

**Interregional Conference on Financing for Development**  
**organized by the Regional Commissions of the United Nations**

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**Summary of Conclusions**

**I. Mobilization of domestic resources for development**

Domestic financial resources constitute the dominant source of resources for development for most economies. Their mobilization requires the strengthening of public and private sources of financing and the institutional structures that facilitate both the supply and demand for savings and investment.

The role of government is to create a conducive environment for saving by fostering financial innovation, strengthening the complementarities between different segments of the market, protecting the financial system from systemic risks and overcoming the barriers that exclude some groups from access to the financial system. Equally important are high standards of governance, property rights and an effective legal system that will support incentives both to save and to invest.

**1. Promoting domestic saving**

The fiscal budget and balance in most of the developing countries tend to be highly procyclical. This has two consequences. First, it tends to heighten the effects of external booms and busts instead of providing room for a countercyclical policy. As is well known, economic fluctuations have a very asymmetrical effect on different socioeconomic groups, with poor groups bearing the brunt of the costs of economic adjustment programmes. Second, stop-and-go cycles that affect the availability of resources reduce the efficiency of public-sector investment by interrupting a process which is long term by nature.

In the light of these considerations and of the essential role which public-sector investment plays in the development of economic and social infrastructure, efforts to strengthen a country's fiscal position should continue to be directed towards promoting efficient expenditure and a broad-based and equitable tax system that improves the efficiency of tax administration and compliance. In addition, mechanisms for stabilizing the supply of public resources for investment should be introduced, together with multi-annual budgeting processes and the creation of stabilization funds to build up surpluses during boom periods and disburse resources during recessions. These mechanisms also provide manoeuvring room for countercyclical stabilization policies

Corporate saving is also an essential source of financing for investment. Many countries have used tax incentives to promote this form of saving. Some experiences have been positive, but concerns have also been raised when loopholes have increased tax evasion and introduced a regressive bias in the tax structure. A particularly useful incentive that deserves attention is lower tax rates or special incentives to retain profits. A far stronger incentive, however, is the formation of a macroeconomic framework that is conducive to stability of investment incentives.

In addition to the basic prerequisite of a proper macroeconomic environment, steps need to be taken to create long-term financial instruments to match investment requirements. Such instruments need to be designed in such a way as to protect their value from inflationary erosion. Developing-country experience demonstrates, indeed, that the market, when left on its own, tends to remain focused in the short run.

Financial instruments which link savings mechanisms to access to housing credit and, more broadly, to asset creation can be an effective tool for enhancing resource mobilization among lower-income groups.

## **2. Investment financing**

More diverse and broad-based financial systems comprising banks (including specialized development banks), bond markets, capital markets, contractual savings institutions such as provident funds, pension funds and insurance companies, savings banks and credit unions are necessary to enhance resource mobilization. Governments should encourage the establishment of such institutions, with appropriate regulation and supervision, and promote their wider availability to investors.

The banking sector will remain the key intermediary in the mobilization and deployment of domestic resources and, therefore, the health of the banking system is central to financial-sector development efforts. The banking system in many countries is fragile, has a limited capital base and a high proportion of non-performing assets in bank portfolios, and is characterized by poor regulation and ineffective supervision.

Governments should take urgent steps, as appropriate, to restructure and modernize the banking system and facilitate the adoption of global standards. The implementation of the proposed revised core principles of banking supervision, which include new risk-adjusted capital adequacy ratios and loan-loss provisions, are critical elements, although their implementation has to be gradual and take into consideration the strength of the financial systems in different regions.

Considering the increasing demand for long-term capital for investment and the growth of institutional investors such as pension and provident funds and insurance schemes requiring long-term assets, the promotion of bond markets remains an important part of the financial-sector development agenda for most countries. These efforts should include the promotion of adequate disclosure and accounting standards, protection of minority shareholders and adoption of corporate governance standards comparable to those prevailing in industrial countries

The achievement of an active market in government securities should be the first step. Once a well-functioning government securities market has been established, efforts should be made to develop a corporate bond market to provide alternative forms of borrowing for firms. However, as has been demonstrated by the experiences of many developing countries at these stages, the effect upon the availability of funds may be limited if the public sector's demand for funds crowds the private sector out of the capital

market. Hence, adopting a sustainable path for public finances is also a requisite for increasing the availability of funds for investment.

