Special High-level Meeting with the Bretton Woods institutions, the World Trade Organization and the United Nations Conference on Trade and Development
New York, 16 April 2007

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 of 28 July 2006, ECOSOC “requests the President of the Economic and Social 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 …” (para. 2). The present note provides background information and appends a number of points for reflection to inform discussion at the 2007 special high-level meeting of the Economic and Social Council. 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 2007 high level meeting: (1) Good governance at all levels; (2) Voice and participation of developing countries in international economic decision-making, including the Bretton Woods institutions; (3) Realizing the Doha development agenda – effective use of trade and investment policies; (4) Aid effectiveness and innovative financing for development.

The high level discussion fulfils the mandate of General Assembly in its resolution 61/191 of 20 December 2006 on “Follow-up to and implementation of the outcome of the International Conference on Financing for Development”, which “Reaffirms its resolve to continue to make full use of the existing institutional arrangements for reviewing the implementation of the Monterrey Consensus, as set out in paragraph 69 of the Consensus and in line with resolution 57/270 B, including the high-level dialogues convened by the Assembly and the spring meetings of the Economic and Social 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” (para. 4).

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1 The present note was prepared in close consultation with staff of the major institutional stakeholders involved in the Financing for Development process; however, responsibility for its contents rests solely with the UN Secretariat.
I. Sub-theme 1: Good governance at all levels

1. All the signatories to the Monterrey Consensus, 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 - as an indispensable ingredient to further development and as the 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 the limiting the scope for public regulation of markets to improve their stable operation, slows down progress in good governance. Effective and efficient state regulation and supervision are a necessary underpinning for a larger private sector role in the economy. In the context of the developmental dimension, we need to caution against frameworks and governance indicators that associate poor governance mainly with the ineffective operations of governments. International support for developing country efforts to strengthen and improve governance and effective regulation is both necessary and desirable, and the Monterrey Consensus indeed prioritizes fighting 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 capacities 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 those governance failures that are the most 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 only as a component of longer-term efforts to advance practices of good governance at all levels and as a component of the overall development effort in building a variety of other capabilities. Weaknesses in one area undermine progress in other areas. There are two parties to any bribe – the giver and the receiver.

4. The UN 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 assigned to the party that has most at stake and has the best competence and capability to address the issue. The active partnership among all stakeholders requires that everyone of them must play the unequivocal role of supporting these efforts, and certainly in avoiding actions that undercut them. In this approach, each country should have the direct and lead responsibility in 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 the development of domestic capabilities to set standards, and to monitor and enforce these standards. Donor-driven initiatives, especially when perceived as externally imposed conditions, can weaken the legitimacy of domestic constituencies against corruption. Donors should consistently work together to strengthen country efforts and avoid “ring fencing” their projects and the setting up of 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 aspects, 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, review of procedures appropriate to a country’s circumstances, are important ways of combating corruption. Since it can only be properly addressed by a strategy coming from within that country, sufficient political and bureaucratic willingness to address the costs of corruption are of course critical. But there is a capacity-building aspect too, such as the need for a civil service that is appointed on merit and is reasonably and reliably paid. Supporting better and transparent management of public finances and parliamentary oversight, legal, judicial and civil service wage reform and codes of conduct, improving the capacity of local governments to be more responsive and accountable to local communities, are important interventions.

6. Attention has to be paid to good governance and corruption activities at the international level. Efforts to combat global crime and corrupt practices are critical in the promotion of a well-functioning world economy. The Monterrey Consensus urged all States to ratify the *United Nations Convention against Transnational Organized Crime*. Developed countries have been slower in ratifying the *UN Convention against Corruption* than developing countries. There should be more rigorous enforcement of the *OECD Convention on Combating Bribery* and developing countries could consider either joining 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 over illicit international transactions, reduce incentives for tax evasion and the concealment of income, and strengthen domestic fiscal systems through more stable tax bases. The 2006 Global Monitoring report published by the World Bank and IMF documents the efforts of these institutions to provide technical support for the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) efforts of developing countries.

