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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 68/204, the present report provides an assessment of the current state of implementation of the Monterrey Consensus and the Doha Declaration on Financing for Development in the key substantive areas: mobilizing domestic financial resources for development; mobilizing international private resources for development; international trade as an engine for development, international financial and technical cooperation for development; external debt; and systemic issues. As noted in the Doha Declaration, numerous challenges have emerged since the adoption of the Monterrey Consensus. The third International Conference on Financing for Development, to be held in Addis Ababa, in July 2015, will provide a timely opportunity to enhance efforts across all the financing streams for sustainable development, in an integrated manner, towards the implementation of the post-2015 development agenda. Section VII of the report, "Staying engaged", presents an update on the intergovernmental follow-up processes in the lead-up to the Conference.

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

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I. Mobilizing domestic financial resources for development

1. Domestic resource mobilization represents the most significant source of financing for most countries. Since the International Conference on Financing for Development, held in Monterrey, Mexico, in 2002, significant efforts have been made by developing countries to enhance their ability to effectively mobilize domestic financial resources for development. Progress has been evident in raising both public and private resources. However, progress has not been uniform across countries, and more needs to be achieved to finance sustainable development across its economic, social and environmental dimensions.

Public domestic finance

2. Domestic finance represents the greatest share of financing sources for most countries. However, it remains insufficient to meet sustainable development needs, and gaps persist between developed and developing countries' capacity to raise public revenues. The median tax-to-gross domestic product (GDP) ratio in low-income countries is about half the median ratio in high-income countries. There is also a significant difference between low-income and middle-income countries.[1]

3. Domestic resource mobilization needs to be viewed in the context of differing capacities of countries. Countries successful in raising revenues have done so through a wide range of measures, including strengthened tax administration, a widening of the tax base, increased revenue from value added tax (VAT), robust receipts from corporate income taxes, and, to a lesser extent, personal income taxes. Many developing countries have significantly improved their tax administration within the last 5-10 years.[2] For example, the average time to prepare, file and pay (or withhold) taxes decreased by almost 20 per cent from 2005 to 2013 in developing countries.[3] Countries that have succeeded in raising revenues have often used innovative mechanisms and experiments, including the use of lotteries, transparency initiatives, and new technology. However, major challenges remain. In particular, revenue administrations in many developing countries remain affected by under-resourcing, misallocation, and weak mid-level skills.

4. Tackling illicit financial flows, along with domestic tax evasion and avoidance, remains one of the biggest challenges in mobilizing domestic revenues for developing countries. The Monterrey Consensus committed countries to strengthening international tax cooperation through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies with a special focus on the needs of developing countries. It also called for enhanced efforts to repatriate illicitly acquired funds to countries of origin. More needs to be done in these areas.

5. G20 leaders have endorsed the Organization for Economic Cooperation and Development (OECD) Action Plan on Base Erosion and Profit Shifting and automatic exchange of information. Further work can be undertaken on beneficial ownership transparency, transfer pricing regulations, country-based reporting and

[1] United Nations System Task Team Working Group on Financing for Sustainable Development, "The variety of national, regional and international public sources for development finance", Background paper (chap. 2), 2013.

[2] IMF, Tax Administration Diagnostic Assessment Tool, 2014, http://www.tadat.org/.

[3] OECD, Revenue Statistics, accessed on 10 July 2014, http://stats.oecd.org/Index.aspx?DataSetCode=REV.

non-economic reporting. The international community can support developing countries in enhancing their taxation capacities and strengthening anti-money-laundering measures, mutual legal assistance and the exchange of information between countries. The United Nations, with its universal membership and legitimacy, could strengthen international cooperation in this area, working with the G20, OECD, the International Monetary Fund (IMF), the World Bank and relevant regional forums. Discussions on how to move intergovernmental cooperation forward in this area should continue. In addition, international dialogues can be important tools for enhancing collaboration and sharing examples of successful reforms, as well as failures.

6. On a domestic level, illicit flows are often associated with domestic corruption. To advance the fight against corruption, all countries should ratify and implement the United Nations Convention against Corruption.

7. In terms of using public finance to advance sustainable development, some countries have begun to incorporate sustainable development criteria into the budgeting process. Some have introduced more sustainable procurement policies, based on minimum environmental and social standards for public sector suppliers. A small number of countries have reduced or completely removed harmful and inefficient subsidies, such as fossil fuel subsidies. However, they need to be implemented with compensatory measures for the people living in poverty.

8. The progressivity of the tax system can improve the distribution of income and stimulate the economy.[4] Efforts should also be made to introduce "social protection floors". Full and productive employment and decent work is the most important form of income security. Macroeconomic and fiscal policies that promote full and productive employment, as well as investment in human capital, are therefore central to poverty reduction and increased equality.

9. Ultimately, domestic resource mobilization is generated by sustained and equitable economic growth, so that macroeconomic policies play an important role. During the past decade, many developing countries strengthened macroeconomic and fiscal management, with an increasing number of countries in a position to be able to implement countercyclical fiscal policies.

