

**IMMEDIATE
ATTENTION**

EB/CW/DC/01/3

August 29, 2001

To: Members of the Committee of the Whole
for the Development Committee

From: The Secretary

Subject: **Financing for Development**

The attached paper on financing for development, prepared jointly by the staffs of the Fund and the Bank, is being circulated for consideration by the members of the Committee on a lapse-of-time basis. The paper is intended to provide background for the discussion of this issue by the Development Committee. Section V of the paper, on “Integrating Developing Countries into the World Trade System—Through Capacity Building, Market Access, and a New Round of Trade Negotiations,” will also serve as background material for the Board discussion of trade issues on Tuesday, September 4, 2001.

It is not proposed to bring this paper to the Committee’s agenda unless a member of the Committee so requests by noon on Tuesday, September 11, 2001. In the absence of such a request and after the World Bank Committee of the Whole discussion on September 11, the intention is to post the paper on the Development Committee’s internal website. About one week before the Annual Meetings, the paper would be posted on the Development Committee’s external website.

Questions may be addressed to Ms. Happe (ext. 38675) and Mr. Dicks-Mireaux (ext. 35699)

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INTERNATIONAL MONETARY FUND

Financing for Development

Prepared by the Staffs of the World Bank and the IMF

August 29, 2001

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I. INTRODUCTION

1. A year ago, at the United Nations, more than 150 heads of state and government endorsed the Millennium Declaration in an effort to ensure that globalization brought opportunities and benefits to all countries. They emphasized the importance of focusing on poverty eradication as the central focus for development efforts and, *inter alia*, reaffirmed the important role of the International Financial Institutions (IFIs). The Declaration also gave new impetus to halving poverty by 2015 and to the other development goals that had emerged from UN Conferences and related discussions.

2. The UN Financing for Development (FfD) process revolves around the means to reach these goals (see Annex for background on the FfD process). The March 2002 FfD Conference in Monterrey, Mexico, provides a good opportunity to help mobilize the resources needed for this purpose, but the means are not only financial and FfD also emphasizes the central role played by domestic policies and by an international “enabling environment.”

3. This paper provides the background for the Development Committee discussion on FfD and then considers a core set of areas for action emerging from recent Development Committee discussions: operationalizing the development goals and ODA requirements to reach them; establishing a hospitable environment for private sector investment; integrating developing countries into the world trading system—through capacity building, market access and a new round of trade negotiations; encouraging harmonization of MDB and bilateral donor policies and procedures; and financing for global public goods.

A. Purpose of the Development Committee Discussion

4. The FfD process addresses the problems of development finance in a comprehensive way. To mobilize resources and put them to the best possible use demands policy coherence—both nationally and internationally. The UN is addressing the challenges and ambition of the FfD agenda with innovative approaches—including the close interaction with the Bank and the Fund.

5. FfD provides an excellent opportunity to work together toward furthering the partnership between the Bank, Fund and the UN with a view to, first, consolidate international cooperation to fight world poverty; and, second, to help build wider public constituency—especially in the donor countries—for necessary action on trade and aid. In the follow-up to the FfD Conference each institution will then play its appropriate role, as determined by their respective governing bodies.

6. The deliberations of the Development Committee in preparation for the Conference can make an important contribution to the FfD process. In this context, the conclusions of the Development Committee could help to:

- ◆ reinforce the growing consensus on the national and international preconditions for achieving growth and poverty reduction;
- ◆ create momentum in a number of key areas and on concrete and practical steps that, from the perspective of committee members, should emerge from the Conference;
- ◆ encourage a focus on realistic, non-duplicative ways of filling gaps in the international community's tool kit for development assistance; and
- ◆ mobilize support and resources for development assistance and global public goods.

7. With the Conference less than six months away, the FfD discussion is now focusing on issues that offer opportunities for concrete progress. A facilitator was mandated to produce a first draft of the FfD outcome document in advance of the October 15-19 meeting of the PrepCom.¹ On the basis of the facilitator's draft, the PrepCom meeting could play a critical role in consolidating the progress made so far in the FfD process and start shaping a fruitful outcome for the FfD Conference in March 2002.

8. Hence, the Development Committee discussion could contribute to such a positive momentum, consistent with the desire of the UN General Assembly to involve all relevant stakeholders, including the Bank and the Fund, in the FfD process.