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 a highly financialized global economy. Good governance in the private sector is an indispensable element of good governance at all levels. The UN’s Global Compact, the World Economic Forum’s Global Corporate Citizenship Initiative (GCCI) 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 in terms of the credibility of information flows that underpin private markets. These problems have arisen in the past from a continuing tension between personal gain, structuring incentives for corporate managers, a duty to maximize shareholder profits and commercial advantages 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 they play a decisive role in the public policies suggested to developing countries and occupy a position of leadership in the donor community, good governance in the international financial institutions, the United Nations and other intergovernmental or multilateral bodies is critical. These agencies are not only significant sources of finance, their actions provide signals to other donors and external private parties. Quite importantly, they are also significant suppliers of ideas about national development strategies and are an influential arbiter of developing country policies. Each within its specific mandate must tread a fine line of balancing the integrity and technical validity of research and policy analysis against the role of each institution and the 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 Evaluation of World Bank research, 1998-2005. This report identified the positive role of the research in policy formulation, but it also noted that policy positions sometimes have to be developed before analysis has resolved all the uncertainty and that the institution placed too much weight on preliminary or fragile results to support existing policy positions in areas such as globalization and governance. Similarly, the work of the UN High Level Panel on Coherence highlighted that even within the UN system, an apparent overlap of different agencies’ mandates, functions and policy interventions at 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 their governing boards. The hiring and promotion practices in these global institutions need to be consistent with basic governance principles and emphasize qualification, merit, and performance. Efforts to strengthen voice and 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 a larger set of stakeholders and inequities among affected parties eliminated. The expansion of peer review processes, such as that in place in the New Partnership for Africa’s Development (NEPAD), also hold great promise in improving good governance. 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. What practical steps can be taken to further encourage and assist strengthening governance capacities at all levels, including fighting corruption, particularly as a participatory process between donors and international institutions, the public sector, the business sector and civil society?

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?
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 programs? How can processes and instruments of international cooperation, such as in the area of cooperation in tax administration, realize their potential of strengthening good governance at all levels?

II. Sub-theme 2: Voice and participation of developing countries in international economic decision-making, including the Bretton Woods institutions

10. The Monterrey Consensus calls 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 percent of the world’s population and contribute 45 percent of the world’s GDP (a proportion that is increasing).

11. With regard to the existing institutions of global decision-making, vast changes have taken place since their creation which occurred mostly immediately after World War II. Since that time, the number of developing countries has exploded and the economic role of emerging economies expanded. Middle income countries in particular play critical roles in the global and their own regional economies. Many non-EU member countries with economies in transition have become key participants in international markets in trade and finance. It is recognized that the effectiveness and the legitimacy of these 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. While most of the attention to improve voice and representation has been centred on the 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 goes beyond the Bretton Woods institutions and highlights the need to extend the discussion of voice and participation to other policymaking bodies.

12. Even relatively newly created institutions do not adequately incorporate developing country participation. For example, developing and transition countries are not at all represented in the Financial Stability Forum (FSF), although non-members attend its regional meetings. Since mid-1990s, there has been steady growth in developing and transition country membership in the Bank for International Settlements (BIS). However, there is no representation of these countries in all three Basle committees (on Banking Supervision, on the Global Financial System and on Payment and Settlement Systems). The Committees do liaise and increasingly consult with developing and transition economies and include them in their working groups. However, as with FSF regional meetings, 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 a fairer, more widely accepted and truly universal regulation that 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 these activities have a significant economic impact on developing countries, it is important to promote increased participation by developing country nationals in these bodies.

14. In other areas, reforming processes of decision-making is critical for expanding the voice and the participation of the developing countries. In the WTO context, developing countries, which represent over two thirds of the membership, are now much more active in the current Doha Round, which is consistent with their deeper integration into the Multilateral Trading System. There are now several groups of them, such as “G20,” “G33,” “NAMA 11” or the “LDC Group,” depending on interests, sensitive sectors and strategy who are active in the negotiations. This is especially true in agriculture which is at the core of the current Round. The main work is no longer done just with the “QUAD.” “There is a new “G-4 “: US, EC, India, and Brazil; and “G-6” with Australia and Japan. Recent years have shown a bigger commitment from all WTO membership to inclusiveness and transparency which are necessary in building consensus among all members in order to be able to advance the negotiations. The recent vigour of these subgroupings in the WTO among countries with shared negotiating interests enhances voice and participation within an overall international framework. The flowering of these “caucuses” among developing countries in other policy areas can also strengthen global governance.