One of the main obstacles that limits the banking system's involvement in investment financing continues to be the risks associated with long-term resource commitments. The absorption of long-term credit risk through the establishment of specialized entities, such as guarantee funds, is critical in order to overcome this obstacle. There is an important role for the public sector in promoting such institutions --with the active involvement of the private sector-- while taking special care to prevent their abuse due to moral hazard problems or considerations of political expediency.

### **3. The links between foreign direct investment and national development**

Attracting foreign direct investment (FDI) and maximizing its growth impact is an issue of considerable importance to most countries, as such investment may enhance their growth potential and the competitiveness of local enterprises. Inward FDI can have a direct impact on output and employment when the foreign affiliates (FAs) of multinational corporations (MNCs) invest in new capacity and/or improve the efficiency of existing operations. FDI can also result in indirect benefits through the creation of positive technology spillovers (externalities) in other parts of the economy. The promotion of these spillovers merit special attention by governments.

The benefits of FDI can be amplified within the host economy through at least three types of spillovers: *intrasectoral* (horizontal) spillovers, which result from the impact of the presence of FAs on the performance of local enterprises (LEs); *intersectoral* (vertical) spillovers, which are associated with the creation of backward and forward linkages between FAs and local enterprises; and *export* (market access) spillovers, which may occur if local firms learn how to export from MNCs. The promotion of industrial clusters may increase positive spillover effects.

Vertical linkages between MNCs and local firms can help to improve the economic performance of the host economy if the MNCs transfer technology, knowledge and skills to local suppliers and induce them to upgrade their products. Such linkages may occur spontaneously as a result of interactions between MNCs and local enterprises, but in general there is some scope for bringing together those enterprises that might not cooperate on their own initiative. The establishment of local linkage programmes may be useful in this regard, since they may facilitate the creation of coherent organizational and policy frameworks and help to ensure that FDI policies are consistent with national development strategies.

Key objectives of such programmes include the creation of databases for resident firms, the selection of the industries and enterprises with the greatest potential for linkage formation, and upgrading the capability and capacity of local enterprises to meet the needs of MNCs. Experiences with the promotion of linkages and linkage programmes might be a particularly fruitful area for an exchange of information between the regional commissions.

In general, the conditions for encouraging positive spillovers are the same as those for attracting FDI in the first place: a favourable investment climate; good infrastructure, particularly in transport and telecommunications; and an effective domestic institutional framework. Policies aiming at the creation of such conditions are considered preferable to specific measures such as the imposition of local content requirements.

Governments may also promote positive spillovers from FDI by increasing the absorptive capacity of the local economy. This can be accomplished by investing in human capital and pursuing appropriate policies towards science and technology. The creation of positive spillovers generally requires deliberate decisions on the part of local firms and the availability of various resources, including management input and financing. Since these may not always be available to local firms, especially SMEs, assistance may be required from MNCs (when the development of local suppliers is at stake) and/or from host governments.

However, FDI may have some negative effects if it simply displaces domestic competition. Hence, it may be useful to promote a comprehensive and neutral competition policy, one that creates a level playing field for all resident firms, both MNCs and local enterprises. More generally, governments should avoid incentive-based competition for FDI as well as policies that channel FDI into non-productive (speculative) purposes. MNCs that are oriented towards the domestic market may contribute to balance-of-payments difficulties, and this is another reason for promoting the development of local suppliers.

#### **4. Financing for small and medium-sized enterprises (SMEs)**

One of the main obstacles to the provision of financial resources to small and medium-sized enterprises is the difficulty of evaluating their creditworthiness, since they frequently lack the managerial abilities required to provide the necessary information and records (production plans, cash flows estimates, assessments of payment capacity and profitability, market prospects, etc). Hence, together with fund provision, a key factor in ensuring the success of lending to SMEs is to strengthen their management capacities through special public/private training programmes.

It is likely that traditional financial systems' bias towards urban and larger businesses will continue. Hence, public support is required for mechanisms to provide banking services to SMEs. Such mechanisms may involve special credit lines (provided at market conditions), guarantee funds in whose operation both SME organizations and banking associations take part, support for portions of the credit process having high externalities (i.e., generation of records to assess payment ability and tracking of business performance), etc.

