fifths of IMF members with 85 per cent of voting rights ratify the change. The International Monetary and Financial Committee, therefore, has reaffirmed the urgency of making the reforms effective by the 2012 Annual Meetings.⁴⁴ In addition, a comprehensive review of the current IMF quota formula will be concluded by January 2013. The second phase of governance reform for the World Bank Group,⁴⁵ agreed upon in April 2010 and approved in April 2011, has helped in making the World Bank more open, transparent and accountable.⁴⁶ Increased voting power for low- and middle-income countries and an open and transparent senior leadership selection process that is based on merit irrespective of nationality and gender remain important objectives. In that context, developing countries welcomed the fact that for the first time in the history of the World Bank there was an open process for the selection of the President.⁴⁷

VII. Staying engaged

53. The General Assembly held its fifth High-level Dialogue on Financing for Development on 7 and 8 December 2011 under the overall theme “The Monterrey Consensus and Doha Declaration on Financing for Development: status of implementation and tasks ahead”. The two-day event included a series of plenary meetings, at which ministers and high-level officials made formal statements. The second day featured three interactive multi-stakeholder round tables on the

⁴⁵ Phase I added a twenty-fifth Board seat for Africa, and increased the basic votes component of total voting power.

⁴⁶ Development Committee, communiqué, 21 April 2012.

⁴⁷ G24, communiqué, 19 April 2012.

following topics: (a) “The reform of the international monetary and financial system and its implications for development”; (b) “The impact of the world financial and economic crisis on foreign direct investment and other private flows, external debt and international trade”; and (c) “The role of financial and technical development cooperation, including innovative sources of development finance, in leveraging the mobilization of domestic and international financial resources for development”. The round tables were followed by an informal interactive dialogue on “The link between financing for development and achieving the internationally agreed development goals, including the Millennium Development Goals”. The Dialogue resulted in a summary by the President of the General Assembly (see A/66/678).

54. The Economic and Social Council held its Special high-level meeting with the Bretton Woods institutions, WTO and UNCTAD on 12 and 13 March 2012, under the overall theme “Coherence, coordination and cooperation in the context of financing for development”. The United Nations Secretary-General addressed the meeting. Following a short opening plenary with brief statements by the President of the Council and the heads of relevant intergovernmental bodies, the meeting included informal thematic debates on the following topics: (a) “Promoting sustained, inclusive and equitable economic growth, job creation, productive investment and trade” and (b) “Financing of sustainable development”. The outcome of the meeting is contained in the summary by the President of the Council (see A/67/81-E/2012/62).

55. On 17 and 18 May 2012, the President of the General Assembly and the Secretary-General jointly convened a high-level thematic debate on the “State of the world economy and finance in 2012” to explore ways of improving the overall global economic and financial situation and to discuss its impact on development efforts and social processes. The event was attended by several heads of State and Government, ministers in charge of foreign affairs, finance and economic development, senior officials of the relevant international agencies and regional development banks, as well as representatives of civil society, the business sector and academia. The two-day event included plenary sessions and four round tables on the following topics: (a) “Combating unemployment, creating jobs, especially for women and youth, and addressing poverty”; (b) “Reducing debt vulnerability, managing inflation/deflation”; (c) “Limiting commodity price fluctuations, increasing production, trade and investment”; and (d) “Increasing stability, predictability and transparency in the financial sector”. A joint letter dated 22 June 2012 from the President of the General Assembly and the Secretary-General highlighted key messages and enclosed a full summary of the discussions.

56. In the outcome document, entitled “The future we want”, world leaders at the United Nations Conference on Sustainable Development, held in Rio de Janeiro, Brazil, from 20 to 22 June 2012, recognized the need for significant mobilization of resources from a variety of sources and the effective use of financing, in order to give support to developing countries in their efforts to promote sustainable development. The Conference agreed to establish an intergovernmental process under the auspices of the General Assembly to assess financing needs, consider the effectiveness, consistency and synergies of existing instruments and frameworks, and evaluate additional initiatives, with a view to preparing an effective sustainable development financing strategy. An intergovernmental committee, comprising 30 experts nominated by regional groups, with equitable geographical

representation, will implement this process, concluding its work by 2014 (see General Assembly resolution A/66/288, annex, paras. 254-257).

57. The 2012 substantive session of the Economic and Social Council, under agenda item 6 (a), "Follow-up to the International Conference on Financing for Development", featured a panel discussion on the topic "Innovative mechanisms of financing for development". The Council further adopted a draft resolution (E/2012/L.26) that contains a number of provisions aimed at strengthening the financing for development follow-up process. In particular, the Council recalled paragraphs 255, 256 and 257 of the outcome document of the United Nations Conference on Sustainable Development and, in this regard, stressed the need to reinforce coherence and coordination and avoid duplication of efforts with regard to the financing for development follow-up process. Furthermore, the Council recalled the earlier decisions of the General Assembly to review the modalities of the financing for development follow-up process and to consider the need to hold a follow-up financing for development conference by 2013. More information is posted at www.un.org/esa/ffd.