15. While the Monterrey Consensus highlights the need for decision-making reform in the broader global institutional context, the question of strengthening representation of developing countries is 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 ensuring that the distribution of quotas reflects member countries’ economic weight and role in the global economy as well as enhancing the voice of low-income countries. There is general agreement that the reform of IMF governance is of utmost importance, as 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 has been outlined for more fundamental reforms, 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 resolution also calls for at least a doubling of basic votes for all members and protect, at a minimum, the existing voting share of low-income countries as a group. It also calls for the proportion of basic votes in the total voting power to remain constant going forward. Current reform efforts need to attend to the substantial decline in the share of basic votes prior to this effort, which has fallen from the level of 11 percent when the IMF was founded to approximately two percent at this time. In addition, the resolution requests an increase in staffing resources available to Executive Directors who represent a large number of members.

17. Reaching an agreement on quota and voice reform will be challenging, 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 toward mutual assistance and responsibility, the 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 the IMF’s credibility in providing policy advice and undertaking surveillance, in designing and monitoring conditionality and in the eyes of private markets, whose resources now greatly exceed those of the IMF. Therefore, it is important that the sought-after quota formula incorporate certain basic principles, which respond to these challenges. These basic principles should inform the choice of indicators, the manner in which they are measured, and their weights in the sought-after formula.

18. At its September 2006 meeting, the Development Committee, while acknowledging 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 enhancement in voice and participation in the governance of the institution. This call was supported by the “G-20” finance ministers and central bank governors. Renewed debate on World Bank governance is welcome and timely.

19. The reallocation of voting power now underway in existing global institutions will be a complex experience, requiring 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. Strengthening the independence and competence of regional and global institutions would also be an important step in broadening governance of critical international issues, away from over-reliance of a narrow set of countries.

1. What kind of political processes would be most effective in advancing efforts toward increased voice and participation of developing and transition countries in global economic decision-making?

2. What should be the principles that govern the allocation of votes in the Bretton Woods and other international institutions which will ensure their relevance and effective operation?

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

III. Sub-theme 3: Realizing the Doha development agenda – effective use of trade and investment policies

21. Domestic economies are increasingly interwoven with the global economic system. The Monterrey Consensus and the 2005 World Summit Outcome recognized the effective use of trade, investment, and technological promotion as critical to the development effort and in fighting poverty. For example, in order for the MDGs to be achieved, in particular the goal to reduce poverty by one half by the year 2015, many developing countries will have to grow much faster than they have 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 groups 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 previous investment.

22. After the suspension of talks in 2006, renewed efforts to conclude the Doha Round are needed and welcome. But while continued progress in the Doha Round is important to tame protectionist pressures, it is equally important for all parties in the negotiations to keep a high level of ambition and not conclude the Round for the sake of concluding the Round. The ultimate success of the Doha round will have to be evaluated by reference to the Doha Development Agenda, including the declared intention that “[t]he majority of WTO members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration.”

23. The decision by WTO Members in 2001 to designate the Doha Round a development Round is recognition that there remain, in today's multilateral trading system, rules and disciplines, imbalances that penalise developing countries — and that these must be corrected. The objective, therefore, is to improve the multilateral disciplines and the commitments by all Members of the WTO in such a way that they establish a more level playing field and providing developing countries with better conditions to enable them to reap the benefits of opening trade.

24. On industrial tariffs, through the reduction formula in this Round, Members can, for the first time, address the tariff peaks, high tariffs and tariff escalation remaining in developed countries. Very often, these highest import tariffs are applied on products in which developing countries have a comparative advantage.