II. FIVE THEMES FOR FfD—BUILDING ON SOUND POLICIES AND GOVERNANCE

9. This paper focuses on five major themes recently addressed by the Development Committee and the Bank and the Fund, which are particularly good candidates for priority attention at the FfD Conference: operationalizing the development goals and ODA requirements to reach them; establishing a hospitable environment for private sector investment; integrating developing countries into the world trading system—through capacity building, market access and a new round of trade negotiations; encouraging harmonization of MDB and bilateral donor policies and procedures; and financing for global public goods. These areas can provide a core set of objectives for agreements on international action in the FfD Conference. Progress in all of them would be a major achievement and would provide significant benefits to developing countries—provided that an adequate foundation exists on domestic policies and on governance.

10. In addition to these five themes the FfD agenda focuses as well on domestic resource mobilization and on systemic issues. While these topics are outside the coverage of this paper, ongoing Bank and Fund efforts on financial sector development, efficient mobilization and deployment of public resources towards the goal of poverty reduction, crisis prevention,

¹ The Facilitator's draft is expected to become available on September 17 and will be distributed in advance of the Development Committee meeting.

and the enhancement of the international financial architecture (including the development of standards and codes) are reported elsewhere and represent an important input into the FfD process.²

11. As the report of the UN Secretary General on FfD shows, the premise of sound policies and governance is crucial. For countries where this premise is not met, external assistance can have only a very limited effect. In countries implementing sound policies and pursuing good governance practices, however, external assistance can have a high pay-off. This will particularly be true where, through the Poverty Reduction Strategy Paper (PRSP), Comprehensive Development Framework (CDF) and similar frameworks, external support is well integrated into national programs and focused on the goal of achieving sustainable growth and poverty reduction.

Recommendations

- (1) FfD could reinforce the consensus on the importance of sound policies and governance as pre-requisites for the efficient mobilization and allocation of domestic resources, and as the foundation for effective external assistance.
- (2) FfD could consolidate the consensus on the principle that national ownership of development strategies with wide participation and a sharp focus on poverty reduction should be at the center of external assistance programs.

Implications

- *The Bank and the Fund should remain closely engaged in FfD to help ensure that the opportunity it offers for policy convergence among stakeholders and countries and for providing an impetus to broad-based support for development turns into a fruitful outcome.*
- *The Bank and the Fund should continue to engage with the UN Funds and Programs and other IFIs to help build national capacity to formulate national strategies for growth and poverty reduction, and support their implementation.*

² For example, see the Statement by the Managing Director of the IMF (April 20, 2001) and the Note from the President of the World Bank (April 27, 2001) to the Development Committee.

III. OPERATIONALIZING THE DEVELOPMENT GOALS AND ODA REQUIREMENTS

12. In 2000, the UN-sponsored Millennium Declaration consolidated and expanded the international development goals that had emerged from the UN Conferences of the 1990s and from discussions in bodies such as the Development Assistance Committee of the OECD. Inter-agency discussions, including the Bank and the Fund, to agree on a set of targets and indicators ensuing from this set of Development Goals (DGs) are well advanced. These targets and indicators would serve as the common basis for monitoring progress towards the DGs and as a means of strengthening accountability, both nationally and internationally. They would also provide a common foundation for the operationalization of the goals by all relevant institutions and for cooperation among the UN, IFIs, bilateral donors and other relevant institutions.

13. The DGs provide a formidable challenge to the international community. They embody a clear view that development and poverty reduction imply not only raising incomes but also improving education, health and the environment. Progress since 1990 has been too slow to achieve most of the goals. A stepped-up effort by developing countries, developed countries and multilateral institutions is required to have a real chance of meeting the 2015 goals.³ Nationally-owned Poverty Reduction Strategy Papers provide a good vehicle for formulating national priorities in line with the international goals and for serving as a strong basis for concerted action by IFIs and development agencies.

14. Progress in achieving the DGs is associated with the level and pace of development, the absence of war and civil conflict, the quality of policies, the effectiveness of governments in providing public services, and the availability of adequate external financial and technical assistance. But even at the same level of development, some countries have done better than others in progressing toward the goals. Policies are important determinants not only of economic growth but also of whether the poor share in the benefits of this growth. Countries with sound policies experienced faster increases in the income of the poor in the 1990s, as well as greater progress in reaching the human-development goals, such as raising primary school enrollments and lowering infant mortality.