Financial cooperatives are an important tool in promoting SMEs' and microenterprises' access to credit. Developed on a regional basis, they have a great potential to provide resources to the poor. However, their sustainability depends on appropriate lending practices, for which regulation and supervision are critical. Countries should take steps to establish an adequate regulatory and supervisory system for these institutions in order to ensure their continuity.

When subsidies are used to promote financing for SMEs, they must be appropriately targeted and transparently budgeted.

## **II. Issues in international financing**

### **1. HIPC**

The external debt burden is one of the key impediments to economic and social progress. The international community's efforts to resolve the problems posed by the external debt burden need to address some critical issues. Those relating to debt relief and proposals for resolving the problem which focus on the enhanced Heavily Indebted Poor Countries (HIPC) Initiative are considered highly important.

There is concern that the enhanced HIPC Initiative may not provide sufficient debt relief to enable low-income countries to attain sustainable external debt levels and thereby permanently eliminate their debt overhang. Scenarios for debt sustainability analysis are too optimistic and do not fully take into account other external shocks and uncertainties that many low-income countries face. The debt sustainability indicators used in the enhanced HIPC framework are inappropriate or, at the least, insufficient. The methodology for debt sustainability analyses should be determined on the basis of the resources required for poverty reduction.

Also, eligibility criteria provided for under the enhanced HIPC Initiative are too stringent and have resulted in the exclusion of countries whose economic and social conditions are very similar to those of the HIPC countries. Such countries should be considered under the HIPC Initiative.

There is a need to have binding arrangements for non-Paris Club creditors and especially for commercial creditors to ensure adherence to the Paris Club terms. This would greatly reduce the burden placed on HIPC countries that have to negotiate with them individually.

The distribution of the cost of the HIPC Initiative is highly inequitable. Several developing nations, including a number of poor countries, have borne a large share of the cost of the Initiative, either directly or indirectly (e.g., through higher spreads and the reduction of technical assistance funds from multilateral banks). These issues should be urgently addressed.

Debt relief should be used for poverty reduction, and the PRSP process should serve as a viable framework for delivering debt relief resources, provided that its current limitations are addressed. The institutional and administrative costs of debt relief and assistance delivery, monitoring and programme implementation should be minimized in order to ensure effective utilization of scarce human and financial resources in HIPC countries. The allocation of assistance should be integrated within the national strategic expenditure framework and budget execution cycle. Donor reporting and accountability systems should be integrated into a national system that has been developed on the basis

of agreed standards, and a mutually agreed system of financial monitoring should be put in place.

It is important to emphasize that debt relief should not be at the expense of additional ODA and should be linked to sound economic management and good governance.

## **2. The balance between debt workouts and emergency financing**

Debt overhangs are also a problem for middle-income countries with access to international markets but with large and unsustainable debts as well as high levels of poverty. In many cases, such debt burdens have originated in the high interest rates prevailing in both international markets and in the domestic markets of developing countries, as well as short debt liabilities issued as domestic debts but largely subscribed by international investors. The participation of these investors in domestic capital markets of developing countries imply that domestic and external liabilities should be added to assess debt sustainability.

There is thus a need for orderly debt workout procedures that address the interests of both creditors and debtors. An international institution that would assist in arranging such workouts --especially in situations where a country needs legal protection from uncooperative creditors-- would be most welcome.

Dealing with external crises requires the relevant parties to accomplish the difficult feat of distinguishing between countries' liquidity problems and problems of payment capacity (solvency), and of finding a rapid solution for liquidity problems when they arise. Debt workouts should not be seen as a substitute for emergency financing, but as a complement, which plays an essential role in managing solvency issues. Thus, such workouts do not eliminate the needs for adequate provision of liquidity during crises, which has increased due to the severity of global financial instability. The temporary issue of SDRs should become the major source of funds for IMF emergency financing. More broadly, SDRs should become again an active instrument of the international community.

The establishment of Contingency Credit Lines (CCLs) for coping with liquidity problems has not yielded the expected results. This is partly because it takes a considerable amount of time to qualify for this facility and partly because of the possible loss of confidence or stigmatization that may be associated with recourse to CCLs.

The IMF should work more closely with the multilateral development banks in designing more effective crisis-prevention instruments. They should play a more active role in monitoring developments in international financial markets, designing vulnerability indicators or early warning systems, monitoring domestic macroeconomic policies and developing programmes aimed at strengthening domestic financial sectors. The United Nations agencies should also play an active role in many of these areas.

