

FINANCING FOR DEVELOPMENT CONFERENCE 2015: VIEWS FROM THE GLOBAL SOUTH

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Developing countries—emerging, middle-income, and least developed—will be going to the Financing for Development (FfD) Conference in Addis Ababa in July 2015 with a set of demands to reform and rebalance the international financial system in order to facilitate the realization of the Sustainable Development Goals (SDGs).

On 19 July 2014 the Open Working Group of the United Nations agreed on a draft of a set of 17 Sustainable Development Goals, taking the first steps toward a renewed development agenda for after 2015. The effort to agree on the SDGs was the follow up to the Millennium Development Goals (MDGs), whose end-date is 2015. Aside from the 17 specific goals, the draft SDGs included 169 associated targets.¹

To mobilize the resources for a renewed development agenda beginning in January of next year, the General Assembly agreed in December 2013 to convene the third international gathering on financing for development, which will take place 13-16 July 2015 in Addis Ababa. The enlarged number of goals and associated targets reflects the ambitious 1992 concept of “sustainable development” defined in Rio de Janeiro by conference participants as the joint realization of three dimensions: environmental recuperation/revitalization, social progress, and economic development.

The FfD Conference will occur shortly before the September 2015 UN Summit that is expected to agree on the post-2015 development agenda to succeed the MDGs. It is likely that the summit’s outcome will incorporate the draft SDGs.

Developing countries lobbied intensely to have the FfD conference precede the summit because they have become increasingly skeptical about taking on new international obligations—implicit in the draft SDGs—without adequate resources and the enabling international economic environment to meet new obligations.

THE FINANCING FOR DEVELOPMENT PROCESS

Created by the 2002 “Monterrey Consensus,” the FfD process seeks to “promote sustainable development.”² The global FfD agreement came in the wake of the Asian financial crises in the late 1990s that overwhelmed economies renowned for their successful embrace of globalization. The new agreement sought to restore confidence in

the international financial economic system. While a UN activity, its review process officially engages not only the UN Conference on Trade and Development (UNCTAD) but also the principal global economic governance institutions—including the International Monetary Fund (IMF), the World Bank, and the World Trade Organization (WTO). The FfD also provides for the participation by civil society and the private sector in its deliberations.

The FfD’s substantive structure is organized into six chapters of “leading actions,” which encompass the key areas for which developing countries face both obstacles and opportunities in mobilizing financial resources to sustain long-term investment in new economic activities critical to promoting structural change. These chapters deal with domestic resource mobilization; foreign direct investment and portfolio flows; international trade; official development assistance; external debt; and systemic issues. For example, the title of the first of the six leading actions, “mobilizing domestic financial resources for development,” signals that resources from domestic private savings—which require non-volatile, macroeconomic growth—and government revenues provide the overwhelming bulk of financing for development.

THE GLOBAL ECONOMIC SITUATION

When the Third Financing for Development Conference takes place, the global economy will still be struggling to overcome the near collapse in 2007-2008 of the international financial system. Unlike previous crises, however, the current one originated in the developed North.

For the countries of the global South, the first reality is that they are net investors in developed countries. The international financial system is not mobilizing resources for development for them. Central banks in developing countries have been building up their international reserves as a form of self-insurance from any sudden reversal of private investment flows like the ones

Future UN Development System supports and helps accelerate change in the UN development system to increase effective responses to global development challenges—especially after 2015, the target date for the Millennium Development Goals. Recognizing the many frustrations that have accompanied UN reform efforts, FUNDS envisages a multi-year process designed to help build consensus around necessary changes. Financial support currently comes from the governments of Denmark, Norway, Sweden, and Switzerland.

that devastated East Asian economies in the late 1990s. For almost two decades, the net flow of investment has been from developing to developed countries.³

For those developing countries without a current account surplus, a good proportion of their reserves are borrowed from external sources. If their authorities had greater confidence in the ability of the IMF to provide adequate, timely, and counter-cyclical liquidity in the event of private sector portfolio reversals, they would reduce their reserve accumulations. The IMF is, after all, meant to be a cooperative among its members for emergency liquidity support. These self-insurance reserves would also be reduced with better international financial regulation. This gap is included as draft SDG target 10.5: “improve regulation and monitoring of global financial markets and institutions and strengthen implementation of such regulations.”⁴

In 2015, developing countries continue to face the consequences of an external shock not of their own making, with the looming increase in US interest rates and reversal of private portfolio flows. In 1980, the US Federal Reserve’s decision to raise interest rates to 20 percent almost overnight to tame inflation sparked widespread debt crises throughout the global South. Developing country international reserves can help stem some potential financial problems, but they certainly are not large enough to withstand large bank runs.