Domestic financial sector resources

10. The Monterrey Consensus recognized the need to strengthen and develop the domestic financial sector in developing countries, and stressed the importance of encouraging the orderly development of capital markets. Indeed, from 2000 to 2013, private credit to GDP increased from an average of 19 per cent to 33 per cent in low-income countries, and from 52 per cent to 82 per cent in middle-income countries.[5] Nonetheless, in many developing countries, especially low-income countries, commercial banks remain the main provider of credit, with private bond markets underdeveloped or non-existent. For example, while private debt securities represent an average of 34 per cent of GDP in high-income countries, they represent

[4] Joseph E. Stiglitz, "Reforming Taxation to Promote Growth and Equity", White Paper, Roosevelt Institute, 2014.

[5] World Bank, *World Development Indicators, 2013*.

only 9 per cent in middle-income countries, and are close to zero in low-income countries.[6]

11. Deeper capital markets should provide a conduit for the long-term investment necessary for sustainable development. Nonetheless, there is a risk that such nascent markets will attract speculative capital, leading to short-term bubbles and shocks to the real economy. It is therefore important for countries to design a strong regulatory framework, potentially including capital account management tools, as discussed below.

12. Building a domestic institutional investor base could help provide a stable source of investment. The presence of institutional investors in developing countries is still significantly lower than in high-income countries. However, there are important exceptions, such as South Africa[7] and Chile, where pension assets are at about 60 per cent of GDP, in line with some developed countries, although still below levels in major developed-country markets, which range from 70 per cent to over 100 per cent of GDP.[6] In most developing countries, building an institutional investor base will require upgrading expertise and skills, as well as reforms in licensing, portfolio requirements and changes to security laws.[8] Nonetheless, even in developed markets, institutional investors, including pension funds, do not necessarily invest with a long-term investment horizon, as discussed below. Policymakers thus need to consider measures to incentivize longer-term investment and investment in sustainable development.

13. At the same time, it is important for countries to continue to strengthen the formal banking sector. More than half of the working-age adults in the world are currently "unbanked" by formal providers, with the vast majority in developing countries. Important progress has been made in providing financial services for people living in poverty, including through microfinance institutions, cooperative banks, postal banks and savings banks, mobile banking as well as commercial banks, but more needs to be done, including by using new technologies to reach the underserved communities. In addition, credit to small and medium-sized enterprises (SMEs) is insufficient. In most countries, SMEs are main drivers of innovation, employment and growth, yet approximately 200 million enterprises in emerging markets lack adequate financing and financial services.

14. Deepening of financial sectors has frequently been associated with stronger economic performance.[9] However, there are important caveats to this. Although research is preliminary,[10] it appears that for countries with shallow financial markets, a larger financial system implies greater productivity growth, but in more developed markets this relationship is unclear. In particular, financial instability and risk do not decrease with financial sector depth. One possible explanation for this is

[6] World Bank, *Global Financial Development Database*, April, 2013.

[7] OECD, "The Role of Banks, Equity Markets and Institutional Investors in Long-Term Financing for Growth and Development," report submitted at the Meeting of the G20 Finance Ministers and Central Banks Governors, February 2013.

[8] Andrew Sheng, "Outlook for Global Development Finance — Excess or Shortage?", background research paper submitted to High Level Panel on the Post-2015 Development Agenda.

[9] R. Levine, "Finance and Growth: Theory and Evidence", in *Handbook of Economic Growth*, ed. Philippe Aghion and Stephen Durlauf, edition 1, chap. 12 (Amsterdam: North-Holland Elsevier, 2005).

[10] Stephen G. Cecchetti and Enisse Kharroubi, "Reassessing the impact of finance on growth", BIS Working Papers No. 381, Bank for International Settlements, 2012.

that growth in credit is not sufficiently directed towards productive investments. In addition, there is some evidence that industries that compete with the financial sector for resources, such as research and development-intensive industries, have been especially impacted,[11] with important implications for investment in low-carbon technology.

15. Importantly, good governance and an enabling environment are crucial for effective mobilization of domestic financial resources and establishment of an inclusive financial system. Though more needs to be done, many developing countries have made progress in this respect, especially in the area of legal and regulatory reform, improving the provision of information, and promoting the ease of doing business. For example, since 2005, the average time to start a business has fallen from 50 to 30 days, with the average falling by half in low-income countries.

Blended finance

16. Over the last decade, public-private partnerships (PPPs), equity investments, guarantees and insurance have become increasingly looked to as mechanisms for using official resources (both domestic and international) to leverage private financing through risk-sharing between the public and private sectors. Such mechanisms can help overcome the constraints that have prevented banks and investors from financing projects with the potential to promote sustainable development. However, it is important that such mechanisms learn from success and failures of the past. Poorly designed PPPs and other blended structures can lead to high returns for the private partner, while the public partner retains all the risks. To be effective, the design of these mechanisms needs to be based on a deeper understanding of the underlying incentives of the private partner as well as the risks of the projects. International institutions, such as the United Nations, can help set up platforms for dialogue and information sharing, so that countries can learn from each other's successes and failures.

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

17. The Monterrey Consensus emphasized the potential contribution of private international capital flows to enhance productivity transfer technology and create jobs, particularly when invested in line with national development priorities. Indeed, there has been a strong upward trend in international private capital flows to developing countries over the last decade. Net private financial flows to developing countries increased from $188 billion in 2003 to $420 billion in 2013, with flows coming from an increasing diversity of sources, including South-South flows. However, the effect of the growth of investment has been less clear, as not all flows have the same developmental impact. In particular, some flows have been subject to great volatility over this period.