15. The implications for aid effectiveness are clear. The highest payoff in terms of likely progress towards the goals is obtained when development assistance is disproportionately allocated to countries with good policies and large segments of the population in poverty. In countries with poor policies, however, even very large amounts of aid are likely to achieve only a limited and possibly short-lived impact on poverty. There is, thus, an inevitable tension between allocating aid to achieve the maximum global progress towards the goals and allocating aid so that each country or region has a chance of meeting the goals. Priority

³ In some cases progress is not fast enough while in others there has even been a deterioration (for instance, fourteen countries saw increases in child mortality between 1990 and 1999).

attention should be given to improving policies in countries where they are weak, so as to provide a resolution to this tension.

A. The Cost of Meeting the Development Goals

16. As the breadth of the FfD agenda indicates, reaching the DGs will require efforts on several fronts. For most low-income countries, however, two main factors are of prime importance in the medium term: a sound policy, incentive and governance framework; and external financing on highly concessional terms. The former—together with expanding market access—will provide the foundation for sustainable, pro-poor growth. The latter will help address financing bottlenecks and provide a multiplier effect for domestic efforts.

17. To illustrate the orders of magnitude of external funding required, it is useful to focus on the goal of halving poverty between 1990 and 2015. On the basis of a preliminary analysis by the World Bank, a group of developing countries can be identified that face an "uphill" struggle to reach the poverty goal and where aid would make a difference—provided there is a sound policy foundation. The remaining developing countries are mostly “on track” to reach the poverty goal or, as in the case of some middle-income countries, their ability to reach the poverty goal does not depend on ODA.

18. ***"Uphill" countries:*** About forty percent of developing countries are in this category (which largely overlaps with the IDA-only group, but also includes Pakistan, Nigeria and Zimbabwe), with total population of just over one billion and average per capita income below \$400. These countries receive currently just over one-quarter of ODA, or about \$15 billion in annual net flows. Given the key role of policies, "uphill" countries can be categorized into two sub-groups—according to their policy performance. The additional resources required to help each of these groups meet the poverty goal can be illustrated with the help of a simple model.⁴

19. “Uphill” countries with reasonably good policies and governance should be the prime recipients of aid. A preliminary classification suggests that 43 countries could fall in this category. These countries are currently receiving \$15 billion per year in ODA but to help them reach the goal, additional ODA flows of nearly \$40 billion per year are estimated to be required in the medium term. Hence, the major increase in aid levels required for these countries to reduce poverty in half should be a top FfD priority.

⁴ In the model, from which illustrative numbers are derived, ODA supplements domestic resources available for investment and thus raises the rate of growth. The impact on poverty is then calculated taking into account country- and region-specific information on the effect of growth on poverty reduction.

<i>Illustrative Funding Requirements to Halve Poverty (US\$ billions)</i>			
	Current Funding Levels (1999)	Additional Funding per Year to Halve Poverty by 2015	
		Current Policies	Improved Policies
43 “Uphill” Countries with Good Policies	15	39	39
22 “Uphill” Countries with Poor Policies	3	n/a	15
88 other Developing Countries	40	--	--
Total ODA	58	39	54

20. For the 22 “uphill” countries (again, on the basis of a preliminary classification) with poor policy performance, the clear lesson of experience is that only if policies improve can ODA make any difference. While large amounts of aid could generate growth in the short term, this would not be sustainable and is unlikely to make a dent in poverty levels. If policy performance in these countries remains unchanged, on this basis, current levels of aid (\$3 billion) should not increase and should continue to focus on humanitarian and emergency assistance. At the same time, every effort should be made to help these countries improve their policies and, then, to provide them with adequate ODA flows. To illustrate, if the policy performance of these countries improved quickly to the average levels of other low-income countries, additional ODA of about \$15 billion per year would be needed to help them reduce poverty in half by 2015.

21. The 88 remaining developing countries appear to be “on track” to halve poverty by 2015 or, as in the case of some middle-income countries, their ability to reach the poverty goal does not depend on ODA. Many of these countries do not receive ODA or do not significantly depend on it (their average per capita income is almost \$1,400). However, because they include some large low-income countries and they have a total population of nearly 4 billion, they account for two-thirds of ODA flows (close to \$40 billion per year, including technical assistance). For these countries it is important to maintain net ODA flows constant in real terms—provided that the countries also continue to improve policies and governance.

22. In sum, current levels of ODA (about \$58 billion per year) are insufficient to help poor countries meet the 2015 target of halving poverty. In addition, ODA flows should be better “aligned” with the challenge of achieving the DGs. To meet this challenge, it would be

necessary to significantly increase ODA levels and to focus all the additional resources on low-income countries that face difficulties in achieving the poverty goal in spite of their efforts on policies and governance. If the policy performance of countries that now have poor policies improves, it will be appropriate to nearly double ODA flows to help low-income countries reach the 2015 poverty goal.