Industrialized economies, middle income developing countries, and even quite a few least developed countries have removed foreign exchange controls both on the inflow and outflow sides over portfolio investment activities (except for those suspected of terrorist links). As a result, the international economy is now shorn of many public policy tools to monitor and control volatile private capital movements. The conventional wisdom was that allowing freer capital movements would increase the availability of financing for developing countries and thus raise their rates of investment. The availability of private financing increased in the 1990s and first part of the twenty-first century but collapsed with

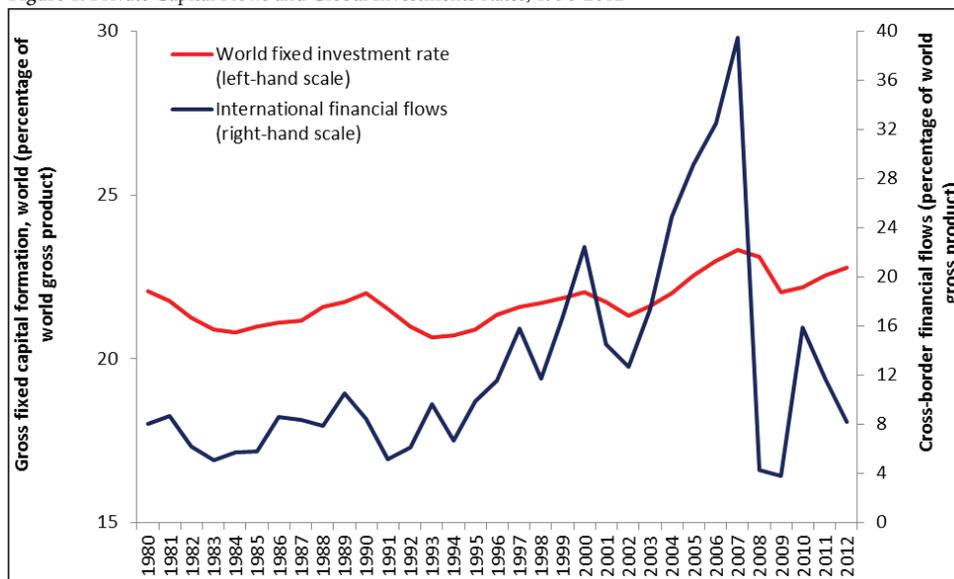
the financial crisis of 2007-2008. Unfortunately, even in the years of explosive private financing flows, the actual result has been little or no increase in the rate of investment worldwide as Figure 1 clearly demonstrates.

The record suggests that the underlying issue is not the availability of finance, either public or private, but the lack of demand for investment. Diminished public policy space is the result because of the reduced scope for public authorities to “dream up,” respond to estimated future needs, and plan investment projects such as in infrastructure and energy. Such space is severely restricted when public authorities feel compelled to continually signal their prudent management approach by meeting fixed or declining public sector deficit targets of private foreign investors, who are ready and able to move their funds at a moment’s notice. The scale of vulnerability is greater the greater the amount of short-term private funds invested in a developing country; thus the availability of finance is not a driver of the amount of investment activity and can even be a hindrance.

The seemingly sudden, recent discovery of a global infrastructure gap is the culmination of years of procyclical public expenditure policies in developing countries to meet fixed public sector deficit ceilings. To meet them, many developing country governments cut investment expenditures in infrastructure and also relied on MDG-motivated aid to try to protect social expenditures. Analysis by the Development Committee of the World Bank and the IMF suggests that delayed infrastructure spending compromises developing country medium-term growth prospects by inhibiting private investment due to inadequate infrastructure, such as energy supply.⁶

While the strength of correlations among interest, exchange, and inflation rates vary by country, restoring capabilities for capital account management or regulation is critical to creating public policy space to sustain domestic demand for long-term investment. Capital controls are also critical to making feasible incomes policies to reduce inequality, increase wage rates, and expand public taxation and expenditures for social objectives.