In crisis situations, the renegotiation of the debt with the private sector should be carried out in the least traumatic way possible for the debtor country and the international community and should seek to achieve a fair distribution of the associated costs, since for every country suffering from a debt overhang, there is a corresponding voluntary over-exposure on the part of its creditors.

To forestall legal action that may hinder the solution of debt overhangs, any measures taken must be agreed to by creditors and/or must meet with the approval of the international community. International financial institutions should establish multilateral rules which, under crisis conditions, will provide for external debt standstills and should develop multilateral arbitration mechanisms that the relevant parties may use on a voluntary basis to settle disputes regarding refinancing or renegotiation processes.

The introduction of collective action clauses in debt instruments to facilitate renegotiations and permit the adoption of agreements when they meet with the approval of a majority of the creditors is of key importance. Such collective action clauses should be universal in order to avoid discrimination against developing countries in international capital markets. If debt standstills are declared, or if the threat of declaring one is used as a means of achieving the necessary coordination, information about the proposed debt restructuring and transparency in this regard will be required.

Debt workouts should provide for an appropriate mix of finance, adjustment and conditionality. Preference must clearly be given to voluntary arrangements, but it is necessary to create conditions that will pave the way for a rapid, appropriate solution for both creditors and borrowers. Early renegotiations appear to be preferable to automatic deferral clauses, which may sometimes simply postpone or aggravate the problem. Steps must be taken to bring about an orderly restructuring before reserves are depleted. Otherwise, countries will be pressured into accepting hurried, disadvantageous negotiations that are unlikely lead to a new, sustainable scenario, whereas the aim is to ensure that the new obligations will actually resolve the original problem and thus prevent its recurrence.

The standstill should cover all of the country's obligations, with priority being given to its sovereign debt; the sovereign debt and private-sector debt should be negotiated separately from one another.

Brady-type bonds could be used as appropriate restructuring instruments. Official development financing will be required during the period after renegotiations in which debtors will lack access to private capital markets. Alternatively, a debt guarantee fund managed by the World Bank and regional development banks could facilitate renewed access to private markets.

### **3. Official development assistance**

Very little progress with regard to official development assistance (ODA) for developing countries was seen during the 1990s. The long-run downward trend in both grants and concessional official loans persisted. According to OECD figures, in 2000 the average donor member country of the Development Assistance Committee (DAC)

provided aid (in the form of official development assistance) equal to about 0.22% of its GNP, which is lower than the 0.35% of this group's combined GNP reached in 1989-1992 and below the agreed goal of 0.7%.

There are many reasons for the poorer-than-expected performance of ODA, for which recipient and donor countries are both partially responsible. Some of these reasons are as follows:

- Insufficient governance, a lack of leadership and a low level of participation by social agents in the design of ODA-supported programmes;
- Frequent changes in the priorities of donors, which has generated programmatic instability;
- Excessive conditionality with respect to the use of ODA, which has resulted in insufficient ownership and underutilization of ODA funds.

A new consensus has recently been reached whereby donor countries will furnish resources on the understanding that recipient countries should expedite the design of the relevant programmes and will seek to increase their efficiency, transparency and accountability in the use of these resources.

Many of the poorest countries in the world have become highly dependent on aid for very large shares of their budgets and GNP. They cannot be quickly weaned from aid without being forced into economic distress. Consequently, an increase in ODA and in the efficiency of its use are required in order to satisfy the countries' growing needs.

The agreed goal of ODA amounting to 0.7% of the developed countries' GDP should be met, as should the 0.15%-0.20% of GDP that is to be allocated to the least developed countries. ODA flows should be predictable and stable in order to ensure that they will not have procyclical effects on low-income countries' economies.

The number of aid agencies has increased from about 7 in 1960 to some 50 in the 1990s in response to increased public accountability and delivery needs, but this has also resulted in administrative overload. Coordination among aid agencies remains an important challenge. The recipient countries should have a say in this.

Aid flows need to be redirected to those purposes where they can have the greatest impact on poverty, human welfare and good governance. They should also be directed to uses that boost productivity, since this is a key element in increasing growth.

Recipient countries need to demonstrate that resources are being adequately and effectively channeled towards poverty alleviation and promotion of good governance. This has to be done in the context of country-specific programmes designed to meet the country's needs while respecting its sovereign right to design its own policy measures, thus reinforcing policy ownership and enhancing effectiveness.

