Intergovernmental Group of Twenty-Four on
International Monetary Affairs and Development

PROPOSALS FOR THE INTERNATIONAL CONFERENCE ON FINANCING FOR DEVELOPMENT FOR CONSIDERATION BY THE G-24

Issue Paper for the Consideration of G-24 Ministers
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G-24 Liaison **O**ffice

G-24 Proposals for the International Conference on Financing for Development(ICFD)

I. Introduction

1. At the April 2001 Meeting, Ministers underscored the importance of the forthcoming ICFD and emphasized the need for the "full engagement of the G-24 in its preparatory process". In pursuance of this directive, the Nigerian Chair arranged for the organization by the G-24 Liaison Office of a Workshop on Financing for Development (FfD) with the help of funding from the OPEC Fund for International Development. A report on the Workshop, which was held at Nigeria House in New York City on September 6-7, 2001 has been transmitted to member-governments. This paper draws heavily on the proceedings of the Workshop to formulate some proposals for the consideration of Ministers.

2. The preparatory process for the ICFD started more than three years ago, much of it consumed by procedural matters. Substantive work was initiated with the issuance of a report by the UN Secretary-General[i] in January 2001 (SGR) which laid out a series of proposals under each of six agenda items.[ii] These proposals were developed in close consultation with the "major institutional stakeholders" i.e., the Bretton Woods Institutions (BWI) and the WTO, and after intensive contacts with different stakeholders, including the non-governmental organizations (NGOs), private sector interests and other elements of civil society. In addition to submitting his own report, the Secretary-General invited a high-level panel of eminent persons under the chairmanship of Ernesto Zedillo, former President of Mexico, to consider the entire range of issues and to produce a report (ZPR) by mid-2001.[iii]

3. The parallel official track entailed the establishment, by the General Assembly, of a Preparatory Committee for Financing for Development (PrepCom) with a Bureau consisting of 25 countries and a Coordinating Secretariat to organize the Conference in Monterrey, Mexico from March 8 to 14, 2002. At its third substantive session in May, 2001 PrepCom decided to ask a Facilitator[iv]to produce a draft "Outcome Document" without brackets that could be considered at their October meeting. This document[v] received a rather critical response from the national delegations of some of the major industrial countries and the Facilitator has been asked to produce a revised version by the end of November. Despite the long preparatory process that has already been traversed, much uncertainty on the final outcome remains in view of the large uncertainties in the world economic situation, especially in the wake of the tragic events of September 11.

4. A United Nations meeting like the ICFD is an attempt to approach the issue of financing for development from a broader perspective in a more representative forum. While it will inevitably carry strong political overtones, the G-77 process

in New York could be assisted by the G-24 focusing on articulating technically sound positions on the various items of the ICFD agenda. The G-24 contribution need not go into the details of redesigning of the international financial architecture. The ICFD should be viewed rather as a forum for discussing and reaching agreement on selected issues of principle and as an opportunity to persuade the international community that addressing these issues would conduce to evolving a more stable and a more equitable global system of finance for development. The Chair country (Nigeria) and other G-24 members that are also members of the Development Committee will also be enabled to formulate developing country positions during the November 18 meeting of the Committee in Ottawa.

II. Principal Issues

5. Of the six agenda items proposed in the SGR (vide endnote ii), the Workshop chose four themes as being of special interest to developing countries[vi], viz.,

- Finding ways to increase the volume and effectiveness of foreign resource flows (private, official bilateral and multilateral) in support of development;
- Establishing a satisfactory, transparent and more representative procedure and institutional framework for resolving external debt problems;
- Making global economic governance more participatory and accountable to a broader community of nations; and,
- Creating an international trading environment that is more supportive of growth and development.