Figure 1: Private Capital Flows and Global Investments Rates, 1990-2012⁵



Estimates of the scale of necessary financing for the SDGs and the post-2015 development agenda are substantial but well within the capacity of the global system. The August 2014 report of the Intergovernmental Committee of Experts on Sustainable Development Financing (ICESDF)⁷ indicated that the global economy generates savings of \$22 trillion annually. The experts estimated that for infrastructure alone \$5-7 trillion annually would be required and for eradicating extreme poverty \$66 billion annually. There are overlaps among the possible areas of financing because, for example, if infrastructure investment can be channeled to increase employment of unskilled workers, it can help reduce extreme poverty. Investment in renewable energy supply, if it can be mobilized on reasonable terms in developing countries, could enlarge access to modern water, sanitation, and electricity and reduce the incidence of disease.

A GLOBAL SYSTEM CONDUCTIVE TO FINANCING DEVELOPMENT

The FfD process has consistently treated the scale and direction of financing for development and the institutional environment as two sides of the same coin. Moreover, both the domestic and international environments are intimately connected. Developing countries, for example, can mobilize domestic financing from national savings and taxes for development, but such an effort can be undone by capital flight and tax evasion if international cooperation is inadequate to monitor and reduce illegal activities.

It is therefore important for the discussions in Addis to result in an outcome that incorporates means of monitoring and accountability in building a global system conducive to financing development. Organized according to the six Monterrey leading action chapters, the following are some of the critical areas for which institutional progress is deemed essential in the global South.

Mobilizing domestic financial resources for development is the first. In this context, it is important to note that public domestic finance in developing countries more than doubled between 2002 and 2011, increasing from US\$ 838 billion to \$ 1.86 trillion. This bright spot in the FFD process must be strengthened with international cooperation. Among these desirable actions are two in particular.

One, upgrading international tax cooperation and multilateral efforts against capital flight and tax evasion. Institutional innovation, including moving more of ongoing efforts to the United Nations instead of relying so heavily on the OECD, can have a large impact not only for reasons of universality, equity, and transparency. The OECD, dominated by the countries of the large transnational corporations and financial companies, has found difficulty in arriving at simple and practical approaches to reporting and regulating financial movements and the treatment of transfer pricing.

Two, developing further domestic financial sectors in developing countries to help mobilize greater long-term finance is essential, which will require not only better domestic financial regulation and supervision and capital account management but also external support to make capital management tools effective in developing

countries. Such progress will be impossible without more effective financial regulation and supervision in developed countries and global financial centers, even if only to generate timely information for developing countries on assets and liabilities of their citizens abroad and their foreign investors.

Increased foreign direct investment and other private flows is the second area for consideration. Private sector investments in developing countries are dominated by a desire to diversify portfolio holdings. The effective regulation of portfolio flows of private investors, now constituting the major proportion of existing flows and a significant proportion of national financial sectors in many developing countries, is a priority going forward. The dominance of these kinds of flows that can be quickly reversed has encouraged beggar-thy-neighbor policies that foster short-term investment through deregulation and harmful tax competition. Important progress can be made in two areas: effective regulation of capital movements and portfolio flows to discourage short-term positions and to encourage greater inflow of long-term institutional investors; and the registration of all foreign investment and allowing only registered investments access to national investor protections. All foreign investors must recognize a host state's rights to protect the public interest.

International trade as an engine for development is the third area. Activities are mainly in the WTO's domain and in the proliferation of free trade agreements (FTAs). A recent development has been the process of negotiating major regional trade agreements with the United States at the center in the TransPacific Partnership and the TransAtlantic Trade and Investment Partnership. In general, less-than-universal trade agreements contain more stringent restrictions on national policies and undermine robust multilateralism. As explained above, increasing the availability of financing does not guarantee more fixed capital investment if undertaking such investment is unduly inhibited by international obligations either by rules themselves or by reduced expected private returns to investment; and many of these restrictions are in the trade regime.