25. In agriculture, in order to rebalance the multilateral trading system in favour of developing countries, Members have already agreed that this Round has to deliver “effective cuts” in trade-distorting agriculture subsidies in developed countries. It will also deliver the elimination of the most damaging type of subsidies: export subsidies by 2013, with a substantial part of them gone by 2010. It also has to deliver improved market access, including on South-South trade, through the reduction of tariffs and removal of quantitative restrictions, especially on products where developing countries have a comparative advantage. At the same time, WTO members have recognised the right of developing countries to protect a number of special products on criteria of food security, livelihood security and rural development and to use a special safeguard mechanism to protect against import surges. All this has already been agreed. 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 LDC’s, there is agreement to provide duty-free and quota-free access to 97% of all LDC products on a lasting basis, with a view to eventually extending this treatment to 100% of their products. Because of the narrow range of manufactured products that LDCs export, the three percent exception could obviate most benefits to market access.
27. To other countries, the development dimension is about preserving tariff revenue, trade preferences, special and differential treatment and less than full reciprocity, special products and special safeguard mechanism in agriculture, commodities, implementation-related issues, concerns of small and vulnerable economies, as well as policy flexibility. The negotiating outcome in all of these issues will determine the extent of the policy space developing countries will have to ensure that trade can be harnessed as an engine of their development. Some flexibilities have been introduced in agriculture, NAMA and services negotiations as well as trade facilitation for developing countries, particularly for LDCs. What is more important in the long run is incorporating the development dimension into the architecture of the WTO and make these fully operational. In this regard, it is important to note the new provisions on access to medicines, which have already been agreed, allowing for compulsory licenses by poor countries that do not have any manufacturing facilities. This provision can make an important difference in saving people's lives or in ensuring that more people can afford minimum medical treatment. The policy space created in this way can be utilized by developing countries, particularly 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 is not enough. Developing countries need to upgrade both in quantitative and qualitative terms their capacity to supply goods in the international market. A recent UNCTAD report contends that building “supply side” capabilities, should be conceptualized 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 policy.

29. The provision of services accounts for over 60 percent of the world’s output. While the share of services in global trade at present is only about 20 percent, 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. In the WTO, the General Agreement on Trade in Services sets out a framework of rules that govern liberalization of services trade. There are significant potential gains to developing countries in increased trade in services, including the area of mode 4 of GATS. 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 of human resources, developing countries should incorporate into their national strategies deliberate interventions for services sector development which take into account and take advantage of increased trade possibilities. Logistics services, for example, are increasingly critical as an 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 this trade does not undermine their potential to establish and grow their own competitive services sectors, do not undermine macroeconomic stability, and are consistent with basic social objectives.

31. Trade opening can only be politically and economically sustainable if it is complemented by flanking policies which address, at the same time, capacity problems — whether human, bureaucratic or structural — and the challenges of distribution of the benefits created by freer trade. The Aid for Trade initiative is one response to this challenge, which, if properly configured and if it avoids the introduction of burdensome conditionality, could empower developing countries to benefit from trade. It can assist in developing the private sector — entrepreneurs, traders, investors — to seize export opportunities. It requires greater international cooperation and coherence — between the WTO, the World Bank, the IMF, and the UN 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 Development Round: ensuring that trade is not just an end in itself, but works to raise living standards and reduce poverty. It seeks to ensure that market opening translates into real gains and benefits to the people, by helping to put in place the necessary conditions for those gains and benefits.

32. Effective trade policy requires effective investment policy. Analysis from the Bretton Woods agencies in recent years have highlighted the fact that insufficient public investment in infrastructure in the pursuit of macroeconomic stability by many developing countries are undermining their medium-term growth prospects. There are glaring shortfalls in infrastructure in many developing countries (in areas such as power, transport and telecommunications, and basic services such as water, education and health). The original confidence that the private sector would substitute for the public sector in 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 objectives of the society at large (in areas such as roads and water) and in low-income countries where private financing is low 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 better leverage private finance through strengthening their complementary services and risk mitigation instruments.

33. Recent multi-stakeholder consultations, such as those organized by the UN/DESA Financing for Development 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 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 also financially sustainable. Other consultations on infrastructure by DESA have also stressed that a critical bottleneck impeding investment finance in some countries is the shortage of identified good projects and called for the official sector to provide technical and financial assistance to strengthen project development capacities in developing countries.
34. Foreign direct investment (FDI) policies need to be in line with the identified development priorities of a country and form part of a broader strategy to raise productive investment and the development of skills and technology. The experience of the most successful late industrializers has shown that well-conceived national support policies can strengthen the creative forces of markets and related domestic capital formation. FDI flows will have a beneficial effect only if these policies ensure that such investments support clear development goals, maximizing the potential benefits of FDI and minimizing the negative effects such as the crowding out of domestic firms and the abuse of market power. In practice, though, the impact of FDI 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 FDI in new plant equipment is more likely to add to productive capacity than FDI 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 FDI to be a channel for diffusing skills, knowledge and technology. Linkage promotion policies have already been adopted in a number of countries and need to be combined with broader measures to strengthen the quality of entrepreneurship in the local economy, since a key factor in inducing foreign affiliates to form beneficial linkages depends upon the availability, costs and quality of domestic suppliers.