23. Given that the problems faced by most low-income countries will present a challenge for many years to come, it is important not only to ensure that they receive adequate ODA flows in the medium term but also that ODA has an appropriate level of concessionality. Flexibility in terms of ODA delivery is important as well—while ensuring that donor programs have a clear focus on poverty reduction. The implications will be different for different countries on the most desirable form of aid, depending on their needs and on the soundness of their policies and governance. Finally, for some aid recipients, it may be appropriate to deliver some of the additional ODA in the form of debt relief. Under the HIPC Initiative, additional assistance is being provided already to 23 countries that have reached their decision points and have been granted debt relief amounting to a total of \$34 billion in nominal terms.⁵

24. The above calculations have focused on the goal of halving income poverty. The DGs also place education, health and the environment at center stage, as key elements of development and improvements in these areas will also raise incomes over the long term. Many countries will require financial assistance to reach these goals. Some of these funding needs are the same as those required to halve poverty but some will require dedicated funding, such as for addressing communicable diseases or to promote “Education for All.”

25. Additional work and continued close collaboration among multilateral institutions will be needed for more reliable estimates to emerge. But it is clear that the additional resource implications of reaching the DGs is considerable. Preliminary estimates, for instance, suggest that at least \$13 billion per year would be required to achieve the education targets (universal primary education and gender equality) and in excess of \$10 billion per year for addressing communicable diseases.

26. This analysis has emphasized that good policies can make achieving the goals much less costly. Good policies require serious analysis for their formulation and support for their implementation—including capacity building. This should be a major focus of international institutions working in partnerships in the context of PRSPs. The stronger the policies, the more achievable the DGs.

⁵ See joint Bank-Fund paper on the HIPC Initiative: Status of Implementation (forthcoming, 2001).

27. Similarly, the relaxation of trade barriers by rich countries reduces the amount of aid required to reach the DGs. Thus, whilst reaching the DGs might require a doubling or tripling of ODA, this need would be reduced substantially with stronger efforts to dismantle trade barriers.

Recommendations

- (3) FfD could further promote the Development Goals as a focal point for development efforts and encourage all relevant institutions to intensify efforts to adopt a common set of specific targets to monitor progress toward the DGs, as well as on the required donor funding, and use them as a basis for their operational strategies.
- (4) FfD provides a unique opportunity to seek commitments for a doubling of ODA and for other official assistance required for all developing countries to reach the DGs—with the additional resources to be allocated to fund the needs of low-income countries that have sound policies and governance.
- (5) FfD could also emphasize the importance of concessionality in ODA flows—ensuring grant elements in any financing to low-income countries of at least 50%—and the need for a flexible mix of instruments to deliver ODA (including debt relief) so as to respond appropriately to the needs of each country.

Implications

- *The Bank and the Fund should continue to support efforts to promote the attainment of the DGs and help low-income countries to integrate them fully into their PRSPs.*
- *The Bank and the Fund should continue to support inter-agency efforts to identify and monitor a manageable set of targets and indicators as well as the related funding requirements.*
- *The Bank, in particular, should intensify its efforts to help countries identify resource and other requirements to reach the education, health and environmental goals.*

IV. ESTABLISHING A STRONG PRIVATE SECTOR DEVELOPMENT ENVIRONMENT FOR POVERTY REDUCTION

28. As emphasized in various Development Committee communiqués, the availability of substantial private sector flows—both domestic and external—is a crucial ingredient in financing development. Sustainable development depends to a large extent on private initiative: the initiative of households to expand production, educate their children, and participate in the labor market; and the initiative of entrepreneurs and farmers to invest and produce.

29. A well-functioning private sector and sound markets help society invest its scarce resources efficiently and create productive employment. This is needed not just for growth but is also an integral part of poverty reduction strategies. Poor people will find routes out of poverty from the expansion of activities in farms and enterprises—particularly in rural areas. Further, competitive markets also provide poor consumers with greater choice and better prices.

30. Critical to successful private sector-led growth is the climate for investment, which largely determines the opportunities for entrepreneurship and the extent to which financial resources are mobilized and the dynamic efficiency with which they are allocated. A thriving private sector is also a crucial component of the capacity developing countries need to realize the potential gains from expanding market access in developed country markets for their goods and services.

31. "Investment climate" refers to the conditions and incentives, both present and expected, for these investment decisions, and in particular the nature and functioning of public institutions, the judicial system, the banking system, macroeconomic policies, and policies that affect the associated returns and risks. The key is to achieve a balance between the freedom of action required to unleash entrepreneurial creativity and the guidance and safeguards required to ensure that growth helps reduce poverty and achieves other social goals.