Increasing international financial and technical cooperation for development is another promising area. This area mainly concerns Official Development Assistance (ODA). Since the 2002 International Conference on Financing for Development, net ODA flows from all OECD/DAC countries increased significantly, from \$84 billion in 2000 to \$134.8 billion in 2013.⁸

The Monterrey Consensus called for "[E]ffective partnerships among donors and recipients...based on the recognition of national leadership and ownership of development plans" (paragraph 40). This call was the basis of the aid effectiveness agenda launched in Paris in 2005, which led to important proposed disciplines on donors and mobilized political support for what became the Paris Principles.⁹ Progress toward the implementation of this agenda has slowed considerably, particularly after a failure to eliminate policy conditionality in 2008. The agenda has mutated into a largely successful effort to sustain ODA levels and a not fully successful effort to draw into the process those emerging economy countries that undertake development partnerships, such

as Brazil, China, and India. Reviving this effort will require a return to pursuing the basic principles associated with national leadership and ownership of development policy, and moving the effort back to the United Nations.

Progress is critical in three areas: first, in obtaining a recommitment by donor countries on achieving the 0.7 GNI target for ODA; second, in dealing with proposals from OECD-DAC to redefine the meaning and the measurement of development assistance to include using development assistance flows to mitigate the risk of private investment in developing countries; and third, in addressing whether and how South-South cooperation can be tabulated as part of ODA. Since the Group of 77's 2008 Yamassoukro Declaration, developing countries have taken the position that South-South development partnerships are conceptually different from the assistance of former colonial powers and other industrialized donors. OECD countries propose setting up common standards and reporting, which is only part of the solution.

Lessening the burden of external debt is the fifth area. Developing countries have experienced the largest development reversals during debt crises, including through the economic reform programs—under the auspices of the IMF and the World Bank and coordinated with donor countries—triggered by these episodes. The Addis conference will likely take place in the context of continuing commodity busts and debt-servicing difficulties.

Relevant here is the burgeoning global effort toward a multilateral legal framework for sovereign debt anchored in the General Assembly process based on the September 2014 resolution 68/304. The elements of a rules-based, comprehensive, and equitable debt resolution process are well known. What is controversial is which institutions will have a decisive role. The FfD process can be tasked to facilitate the process.

The sixth and final area consists of *enhancing the coherence and consistency of the international monetary, financial, and trading systems*. That developing countries, as a group, are net investors in developed countries reflects the open trapdoors in the global

financial system. The ongoing financial crisis originated in the developed countries but threatens to engulf developing countries in balance-of-payments crises. The Addis outcome must revive the effort at systemic reforms that animated the Monterrey Consensus. The FfD process should monitor progress. To make a contribution, the Addis conference must achieve at least three things.

One, progress is needed in international cooperative efforts to strengthen financial regulation and supervision of important financial companies. In 2009, UN Secretary-General Ban Ki-moon recognized that “in a financially integrated world with competing national financial centres in which financial companies can choose to locate specific activities in order to exploit regulatory advantage, these reforms will be successful only if coordinated internationally.”¹⁰ Developed countries, especially those with major financial centers, should take the lead in financial re-regulation.

Two, the conference should initiate a process of designing and agreeing to international disciplines on reserve-issuing countries, and facilitate efforts to steadily reduce the dependence of the global payments system on the US dollar. The IMF can issue new special drawing rights (SDRs) annually at a level consistent with the growth of world trade. The new issues can be allocated to members most in need of shoring up their reserves. Special temporary SDRs allocations can also be issued in time of global slowdowns.

Three, emerging and developing countries should seek comprehensive governance reform of the IMF. A process to review governance and accountability mechanisms in other development agencies should also be launched in Addis.

CONCLUSION

What is at stake for developing countries at the July meeting is not so much how much more financing can be made available, but rather the extent to which future financing flows are fit for the purpose of achieving the agreed goals of sustainable development. The revival of multilateral cooperation will be required to regulate volatile private capital flows, mobilize long- instead of short-term international financing, open greater public policy space for investment, and mitigate the scourge of sovereign debt crises.

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NOTES

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3. United Nations, *World Economic Situation and Prospects 2015* (New York: UN, 2015), 63-5.
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5. UN, *World Economic and Social Survey 2010: Retooling Global Development*, UN Sales No. E.10.II.C.1., Figure V.1, page 104.
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8. UN, *Follow-up to and Implementation of the Monterrey Consensus and Doha Declaration on Financing for Development: Report of the Secretary-General*, UN document A/69/358, 27 August 2014, para. 40.
9. OECD, *The Paris Principles for Aid Effectiveness* (Paris: OECD, 2005), <http://www.oecd.org/dac/effectiveness/34428351.pdf>.
10. UN, *Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus*, para. 53, <http://www.un.org/esa/ffd/doha/>.