35. In designing public policy for FDI, there is no single universally valid set of recommendations, so policies must be country-specific in design. Small, landlocked least developed countries (LDCs) in particular have special circumstances that cannot be ignored in policy design. FDI policy must not be considered in isolation from the broader development strategy or without reference to a 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 FDI can potentially contribute to development by generating growth and employment and improving skills, technology and infrastructure. Creating linkages between foreign and domestic investment is extremely helpful in that respect. Success in structural transformation and poverty reduction will necessitate strengthening institutions as well as building institutional capacity that will enhance the ability to design and effectively implement investment and other policies.

36. Recently, developing countries (especially from East and South Asia) have become increasingly important as a source of FDI. 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 FDI inflows to some developing countries. The most recent World Investment Report includes initial indications that investment from developing countries are 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 undertake mergers and acquisitions, as a mode of entry. Moreover, given the generally greater labour intensity of developing country corporations, 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 FDI 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 development impact. Multilateral organizations can play an important role by providing the requisite analysis, technical assistance and fora where policymakers could share experiences and discuss methods of further cooperation.

1. **What scope is there in the renewed effort to conclude the Doha 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?

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

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 in developing country infrastructure projects?**

**IV. Sub-theme 4: Aid effectiveness and innovative financing for development**

37. The Monterrey Consensus asserted that “effective partnerships among donors and recipients are based on the recognition of national leadership and ownership of development plans and, within that framework, sound policies and good governance at all levels are necessary to ensure ODA effectiveness.” The 2005 Paris Declaration on Aid Effectiveness is a milestone in setting out the principles and launching a process to achieve this mandate. These ongoing efforts should be intensified and lessons learnt, including those to be gathered from the outcome of the September 2008 High Level Forum on Aid Effectiveness to be held in Accra, will serve as key inputs to the Follow on conference on Financing for Development in Doha later in 2008. Deliberations in the Development Cooperation Forum in July 2007 and in the summer 2008 and the High Level Dialogue on Financing for Development in the autumn of 2007 would also be key points in advancing the aid effectiveness agenda.

38. The April 2007 OECD/DAC report on the baseline for and progress on the Paris Declaration documents the wide-ranging monitoring efforts and discussions on implementation that have been launched. 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 to make real and deep changes in aid effectiveness. Aid effectiveness assigns to partner countries the lead in the implementation of Paris Principles at the country level, making clear the expectation of donors to adopt harmonization of 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. These 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 with inadequate voice for recipient countries. While the interests and views of the donor countries are well represented in the boards of the Multilateral Financial Institutions (which in most cases are dominated by the developed economies) and the OECD’s DAC, there is no permanent forum which represents the interests of the recipient countries. The UN General Assembly has called for the convening of a Development Cooperation Forum which has the potential to build political oversight over aid effectiveness with the full participation of developing countries. At the country level, it is critical that institutions for measuring and monitoring aid effectiveness involve a genuine partnership between donors and recipients, which requires that these processes avoid using donor templates and indicators exclusively. Legislatures and citizens groups of 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 official assistance is increasingly expanding, complex, fragmented, and not adequately 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 UN system agencies and the global and regional financial institutions; 33 bilateral agencies which are members of OECD/DAC; several non-OECD/DAC governments providing significant sums of ODA; and a growing number of special-purpose global funds, such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria (GFTAM). As in the case of earmarking, these special funds can distort the balancing of national priorities and it is important that these funds accelerate their commitment to apply 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, recipient countries have to deal with a variety of aid instruments and associated agreements with a large number of donors for aid provided either through the budget or through projects. The number of donor missions some recipient countries receive can be so great it leaves little time, space and resources for independent policy making. Among donors, there is a proliferation of indicators to be monitored, which can sometimes be inconsistent among themselves. Aid is the most conditional source of external finance and thus efforts to streamline conditionality are even more pressing in this area.

42. Aid allocations by donors are often characterized by selectivity and instability. The top 20 aid recipients received more than half of net bilateral ODA and less than 50 percent of aid recipients received 90 percent of all aid from DAC 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 their development needs. Donors sometimes move in and out of countries together causing surges and reversals and making aid more volatile than fiscal revenues. In the presence of these sudden changes, central banks and ministries of finance have to respond with costly policy changes. For instance, fiscal adjustments in the form of increased taxation and spending cuts may reinforce the cyclical impact of declining aid flows and further increase the macroeconomic volatility that characterizes most developing countries with a detrimental impact on growth and development.