Resource Flows

6. The first issue identified in the preceding paragraph covers the financial transfer of resources to developing countries.[vii]The Workshop recognized that large-scale private capital transfers were required if the developing world was to succeed in raising living standards but that official capital through bilateral and multilateral channels would remain essential to secure poverty alleviation in a large number of poor countries whose prospects for attracting private capital were minimal. Rather than repeating exhortations for industrial countries to move towards the 0.7 percent of GNP target (from the current level of 0.24 percent), it would be more helpful, as a first step, to seek a consensus on the quantum of resources needed to attain the Millenium Development Goals (MDG) that had been endorsed by a series of UN Conferences. Work on quantifiying these needs has been proceeding apace in the BWI.[viii] Meanwhile, the ZPR had suggested that, as a rough order of

magnitude, an extra $ 50 billion per year of ODA would be required for meeting these goals. Beyond this amount, however, additional resources were needed for meeting humanitarian crises and for raising the supply of global public goods (GPG). The ZPR had emphasized that it was "imperative to separate finance for development and humanitarian assistance from finance for global public goods and to provide adequate finance for each of these causes"[ix] Also debt relief operations should remain segregated from ODA.

7. It was in a desire to find adequate and stable mechanisms for the future financing of these several causes that the possibility of using "innovative sources" had entered the public debate. The issue had been mandated for "rigorous study" by the UN General Assembly but it was not obvious that any consensus could be reached in time for the ICFD. There were thorny issues of organization and implementation with ideas such as small taxes on short-term currency conversions (so-called "Tobin" taxes) or on carbon emissions (mooted by ZPR) or on the exploitation of the global commons or the mineral resources of sea-beds. Workshop participants nevertheless favored further exploration of such proposals. Also noted was the possibility for individual countries adopting innovative means to raise finance (without having to wait for collective agreements) such as applying a small tax on the sale of pharmaceuticals that could be used to subsidize the provision of essential drugs to developing countries.

8. As important as raising the quantum of aid was the need to increase its effectiveness. The "transaction costs" of aid delivery tended to be high, most egregiously in the technical assistance area, where the largest degree of "aid-tying" took place. It was essential in this context to encourage the harmonization of bilateral and multilateral donor policies and procedures, the coordination of disbursement and delivery mechanisms and the exploration of "common pooling" arrangements whereby donors would provide direct budget support on the basis of programs developed under the leadership of the recipient country instead of tying their aid to specific projects selected by them without regard for the country's own priorities. Also for consideration is the need to give substance to the concept of "ownership" of policy reform by calling for an independent evaluation of donor performance at the level of the individual recipient country. This idea need not have to wait upon a global agreement, since individual donors – or a "like-minded" group – could offer themselves for such an evaluation.

9. Turning next to private capital flows, the central issue was how to attract them to a large majority of developing countries that had been not shared in the greatly enlarged flows that had materialized in the past decade. This was particularly true of portfolio flows that had been attracted to not more than a dozen countries. However, even foreign direct investment (FDI) in poor countries (with the exception of those very few like China and India that offered large domestic markets) were largely confined to projects for the exploitation of oil and other natural resources or were connected with large infrastructure projects in Build-Operate-Own/Transfer frameworks. At the same time, the sharp distinction

conventionally made between FDI and portfolio flows was becoming less relevant. This resulted from the fact that decision-makers in transnational corporations (which typically do most of the direct investment) were concerned with minimizing corporate exposure risks and/or realizing capital gains (from appreciated investments) and tended to seek exit strategies not much different from those sought by foreign portfolio investors.

10. These risk-minimization strategies meant that developing countries had to provide enabling environments that went much beyond the provision of tax and other monetary incentives. Private capital of whatever type was more likely to be attracted to countries with well-developed domestic capital markets and well-established legal systems. It also required improving governance, reducing corruption, maintaining macroeconomic stability, introducing effective banking supervision and regulation etc. These were all necessary, even if they might not prove sufficient conditions because of external developments over which developing countries had little or no control.