[11] Seo, Hwan Joo et al. "Financialization and the Slowdown in Korean Firms' R&D Investment", *Asian Economic Papers*, 2012, vol. 11, issue 3; Stephen G. Cecchetti and Enisse Kharroubi, "Reassessing the impact of finance on growth", BIS Working Papers No. 381, Bank for International Settlements, 2012.

18. Of the individual components of private capital flows to developing countries, foreign direct investment (FDI) has exhibited the largest net increase over the last decade. Gross FDI inflows to developing economies reached a new high of $778 billion in 2013, up from $197 billion in 2003. Nevertheless, FDI to developing countries has been concentrated in a few countries and sectors particularly in Asia and Latin America. Flows to Africa increased in the last decade, from $18 billion gross in 2003 to $57 billion in 2013.[12] They remain limited but are increasingly directed to services and manufacturing.[13]

19. In addition, greenfield FDI to developing countries, the form of FDI that has the most impact on sustainable development, has fallen by more than 50 per cent since the crisis, signalling a potential reduction of the positive impact of FDI on the real economy. Although the value of announced greenfield projects to least developed countries increased by 9 per cent in 2013, it remains significantly below historical levels. At the same time, there is evidence that a sizeable proportion of the increase in FDI flows to developing countries has been in intra-company loans, which are often short-term and not investment oriented. They have also been highlighted as one way that transnational corporations avoid taxation in developing countries.[14] In addition, host Governments should require all companies, including foreign investors, to meet the core labour standards of the International Labour Organization.

20. There are many reasons for the low level of long-term direct investment. It is well-known that an enabling environment, including the policy, legal, regulatory and institutional environment reduces risks associated with investment, and is thus critical to increase investment. Similarly, corruption is often a major deterrent to long-term investment. Furthermore, investors often point out that a major impediment to investment is the lack of “bankable projects” competitive with other investment opportunities, underscoring the need for capacity development for project preparation in many countries.

21. Outward FDI from developing countries has increased sharply, reaching $454 billion in 2013, with outflows from the BRICS countries (Brazil, Russia, India, China and South Africa) alone amounting to $200 billion in 2013.[13] It is thought that the scope for beneficial linkages and technology absorption arising from South-South FDI is increased by the fact that the technology and skills of developing-country transnational corporations are often closer to those used by firms in host countries.[15]

22. Cross-border bank flows to developing countries have demonstrated particularly high volatility, and have remained subdued in the years following the crisis as a number of international banks — particularly in Europe — have continued to be saddled with financial difficulties, non-performing loans and deleveraging pressures. In particular, this has affected long-term financing for

[12] United Nations Conference on Trade and Development, UNCTADstat: World Statistical Database, 2014.

[13] UNCTAD, *World Investment Report, 2014* (United Nations Sales publication, Sales No. E.14.II.D.1).

[14] OECD, Part 1 of a report to G20 Development Working Group on the Impact of Base Erosion and Profit Shifting (BEPS) in Low-Income Countries, 2014.

[15] United Nations Industrial Development Organization, Industrial Development, Trade and Poverty Reduction through South-South Cooperation, 2006.

infrastructure projects in emerging market and developing countries, a significant portion of which had previously been provided by large developed country banks. There is moreover a concern that the new Basel III capital adequacy rules might, by raising the cost of long-term and riskier lending, have the effect of further limiting the availability of long-term financing, which could have a negative impact on infrastructure and green investments. Similarly, with know-your-customer rules becoming a focus of advanced economy regulators, access to the global financial system for some least developed countries is becoming curtailed and/or more expensive. Reduction in corruption in these countries could help alleviate some of these pressures.

23. Institutional investors, who are estimated to hold between $75 trillion and $85 trillion in assets, are often referred to as a potential source of long-term investments in sustainable development. Some investors, such as pension funds, life insurance companies, and sovereign wealth funds, which together hold about $60 trillion in assets, have long-term liabilities that are well-suited to invest with longer-time horizons. Yet, even these long-term investors currently do not invest sufficiently in the long-term direct investment necessary for sustainable development, in both developed and developing countries — across a wide range of institutional and regulatory structures. For example, investment in infrastructure globally represents less than 3 per cent of pension fund assets.[16] While investment is limited in both developed and developing countries, investment in infrastructure is particularly inadequate in some developing countries, as well as in low-carbon infrastructure. There are often a range of risks associated with these investments, so that investors demand extremely high expected returns. There is thus an important role for Governments and IFIs in these areas, including through risk-sharing mechanisms, as discussed under blended financing. In particular, IFIs and Governments could support clean energy projects, where in many cases the expected financial returns are lower than the expected returns on conventional power projects, at least in the near term, but which, nonetheless, might offer greater societal benefits.

24. In addition, one impediment to long-term direct investment by institutional investors is that many investors do not have the capacity to do the necessary due diligence to invest directly in infrastructure. For all but the biggest investors creating such capacity is likely to be cost prohibitive. Instead, institutional investors make these investments through secondary financial intermediaries, whose incentives tend to be much shorter term. An alternative would be for investor groups to build joint platforms, e.g., for clean infrastructure investments. In addition, other regulatory reforms, such as adjustments to mark-to-market accounting rules, and changes to the structure of investment manager incentives can help incentivize greater long-term investment.