Humanitarian needs and the demand for global public goods are growing. New initiatives for covering them properly are urgently required. However, resources to guarantee an adequate provision of global public goods should be additional to ODA.

#### **4. Multilateral development finance**

During the early 1990s, multilateral lending to developing countries exhibited a slow and nearly uninterrupted tendency to decline. Later on, as a consequence of the crisis experienced by some Asian countries, there was an increase in loan flows to developing countries, particularly of non-concessional funds. By the end of the decade, multilateral lending, both concessional and non-concessional, was again declining.

Banks capable of channeling multilateral finance have an important role to play, especially when private capital financing is scarce. In this regard the potential role of multilateral banks as countercyclical sources of funds can be quite significant. The access of all low and middle income developing countries to multilateral development financing should thus remain a central rule of the international financial architecture. Within this context, “graduation” will be the result of stable access to private capital markets, rather than of explicit rules that may limit the access of some developing countries to multilateral resources.

Multilateral financing should be clearly oriented towards development needs, particularly towards sectors with high social returns which lack adequate private sector financing. In this regard, project financing should remain a central feature of multilateral development banks’ practices. These institutions can also promote access to international capital markets through cofinancing mechanisms or guarantees, and innovative investments in such sectors as water, transport infrastructure, energy, and financing to micro, small and medium-sized enterprises. Multilateral development financing should also be used to compensate, at least partially, for the reduction in private financing in times of crisis. A broader use of guarantees can facilitate renewed access to private markets after crises and to facilitate such access for countries that have lacked it in the past. Multilateral banks should assign appropriate priority to the provision of specialized technical assistance and to the adequate supply of global public goods, in close cooperation with United Nations agencies.

Conditionality attached to the financing of policy reforms by multilateral banks should respect the sovereign right of countries to design appropriate structural reform programmes. A precondition for the success of reforms and adjustment policies is for these efforts to be consistent with a strong domestic social policy framework which includes ambitious poverty eradication programmes. Those conditions are necessary in order to ensure ownership of these measures and thereby increase the likelihood that they will prove to be sustainable.

#### **5. Regional schemes**

There have been a number of interesting experiences involving regional and subregional institutions in the developing world. These initiatives need to be complementary rather than competitive with global institutions, such as the IMF in relation to the provision of liquidity, the World Bank in relation to financing for

development and the Bank for International Settlements in relation to regulation and supervision of the financial system. By playing a complementary role, they can give a regional dimension to global institutional arrangements.

Illustrative examples include the agreement reached by the ASEAN countries, China, Republic of Korea and Japan to establish swap arrangements among their central banks; ASEAN pilot macroeconomic surveillance and monitoring schemes; the Arab Monetary Fund's provision of liquidity for intraregional trade; the Latin American Reserve Fund (FLAR), which complements the IMF in providing liquidity financing during crises; the operations of subregional development banks such as the Andean Development Corporation (ADC); and the Arab Investment Guarantee Fund.

These experiences indicate that regional bodies can be very effective in providing liquidity, sustaining trade links and facilitating access to international financial resources through risk pooling. They can also contribute to macroeconomic policy coordination and peer review and to the adaptation of regulatory systems to regional conditions. The sense of ownership surrounding them contributes to efforts aimed at adapting stringent rules, promoting full disclosure, and undertaking joint monitoring and surveillance of regional financial markets, as well as encouraging regional arrangements for monetary, financial and fiscal coordination to support sound macroeconomic policies. Regional and subregional institutions should thus be actively promoted and recognized as central players in the international financial architecture.

Two such institutions deserve particular attention.

Regional reserve funds and swap arrangements can contribute to crisis prevention and resolution thanks to their ability to provide international liquidity. They can help improve access to credit (including contingency lines) from international markets, thereby improving crisis protection capabilities, modifying the expectations and confidence of international and national investors, and reducing contagion when economies come under stress.

Regional and subregional development banks can complement multilateral financing by providing and facilitating access to financial resources that support State reform and activities which yield high social returns and which the private sector is not prepared to finance. They can also play a countercyclical role in providing access to financial resources at times when international private capital becomes scarce. They can, in addition, promote better mechanisms to transfer the remittances from migrant workers and to encourage innovative mechanisms to productively use such funds in receiving countries and communities.

The experiences in this area are highly specific to each region but nonetheless serve as a basis for productive interregional exchanges of best practices.