11. This required compensating official actions to help attract capital to countries where risks were deemed to exceed what private investors were willing to accept. Various ideas have been offered for both generic and project-specific schemes for risk sharing beyond what is currently available or affordable in derivative markets. The World Bank and other regional development banks could play a more active role in this domain. There is also an issue of how foreign investment could be more supportive of national development through a greater exercise of corporate responsibility. A great deal of work has been done in the United Nations on establishing a "Code of Conduct" for transnational corporations that could serve to balance investor protection arrangements, such as were incorporated in the OECD-MAI framework.

External Debt

12. The second major issue considered by the Workshop relates to external debt and it has to be treated in two separate contexts. One is a *chronic* problem of dealing with sovereign debt burdens when they have become unsustainable and the other is the *acute* problem of involving private creditors in the efforts of the official sector to resolve financial crises. The first set of problems has been handled in the past through Paris Club arrangements but latterly through the Highly Indebted Poor Countries Initiative (or HIPC) for eligible low-income countries. The main distinction between the two arrangements is that while the Paris Club has dealt only with bilateral official (or officially guaranteed) debts, the HIPC has been designed to cover debts owed to multilateral institutions as well. In both cases, an upper tranche arrangement with the IMF is a precondition for obtaining debt relief.[x] The HIPC Initiative is being steadily implemented[xi] but will require considerable augmentation if it is to result in sustainable debt positions in the aftermath of the sharp slowdown of the global economy. There was already a

deficiency of resources available to some of the creditor financial institutions to provide the requisite relief under the enhanced HIPC but it now appears that the overall resource needs are going to be much greater than those currently in prospect. The ICFD forum should provide an occasion for reinforcing the case for providing much larger relief than is now contemplated (including total debt write-offs) and for substantial aid resources in addition to debt relief.

13. Turning to the Paris Club, its protocols are found to be neither efficient nor equitable in their outcomes. Protracted negotiations year after year – with unchanging cut-off dates – feed uncertainty and damage the prospects for economic recovery of the indebted countries. This situation benefits neither creditors nor debtors. The equity issue is engaged in the Club's disregard of the three basic principles that undergird domestic bankruptcy laws in most industrial countries and are perhaps best codified in Chapter 9 of US law governing debts of States and municipalities. These principles are that (i) judgments are to be rendered by independent arbiters, (ii) creditors are not allowed to decide on their own claims and (iii) debtors' income earning capacity is not compromised. An international bankruptcy regime that would incorporate a similar rule of law would appear to be a worthy objective to pursue at the ICFD in respect of the sovereign debt owed to official creditors.

14. A different set of issues arises in the case of debt owed to private creditors. The sovereign debtor confronting financial crisis, whether originating in its own domestic policy deficiencies or resulting from cross-border contagion, has access to financial assistance from the IMF and other institutions established by the official sector to prevent default. The question that is posed for the international community is whether its assistance "bails out" private creditors and investors and thereby generates moral hazard by encouraging excessive risk-taking. How to "bail in" private interests that will typically include a large number of anonymous bond holders and highly leveraged financial intermediaries in the course of helping the debtor country has been the subject of much debate ever since the Mexican crisis of 1994-95. The principal issue in contention is whether the modalities for private sector involvement should be laid out in advance or whether they should be handled on a "case-by-case" basis to take account of the particular circumstances of the crisis affected country and to preserve a degree of "constructive ambiguity". The Workshop did not reach any definitive conclusion while noting that the absence of a rule-based framework facilitates selectivity in treating the claim holders of "systemically significant" economies while smaller countries are left alone to work out settlements with their private creditors and with no assurance of new money. One aspect that received attention was the feasibility of "standstills"; some international understanding on the modalities of declaring them were considered necessary to prevent a period of financial turmoil from turning into full blown crises and as a means of preventing a creditor's race to grab assets which is not only hurtful to the debtor but harms creditors as a group. It would be helpful to propose the further exploration of "standstill" modalities as a first stage in developing a rule-based framework that, hopefully.

could eventuate into an international bankruptcy regime covering both official and private debts incurred by governments. Whether to take advantage of any rule-based “standstill” arrangement would remain entirely in the discretion, and at the initiative, of the debtor government.