25. The short-termism of institutional investors is to some degree reflected in the trends in portfolio flows to developing countries, which have been highly volatile. For example, after a net outflow of portfolio investment of $36 billion in 2008, net portfolio inflows peaked in 2012 at $165 billion, but fell to $116 billion in 2013.[17] The nature of portfolio investment in emerging markets has evolved over the past

[16] United Nations Department of Economic and Social Affairs, *World Economic Situation and Prospects, 2014* (United Nations Sales publication, Sales No. E.14.II.C.2).

[17] United Nations estimates based on *IMF World Economic Outlook Database*, April 2014.

decade, as the share of emerging market bonds and equities in global investors' portfolios has risen sharply, supported by their growing importance in the world economy and their deepening financial sectors. While the increased participation of foreign investors in domestic capital markets can be beneficial, it can also increase the potential for instability and contagion, as highlighted by the pattern of expansion and retrenchment in portfolio flows. Macro-prudential measures, capital account management techniques, and foreign exchange interventions can help to reduce the volatility of capital flows, and should thus be seen as an essential part of the policy toolkit to combat capital flow surges and outflows. In addition, given the cross-border spillover effect of monetary policy decisions in the advanced economies, better international and regional coordination of monetary and capital account policies and better management of global liquidity are needed.

III. International trade as an engine for development

26. Since the Monterrey Conference, the share of developing countries' exports in the value of total world exports has increased, from about 32 per cent in 2000 to about 45 per cent in 2013.[18] South-South trade has also expanded, rising from one fifth to approximately one fourth of world trade in the past decade, accounting for roughly the same share of trade as North-North trade in 2012. Nonetheless, progress in the area of international trade has been uneven.[16] Least developed countries trade was strongly impacted by the global economic slowdown and their share in world trade in goods and commercial services remains low at 1.14 per cent of world trade.[19] The international community has failed to reach a successful conclusion to the Doha round of trade negotiations, owing to significant differences over the balance to be struck in the liberalization of trade in agriculture, services and industrial goods. The failure to reach a comprehensive multilateral trade agreement has encouraged the proliferation of bilateral, regional and interregional free trade agreements, which risk further fragmenting trade rules and increasing the marginalization of the smaller and more vulnerable countries.

27. Furthermore, the financial and economic crisis had a significant adverse impact on international trade. World trade grew about twice as fast as GDP from the 1990s through 2009, but collapsed in 2009, and trade growth has been anaemic since then. Real exports are forecast to grow by 4.1 per cent in 2014, still below the pre-crisis trend of double the global output growth.[20] At the same time, trade in services continues to expand at a faster pace than merchandise growth, owing for the most part to the rise of global value chains, which rely on services, such as information and communications technology, communication, logistics and transport. The share of services amounts to about 20 per cent of gross exports, but 46 per cent of value-added in exports.[16]

28. Given the sluggish global recovery, it is too early to assess whether the continuing low levels of the ratio of world trade growth to GDP growth is a function of cyclical or structural factors (such as subtle protectionism and the spread of

[18] UNCTAD, *Trade and Development Report, 2013* (United Nations publication, Sales No. E.13.II.D.3).

[19] World Trade Organization, Note by the Secretariat, "Market access for products and services of export interest to least developed countries", 2013.

[20] *World Economic Situation and Prospects 2014, update as of mid-2014*.

supply chains) and whether earlier trade growth rates will return in the medium and long run. Nonetheless, the slowdown in trade growth highlights the risks associated with export-oriented growth strategies in developing countries, and points to the need for a greater reliance on domestic and regional sources of demand.

29. Supporting trade growth by avoiding protectionism and by upgrading the rules for an open, fair and development-oriented international trading regime in the spirit of the Doha Development Round is critical. The vast majority of trade restrictive measures taken since the global crisis still remain in place, according to the World Trade Organization (WTO), with only one fifth having been removed as of May 2014.[21] At the same time, there is a lack of information regarding other types of actions affecting trade in goods and services, especially subsidies and other support measures.

30. The multilateral trade agenda received a boost when the WTO Ninth Ministerial Conference, held in Bali, Indonesia, in December 2013 produced an important package of agreements. The "Bali package" contains 10 ministerial decisions, aimed at reducing trade transaction costs, addressing certain developing-country trade concerns in agriculture, enhancing least developed country trade and establishing a mechanism to monitor the functioning of existing development provisions in WTO agreements. Unfortunately, progress in the implementation of the Bali package has stalled over the demands of a few developing countries to secure more permanent exemptions from challenges to their public stockholding schemes for food security purposes. As a result, the trade facilitation agreement missed its first implementation deadline on 31 July 2014. The Agreement on Trade Facilitation aims to simplify and modernize customs procedures and holds great potential to increase the trade competiveness of developing countries. Finding a solution on the Bali package in the short term would allow the international community to focus its efforts on establishing a work programme for tackling the rest of the core issues in the Doha development agenda as mandated by ministers in Bali, thereby preserving development at the centre of the negotiations and ensuring clear results for the poorest countries.

31. The alternative to progress in advancing a multilateral trade agenda would be the continued proliferation of bilateral, regional and interregional free trade agreements. Regional trade agreements have increased since the early 1990s. As of June 2014, some 585 notifications of regional trade agreements were received by GATT/WTO, of which 379 were in force. By allowing member countries to depart from the "most favoured nation" principle, regional trade agreements threaten to further fragment trade rules and undermine the consistency of the multilateral system. In addition, regional trade agreements and free trade agreements are not negotiated under a development mandate and thus may not adequately consider the sustainable development implications of their provisions.