43. Progress toward the goal of aid effectiveness will require political and conceptual agreement regarding approaches to measuring both the quantity and the quality of assistance. There is increased interest in moving toward 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 programs. In the case of balance-of-
payments support, questions have been raised about whether an outcomes-based approach will
permit the disbursement of funds in a timely manner. Outcomes-based conditionality require
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 their use as conditions for disbursement should be approached with caution. The key
advantages of outcome-based conditionality are that it enhances ownership and it increases the
probability of applying the proper instruments to meet agreed goals.

44. As noted in previous reports, in 2002, the declining trend of ODA was reversed. ODA
rose to $106.5 billion in 2005 or 0.33 percent of GNI of developed countries though a large part
of the increase was due to debt relief to a few countries and Tsunami aid. The “G8” pledged to
double aid to Africa by 2010 to $50 billion. 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 MDGs by 2015 and ODA remains below the
0.5 percent achieved in early years of Development Assistance Committee (DAC) and below the
0.7 percent target. The latest simulation of DAC members ODA volumes by the OECD-DAC
secretariat shows a fall in aid to 0.30 percent in 2006.

45. The enduring financing gap to reach the MDGs by 2015 confirms the need for additional
efforts to increase the flow of financing for development, including through new and innovative
mechanisms. In the 2005 World Summit, Heads of State and Government recognized the value
of developing innovative financing for development. Building on these grounds and considering
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 one hundred countries adhered to the New York Declaration on the
Action against Hunger and Poverty, followed by a Declaration on Innovative Sources of
Financing for Development adopted at the United Nations in New York on September 14, 2005
and endorsed by 79 countries. Most recently, a meeting of the Technical Group was held in
Santiago, Chile, and the Norwegian government hosted a second international conference of the
46 countries part of the “Leading Group on Solidarity Levies to Fund Development”, established
in Paris last year. It is important that this momentum be maintained and continues to encourage
new initiatives, in view of the 2008 Doha Conference.

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 to introducing the levy or,
in a few cases, to providing a voluntary contribution. It was agreed to focus on scaling up access
to treatments against HIV/AIDS, tuberculosis and malaria: the pooled proceeds are geared to
UNITAID, a new facility launched in New York on 19 September 2006 and hosted by the World
Health Organization, which aims to lower the price of quality drugs and diagnostics and increase
the pace at which they are made available. Second, an International Finance Facility for
Immunization (IFFIm) 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 program increases current aid flows to ensure reliable and predictable funding flows, up to and including 2015. Funds will be used for health and immunisation programmes through the GAVI Alliance. Third, an advanced market commitments pilot program was most recently launched on 9 February 2007, in Rome. It 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, amongst others, ways to promote microfinance for development; projects that focus on the environment; analyses around a low currency transaction levy of around half a basis point, which countries would introduce on a voluntary basis to fund specific development projects; 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 GDP indexed and commodity linked bonds) and a renewed effort to provide financing for crisis prevention through a proposed Reserve Augmentation Line (RAL) facility in the IMF. More recently, the President of Costa Rica has launched an initiative – Costa Rica Consensus - to increase social expenditures to be financed by concessional flows to countries that reduce or limit military expenditures. For this purpose, some of the existing financial mechanisms or a new fund could be used.

48. Several broad challenges remain. It is important to be realistic and recognize that while these initiatives could raise some funds, the amounts are not likely to be very large. There is a general view that these efforts are additional to the commitment of donor countries in reaching the 0.7 of their GNI for ODA. Several of these efforts involve earmarking collected funds and can unduly place priority on issues when other problems are more pressing. However, this weakness has to 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 terms of achieving development results, and where possible UN-system organizations should be utilized. In order to mobilize wider support for new funding mechanisms, priority should continue to be given to clearly identifiable programs with a high degree of visibility. Furthermore, civil society should play a more visible role in participating in the design and in monitoring the use of resources, and it would also be relevant for the private sector, when beneficial, to be incorporated in certain project designs. Overall, an important challenge will continue to be in building consensus around pilot projects and other implementable ideas.

1. How can the aid system further improve 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?

2. What are the constraints to gaining the involvement of a greater number of partner countries in the process of improving aid effectiveness? What modalities should be put into place for improved development outcomes, such as greater donor-recipient coordination, outcome-based
conditionality and effective dialogue with others? How can we involve newly emerging donor countries in donor coordination and harmonization?

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?