Global Economic Governance

15. This subject was treated under two heads: the first related to the governance of the BWI and the second to the relationship of these institutions to the United Nations system. Given the fact that the broadening of conditionality has been extended in recent years to cover governance issues, it was argued that the performance of the BWI should be evaluated by the same standards of governance that they hold important for developing countries. The area of greatest concern was that while their lending transactions were now with developing countries exclusively, their weighted voting arrangements made their decision-making on lending operations subject to the disproportionate influence of the leading industrial countries. The formulas determining voting power (quotas in the IMF and shares in the capital of the World Bank) had changed little since inception and, over time, had become increasingly disconnected from the growing importance of developing countries in the world economy.[xii]A change in the quota formulas[xiii] that would correct for this growing lack of representativeness would constitute an important step in restoring the legitimacy of the existing structure of governance in the BWI. Other measures for enhancing accountability and improving transparency could also be envisaged, but in the context of the ICFD, it would be appropriate to focus on a basic principle of governance instead of seeking a number of administrative reforms.

16. In addition to the need for greater voice and representation of developing countries, as directly affected parties, in the formulation and design of economic policy, the Workshop found a need for independent monitoring and evaluation of performance of the BWI and the regional financial institutions. It also felt the need for greater coherence within the international institutional structures given the fact that in addition to the BWI, there are other treaty-based organizations that operate with overlapping mandates in the economic sphere. The international community is confronted with a number of competing objectives and to minimize conflicts and to prioritize among them would require an overseer with an overarching perspective. The United Nations can be regarded as having the moral authority to take on such a role, although it has to be recognized that its place in global economic governance has fallen far short of what was intended by the founders and that the UN system of organizations has suffered from some erosion of its intellectual and managerial capacities in recent years. Proposals for a “world economic body at the highest level”[xiv] or an Economic Security Council proposed in the ZPR were not held by Workshop participants to have much chance of being adopted at the ICFD. In fact, there was little support for any new international organization. There was instead a preference for making greater use of the

Economic and Social Council (ECOSOC) to promote the coherence and consistency of the international monetary, financial and trading systems. While protecting the mandates of the BWI, it might be pertinent for the G-24 to support the idea of an oversight role to be exercised by a suitably reformed ECOSOC.

Trade

17. Turning to the last of the four themes, namely trade, much of the discussion at the Workshop focused on the interests of developing countries in the forthcoming WTO meeting in Doha. Since this meeting will have taken place by the time G-24 Ministers meet, it appears difficult to formulate proposals that address the subject beyond noting three points. First, that there is a direct linkage between market access imperatives for developing country exports and the sustainability of trade deficits through which a real transfer of resources is absorbed by them. Second, it is important to bear in mind the connection between the gains from trade liberalization and how those gains are distributed. As primary producers, many commodity exporters in the developing world have experienced a secular decline in their terms of trade, an issue that has not been addressed in recent times. Third, the instability of commodity prices results in dramatic fluctuations in income from year to year and produces serious losses in public revenues from import taxation. In any statement on the subject of trade, Ministers may wish to emphasize the vital importance of the commodity issue, especially the need for low-conditionality compensatory financing mechanisms, new commodity price risk management schemes and other measures to deal with the issue of price instability.