32. The prevalence of global value chains and the intensified transport of goods within such chains produces significant carbon dioxide emissions. Transport associated with merchandise trade alone may contribute to more than 7 per cent of global carbon dioxide emissions. The coherence between trade, transport and environmental policies needs to be increased, including through measures to reduce emission from freight transport. There is limited progress in negotiations on

[21] WTO, *Report on G-20 Trade Measures*, 2014.

environmental goods and services, with a small group of countries formally launching negotiations on an environmental goods agreement aimed at eliminating tariffs on a broad range of environmental goods in July 2014.

33. The rise of value chains has also led to a much tighter link between trade and FDI. This also has implications for the international investment regime. Since the Monterrey Consensus, international investment agreements have continued to increase in number, most of them in the bilateral sphere, but increasingly also at the regional level. By the end of 2013, almost every country was party to an international investment agreement and the overall number of agreements exceeded 3,200. This includes more than 2,900 bilateral investment treaties and more than 330 "other" international investment agreements. Today, international investment rule making is characterized by diverging trends: on the one hand, disengagement from the system, partly because of developments in investment arbitration; on the other hand, intensifying and up-scaling treaty-making. Negotiations of megaregional agreements are a case in point. Once concluded, they may affect global investment patterns and have systemic implications for the multi-layered international investment regime. Concerns about the functioning and impact of the international investment agreement regime are resulting in calls for reform. New international investment agreements already illustrate the growing tendency to craft treaties that are in line with sustainable development objectives. Multilateral discussions could explore a more holistic approach to designing investment frameworks that promote sustainable development and that are in line with the investment and development paradigm shift. The UNCTAD Investment Policy Framework for Sustainable Development could offer guidance in this regard.

34. Aid for trade, the category of official development assistance (ODA) that supports developing countries (particularly least developed countries) in addressing trade-related constraints and in strengthening their capacity, declined in 2011 before increasing in 2012, according to preliminary figures presented by OECD. However, the share of the least developed countries of total aid-for-trade flows fell 2 per cent in 2012 to $13.1 billion, or 24 per cent of the total, as the large increase in aid for trade was directed to middle-income countries, mainly in the form of loans. In recent years, there was also a shift from supporting large infrastructure projects towards building productive capacities, indicating the prioritization of private sector development by donors.

IV. Increasing international financial and technical cooperation for development

35. International public finance, and ODA in particular, remains a critical source of public financing for development, particularly for those countries that have limited capacity to raise public resources domestically, including the least developed countries and other vulnerable countries. At the same time, international public finance is increasingly looked upon to finance other global needs, such as global public goods and climate finance.

36. Since the 2000 Millennium Summit and the 2002 International Conference on Financing for Development, net ODA flows from all OECD Development Assistance Committee donors (OECD DAC) increased significantly, from $84 billion in 2000 to $134.8 billion in 2013. Although ODA fell in 2011 and 2012 in real terms, ODA

rebounded in 2013, rising by 6.1 per cent in real terms, to reach a record $134.8 billion. According to donor surveys, ODA is likely to increase further in 2014 and stabilize thereafter. Despite the increase in aid flows, many donors still fall significantly short of commitments. Five donors (Denmark, Luxembourg, Norway, Sweden and the United Kingdom) exceed the target of disbursing 0.7 per cent of their gross national income (GNI) as aid, but the combined DAC donors' ODA was equivalent to only 0.3 per cent of their GNI.

37. Overall, the share of ODA allocated to least developed countries fell in recent years, from 34 per cent in 2010 to 32 per cent in 2012. ODA to sub-Saharan Africa decreased by 4 per cent in real terms in 2013, to $26.2 billion. This worrying trend is projected to continue. DAC surveys on donors' forward spending plans indicate that aid flows[22] will increasingly focus on middle-income countries in the medium term, with further declines projected for least developed countries and low-income countries, particularly in sub-Saharan Africa.[23]

38. As concerns about environmental degradation and climate change have become increasingly urgent issues in international development, climate financing has taken centre stage. In the 2009 Copenhagen Accord of the United Nations Framework Convention on Climate Change, developed countries agreed to the joint mobilization of $100 billion annually by 2020 to address the needs of developing countries. A preliminary assessment of "fast-start finance" finds that $35 billion were mobilized between 2010 and 2012. Of these flows 80 per cent were also counted as ODA, and were paid out with similar modalities, largely through bilateral channels, with aid targeting environmental sustainability now representing a quarter of all bilateral aid.[24] Fast-start finance has benefited middle-income countries disproportionally, and is often focused on leveraging private financing flows.

39. While there are large overlaps between traditional development cooperation and climate financing, there are also important differences. Many adaptation projects have direct impacts on development. Others, while important for mitigation, might have a relatively smaller impact on alleviating poverty (per dollar spent). Nonetheless, to date, much climate financing in ODA has been broadly focused on mitigation, while financing for adaptation — critical for the most vulnerable countries — is more limited. The question of how to account for financing global public goods, such as climate financing, in development cooperation is currently part of ongoing discussions in DAC, as well as other discussions in the context of the post-2015 development agenda.

40. In addition to increasing the volume of aid flows, many countries have committed themselves to increasing the effectiveness of aid. Building on the Paris Declaration on Aid Effectiveness and the Accra Agenda for Action, the 2011 Busan Partnership agreement endorses four principles of effective development cooperation: ownership of development priorities by developing countries, focus on results, inclusive development partnerships, and transparency and accountability.

[22] Surveys are focused on country programmable aid, which is generally considered to be a proxy for aid recorded at the country level.

[23] OECD, Outlook on Aid: Survey on donors' forward spending plans 2013-2016 (www.oecd.org/dac/aidoutlook)

[24] OECD, *Development Cooperation Report 2012: Lessons in Linking Sustainability and Development*.

Progress has been made in some areas such as untying aid, reporting ODA in the national budgets, and using country administrative systems in the management of aid-funded programmes and projects. Nonetheless, progress remains slow, and aid providers face heightened scrutiny from taxpayers, with implications for resource allocations, modalities for delivery and risk management.

41. In response to the rapid changes in the global development landscape and criticism of the existing ODA concept, the OECD DAC is undertaking a review of the measurement and monitoring of external development finance, including constructing a concept of "official support for development" that would be broader than ODA. Issues include the measurement of "donor effort" (or fiscal impact) of equity and mezzanine financing and of guarantees by donor-country development institutions, as well as the treatment of concessional loans in the measurement of ODA. Options for expanding the measure of total official support for development potentially include: financing at market rates (such as non-concessional loans), financing of "enablers of development" (such as outlays on peace and security), and private flows mobilized by public sector interventions. However, some developing countries fear that some of these new measures would be difficult to calculate and would inflate the headline numbers for assistance. In particular, there is a fear that including private financing would reflect benefits to companies in developed countries and potentially increase the use of "tied aid".

42. Over the last decade, South-South cooperation has continued to rise in scale and importance, together with growing South-South trade, investment and regional integration. Several non-DAC donors have dramatically scaled up aid in recent years. South-South concessional loans, grants and technical cooperation have reached between $16.1 billion and $19 billion in 2011, and are estimated to constitute 10 per cent of overall development cooperation (see E/2014/77). South-South cooperation tends to come with limited conditionality, although it is often tied to profit-oriented projects. It covers a wide range of sectors, but often focuses on infrastructure and production.

43. The Monterrey Consensus called for exploring innovative sources of financing. Although some of these sources, such as financial and currency transaction taxes or carbon taxes, have existed for decades, they are considered innovative in that they have not been implemented on a wide scale for global development. In addition to raising resources, many of these mechanisms also incentivize behaviour change, e.g., to encourage investments in green energy. To date, innovative mechanisms have been implemented on a relatively small scale, albeit with positive results. For example, nine countries have implemented the international solidarity levy on air tickets, the funds from which are contributed to UNITAID to help develop drugs to treat HIV/AIDS, malaria and tuberculosis. There are 11 countries using the euro currency that are currently envisioning a financial transaction tax from 2016, albeit without all countries earmarking funds for development or financing of global public goods as of yet. Overall, there are a number of proposals that are technically feasible and have the potential to raise significant revenues. It has been estimated that about $400 billion to $450 billion per year could be raised through a combination of new mechanisms.[25]

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

V. External debt

44. The Monterrey Consensus called for new mechanisms to comprehensively address debt problems of developing countries, and welcomed consideration of an international debt workout mechanism to engage debtors and creditors in restructuring unsustainable debts in a timely and efficient manner. While there have been some important improvements in the debt architecture, significant gaps still remain. The Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief (MDRI) initiatives helped to resolve debt overhang in poor countries. However, HIPC is coming to a close. With the increase in private capital flows to developing countries, as well as lending from bilateral lenders of the South, the importance of the Paris Club is reduced. New issues in creditor coordination pose challenges for timely and adequate resolution of debt problems. In addition, there is a greater understanding of the cost delaying necessary default. Given the possibility of further potentially disruptive debt crises, the international community should make serious efforts to work towards a framework for timely, orderly and fair restructurings of sovereign debt.

45. HIPC and MDRI have written down debt in 35 low-income countries, with only Chad remaining in the interim phase receiving temporary relief. There are currently three more eligible countries that have not yet started the initiatives (Eritrea, Somalia and the Sudan). Nepal remains potentially eligible for the debt relief under the Initiative, while the potential eligibility of Myanmar and Zimbabwe has yet to be formally assessed.

46. On an aggregate level, the debt ratios for developing countries look benign at 22.6 per cent of external debt-to-GDP in 2013. Low-income countries register higher external debt-to-GDP ratios than middle-income countries at an average of 31.5 per cent in 2013, although a large portion of this is long-term debt at concessional interest rates. However, some developing countries, particularly small States, remain critically indebted. Small States have an average external debt-to-GDP ratio in 2013 of 57.7 per cent. Total public debt-to-GDP ratio for small States stood at 107.7 per cent, versus an average of 26 per cent for developing countries as a whole.