III. Summary and Conclusions

18. This paper has attempted to draw certain recommendations from the proceedings of the G24/OPEC Fund Workshop on Financing for Development that was held in New York on September 6-7, 2001. Rather than making suggestions of a highly specific and detailed character, it is proposed that the G-24 contribution focus on a set of issues of principle and use the ICFD as an opportunity to persuade the international community that addressing these issues would conduce to evolving a more stable and a more equitable system of finance for development. These issues are treated under four heads: resource transfers, external debt, global economic governance and trade. The first set covers measures for ensuring that foreign resource flows – official bilateral and multilateral as well as private direct investment and portfolio capital – are directed in amounts adequate to support globally accepted development goals and are effectively used in developing countries through the maintenance of an enabling environment that is supported by both domestic resource mobilization and donor cooperation. The external debt issues are related to the application of the rule of law under which official creditors cannot decide on their own claims, judgments on debt workouts are made by independent arbiters and the income earning capacity of the sovereign debtor are not compromised. In the case of private creditors, the exploration of "standstill" mechanisms is proposed as a first step in evolving a rule-based framework that could eventuate into an international bankruptcy regime. In the

global economic governance area, it is proposed to revise quota formulas in order to raise the voice and vote of developing countries in decision-making. An oversight role for ECOSOC is proposed to bring the United Nations into a global governance role that is essential for promoting the coherence and consistency of the international monetary, financial and trading systems. Finally, in the trade area, it is suggested that while awaiting the outcome of the Doha Meeting, emphasis be given to the market access imperative for developing country exports, attention drawn to the distribution of the gains from trade as indicated by movements in the terms of trade and to the vital importance of commodity issues.

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[i] Report of the Secretary-General to the Preparatory Committee for the High Level International Intergovernmental Event on Financing for Development (A/AC.257.12) January 2001.

[ii] The six items cover (i) Mobilizing domestic financial resources for development; (ii) Mobilizing international resources for development: foreign direct investment and other private flows; (iii) Trade; (iv) Increasing international financial cooperation for development through, inter alia, ODA; (v) Debt and (vi) Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development.

[iii] The Panel submitted its report under the title "Recommendations of the High-Level Panel on Financing for Development" ((A/55/1000) June 22, 2001.

[iv] Minister Mauricio Escanero of Mexico

[vv] The Draft Outcome document (A/AC.257/25) was issued on August 15, 2001.

[vi] See <u>Report on the G-24 Workshop on Financing for Development</u>, (memeo).

[vii] The real transfer of resources is measured by the current account deficits that developing countries are enabled to sustain; this is a function of both financial transfers and movements in their terms of trade.

[viii] The work is described in a joint Bank/Fund paper entitled "Financing for Development" (08/29/01)

[ix] op.cit, endnote (iii), p.10

[x] There have been exceptions when an overriding political interest has mandated the provision of debt relief by the principal creditors without the requirement of an IMF agreement, notably in the case of Egypt, Poland and the Russian Federation.

[xi] By mid-2001, 23 countries have reached their decision points and have been granted debt relief amounting to $ 34 billion in nominal terms. However, the net increase in resource flows through the HIPC program is understood to be quite small (and in some cases zero or even negative) since little of the debt was actually being serviced whereas all the reduced debt must now be serviced.

[xii] Thus, the quota of China, even after its most recent revision, was kept at the same level as that of Canada, the smallest economy among the G-7 countries. Some other developing countries that are among the world's ten largest economies (e.g., Brazil and Mexico) have voting power less than that of relatively small industrial countries, such as Belgium, the Netherlands and Switzerland. Note that Switzerland is a relative newcomer to the membership of the BWI but was granted a quota in line with that of other European countries rather than in relation to its overall importance in the world economy.

[xiii] The use of purchasing power parity exchange rates instead of market exchange rates in evaluating the size of national economies for the purpose of calculating quotas would be an example of a change that could be accomplished without changing the Articles of Agreement of the IMF.

[xiv] An example is the proposal to establish a Global Governance Group (3G) in a report to the Commission of the Bishops' Conferences of the European Community (COMECE). It is proposed that the 3G meet periodically at the level of heads of government and comprise of 24 members representing countries or constituencies that provide executive directors to the IMF/World Bank; other participants would be the UN Secretary-General and the heads of the IMF, World Bank, WTO and a (new) World Environment body.