47. Many low- and middle-income countries are accessing international capital markets, some of them for the first time. For example, aside from South Africa, no other sub-Saharan country floated a bond issue internationally in 2010, but three did in 2011 and four did in 2012, raising about $2 billion in both years. A further six tapped international capital markets in 2013, raising almost $7 billion.[26] The issuance of public debt in domestic currencies (which, unlike external debt, does not subject the issuing Government to foreign exchange risk) has also grown, reflecting the development of local capital markets. For example, local currency government debt in sub-Saharan Africa increased from $11 billion in 2005 to $31 billion in 2012.[27] While this growth reflects improving credit fundamentals in many countries, excessive growth in both domestic and international debt also poses risks to financial and economic stability, underscoring the need for prudent debt management.

[26] IMF, *Global Financial Stability Report*, April 2014, Statistical Appendix, table 5.

[27] African Financial Markets Initiative, 2013 based on a sample of 29 sub-Saharan African countries.

48. Since the Monterrey Conference, changes in contractual terms to facilitate the so-called "voluntary" market-based restructuring process for sovereign bonds through the introduction of Collective Action Clauses and laying down voluntary principles for a code of conduct are marks of progress. Recent experience of restructuring, however, has shown that contractual technology has gaps, and that the existing debt architecture does not deliver on timeliness and fair burden sharing. The recent case of holdout creditors versus Argentina is feared to potentially increase the leverage of holdout creditors and risks the success of future debt restructurings.[28] While it is possible to strengthen Collective Action Clauses by agreeing on rules for their aggregation across series of bonds,[29] this will not affect all forms of debt, and only addresses issues pertaining to collective action.

49. Following the recent debt problems in the euro zone, which necessitated the largest IMF loans in history, along with the litigation by holdout creditors, there is renewed interest in improving the architecture for sovereign debt restructuring. Currently, discussions are ongoing in various forums, including in the United Nations system. UNCTAD published "Principles on Responsible Sovereign Lending and Borrowing" in 2012 and in 2013 has a project to identify and formulate a body of principles and rules on which a sovereign debt workout mechanism should be built. The Financing for Development Office of the United Nations Secretariat Department of Economic and Social Affairs organized a series of expert group meetings involving official and private sector experts to develop an understanding of the key issues to be resolved in sovereign debt restructuring and potential options going forward.[30] IMF is currently reviewing its lending framework in situations of sovereign debt distress, particularly in the context of exceptional access to Fund resources, and has presented preliminary considerations to its Executive Board to make the Fund's lending framework more flexible and calibrated to members' debt situations, and to thus enhance the ability of IMF to strike an appropriate balance between financing and adjustment.[31] A complementary paper will be issued in the next several months to the IMF Executive Board on reforms to contractual provisions to address collective action problems in the context of debt restructuring.

50. Overall, a timely reform of the architecture for debt restructuring is needed. Setting up universal rules that provide comprehensive and fair treatment for all components of debt will require continued discussions to reach intergovernmental agreement.

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

51. In the wake of the 2008 financial crisis, efforts were launched to improve the functioning, stability and resilience of the international monetary and financial

[28] In 2013, the World Bank and IMF reported that litigation was ongoing against eight HIPCs.

[29] The euro zone has already agreed on a model Collective Action Clause which has a two-staged voting structure for aggregation across different series of bonds.

[30] See reports of the Expert Group Meeting on www.un.org/esa/ffd and for identifications of problems and options going forward.

[31] See *Life After Debt: Debt Crises Origins and Resolutions*, eds. Joseph E. Stiglitz and Daniel Heymann (Palgrave Macmillan, 2014).

system. New coordination mechanisms were established, and regulatory reforms were initiated. However, systemic shortcomings remain that risk undermining the stability of the system and its effectiveness in mobilizing and allocating resources to finance sustainable development needs. To address this, additional initiatives are needed in key areas relating to international economic policy coordination, multilateral surveillance, the global financial safety net, global governance, and financial regulation. The international community needs to create an adequate international enabling environment and policy architecture that provides the policy space necessary to implement effective national sustainable development strategies.

52. Selected international country groupings, such as the Group of 20 (G20), have become important forums for international economic policy coordination. The G20 played a major role in providing a coordinated and effective response during the global crisis that proved to be instrumental in averting an even more serious downturn. However, recent years have witnessed monetary policy decisions in the advanced economies generating cross-border spillovers on developing countries. Indeed, during the past year, expectations of an end of quantitative easing in the United States led to a sharp depreciation in currencies and equity markets in Brazil, India, Indonesia, Mexico, South Africa and Turkey due to portfolio outflows. Given this, and the potential for contagion and instability, there is a need for better international coordination of monetary policies, management of global liquidity and communication.

53. A number of important steps have been taken in recent years by IMF to strengthen multilateral surveillance. A new legal framework was adopted in 2012 to better integrate bilateral and multilateral surveillance, and greater emphasis is being placed on risks, cross-border and cross-sectoral linkages, spillover effects of economic policies in the world's largest economies, as well as the linkages between the financial sector and the real economy. A formal strategy for financial sector surveillance was approved in 2012 and financial sector assessment programmes have become mandatory for 29 countries. The forthcoming triennial surveillance review will consider how effectively the new "integrated" surveillance framework is being implemented; examine the consistency and focus of IMF policy advice; and look at the even-handedness of IMF surveillance across its membership. Concurrently, a review of the financial sector assessment programme is being carried out.

54. Global imbalances on the current accounts of major advanced and emerging market economies have narrowed considerably from their peak in 2006-2007, however, some cases of new imbalances have emerged. The accumulation of international reserves continued in 2013 and central banks continue to hold a large proportion of global savings in the form of international reserves, with the five largest developing country holders of reserves accounting for 65 per cent of the developing country total reserve holdings. While for many countries reserves are a form of "self-insurance" against potential external shocks, their accumulation comes at an opportunity cost since these reserves could otherwise have been invested in sustainable development. In addition, reserve accumulation increases systemic risk at the international level, by adding to global imbalances. Several proposals have been put forward to reduce reliance on self-insurance, including making greater use of IMF special drawing rights (SDRs); enhancing the effectiveness and legitimacy of global financial safety nets, including IMF; and reducing risks in the international financial system.

55. A reliable global financial safety net, which can provide liquidity in times of systemic crisis, remains an important element in ensuring global financial stability. As part of its lending reforms following the global financial and economic crisis, IMF has introduced several new facilities with the aim of encouraging countries to seek assistance before they face a full-blown crisis (see A/69/188).

56. Since the global crisis, regional financial stability mechanisms have also been strengthened (such as the Latin American Reserve Fund or the Chiang Mai Multilateralization Initiative) to serve as a first line of defence against contagion from global crises. In addition, the BRICS have recently launched a New Development Bank and related Contingent Reserve Agreement. The Contingent Reserve Agreement is meant to help countries forestall short-term liquidity pressures and complement existing international arrangements.[32] The aim of the new development bank is to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging and developing economies. Similarly, a new Asian infrastructure bank is being considered. These efforts will need to be managed within the broader global financing architecture to ensure complementarities and coordination.

57. Strengthening international financial regulation is one crucial way of addressing the risks in the international financial system. In general, regulations and policies need to strike a balance between the safety of the financial system and ensuring sufficient access to credit. In recent years, the international community has taken important steps to strengthen the resilience of the financial sector through regulatory reform. To date, these reforms have focused on ensuring the safety and soundness of the financial system, primarily through regulation of the banking sector through Basel III, supplemented by a series of recommendations from the Financial Stability Board. Much progress has been made on this front and most large internationally active banks are on course to meet the new Basel III capital requirements in advance of the agreed deadline.[33] Further progress is needed in other aspects of the international regulatory agenda, including addressing problems created by systemically important institutions that are considered “too big to fail”. There is also a need for stronger cross-border resolution regimes with fair burden sharing. The development and implementation of international financial regulation would also benefit from greater representation of and participation by developing countries in international financial regulatory bodies, such as the Bank for International Settlements, the Basel Committee on Banking Supervision and the Financial Stability Board, as well as technical assistance from other member countries.

58. The IMF and World Bank Group governance reforms in 2010 were important steps towards an improved governance structure considering representation, responsiveness and accountability. Governors also agreed in 2010 to conduct International Bank for Reconstruction and Development shareholding reviews every five years to reflect economic changes in IBRD shareholders. Despite an early 2014 deadline, the IMF quota and governance reforms agreed in 2010 still require ratification by the largest shareholder to enter into force, possibly imperilling efforts to agree a further round of needed reforms, which is due to be concluded in January 2015.

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[32] BRICS Summit Declaration, 15 July 2014.

[33] Basel Committee on Banking Supervision, Progress report on implementation of the Basel regulatory framework, April 2014.

VII. Staying engaged

59. Pursuant to the General Assembly adopted resolution 68/279, "Modalities for the third International Conference on Financing for Development", the third International Conference on Financing for Development will be held in Addis Ababa, from 13 to 16 July 2015, at the highest possible political level, including Heads of State and Government and Ministers of Finance, Foreign Affairs and Development Cooperation. The Conference will result in an intergovernmentally negotiated and agreed outcome, as well as summaries of its deliberations. The scope of the Conference will focus on: (a) reviewing the implementation of the Monterrey Consensus and Doha Declaration on Financing for Development; (b) addressing new and emerging issues related to the mobilization and effective use of financial resources for sustainable development; and (c) reinvigorating the financing for development follow-up process. The outcome of the Conference should constitute an important contribution to and support the implementation of the post-2015 development agenda.

60. The preparation of the Conference, under the auspices of the President of the General Assembly, will include substantive thematic sessions and hearings of civil society and the business sector during the period from September 2014 to March 2015. A draft outcome document, to be prepared by two co-facilitators by February 2015, will be the subject of informal consultations and drafting sessions in January, April and June 2015. The Secretary-General is requested to prepare a note on the organization of work of the Conference and to provide support to the preparatory process and the Conference and to ensure inter-agency cooperation and effective participation and coherence within the United Nations system.

61. On 8 August 2014, the Intergovernmental Committee of Experts on Sustainable Development Financing, established at the United Nations Conference on Sustainable Development, held in 2012 in Rio de Janeiro, adopted its report proposing options on an effective sustainable development financing strategy to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives. The report develops an analytical framework for financing sustainable development and suggests areas for advancement of the global partnership for sustainable development. It recognizes that there is no one simple policy solution and puts forth a basket of policy options for countries to choose from.

62. Along with the report of the Intergovernmental Committee of Experts on Sustainable Development Financing, the report of the Open Working Group on Sustainable Development Goals and the Secretary-General's synthesis report will serve as important input to the preparation of the third International Conference on Financing for Development.