32. Where the investment climate is not hospitable to private activity, improving it must be a priority (for national governments and donors alike). This will raise productivity and generate opportunities throughout the economy, particularly for the small businesses and farms vital to the incomes of poor people. Further, without such improvements the impact of donor resources and of foreign capital flows will be sharply reduced. But where the policy environment is sound and corporate governance adequate, organizations like IFC and MIGA can play an important catalytic role, by signaling to institutional and individual investors the soundness of the investment climate, and more specifically, by leveraging private investments through co-financing and guarantees.

33. Efforts to systematically analyze and assess investment climates are important to help countries improve their ability to attract efficient investment, both domestic and foreign, that produces jobs, raises incomes and reduces poverty. Particularly useful is information that highlights any special problems faced by small- and medium-size enterprises—which suffer most when the investment climate is hostile—and by foreign investors—whose location decisions may be most influenced by perceptions of the investment climate. Assessments of the investment climate can also provide the basis for focused discussions between governments and private investors on reform priorities, and for donors to coordinate with national policymakers and civil society to support an integrated reform strategy.

34. Improving the investment climate and promoting a private sector that contributes to equitable growth is an appropriate and effective use of ODA and other official financing to

fight poverty. Similarly, engaging the private sector in service delivery (including aid-funded services) can be an effective means of pursuing the poverty reduction goal in some circumstances. In this context, two basic principles should guide donor involvement: performance risk in service provision should be transferred—when possible and economic—to the private sector; and any subsidies that may be channeled through the private sector should be sharply targeted to benefit the poor.

Recommendations

- (6) FfD could emphasize the importance of the investment climate to generate both domestic and foreign investment that contributes to development. In many countries this requires major reforms of the policy and regulatory framework.
- (7) To facilitate efforts in this area, FfD could encourage work by the UN system and others to assess the quality of national investment climates, including through comparable indicators, and disseminate information on them.
- (8) FfD could also emphasize the role of external assistance to attract foreign direct investment to developing countries that are improving their investment climates. This could include facilitating private investment into low-income countries by developed countries and using aid resources to pave the way for unsubsidized private activity.

Implications

- *The Bank and the Fund should support efforts to enhance investment climates and the availability of information on them.*
- *The Bank Group should also ensure that countries with sound investment climates are priority recipients of financial assistance—including guarantees and technical assistance to attract private investment—while offering all countries assistance to improve their investment climates.*

V. INTEGRATING DEVELOPING COUNTRIES INTO THE WORLD TRADING SYSTEM— THROUGH CAPACITY BUILDING, MARKET ACCESS AND A NEW ROUND OF TRADE NEGOTIATIONS

35. Trade is a vital engine for growth and poverty reduction and, hence, a key component of the FfD agenda. Developing countries that have intensified their links with the global economy through trade and investment have tended to grow more rapidly over a sustained period and have experienced larger reductions in poverty than other developing countries. Unfortunately, many countries, particularly low-income countries, have not shared in the benefits of globalization and still lag both in trade growth and in policies and institutions conducive to the integration process. Expanding market access for developing country exports is a clear priority and must be complemented by a concerted effort to ensure that all countries are in a position to benefit from increasing trade liberalization.

A. Market Access

36. Tariff and non-tariff barriers imposed by rich countries, together with the agricultural subsidies that they give to their farmers, cost developing countries much more than the \$58 billion that they currently receive in foreign aid every year. Developing countries also impose costly barriers to trade among themselves.

37. Improving market access for all developing countries should be an integral part of the international community's efforts to help achieve the DGs. Expanding market access for manufacture, agriculture and services trade would generate large income gains in developing and developed countries alike. Such gains would be greatest if barriers to trade in developing countries were also reduced. This suggests the need for broad-based reciprocal liberalization of barriers to trade in goods and services that can only be achieved through a new WTO trade liberalization round. Indeed, for the key trade issues facing developing countries there is no substitute for a new trade round with an appropriate focus on development.

38. Tariff peaks—rates above 15 percent—are often concentrated in products that are of export interest to developing countries. Two sectors that matter most from a developing country export perspective are textiles and clothing and agriculture. Although textile quotas will be abolished by 2005, tariff barriers in this sector remain high. High tariffs for agricultural commodities and continued subsidization of agriculture in many OECD countries also have detrimental effects on agricultural exporters and world commodity prices. In addition to labor-intensive manufacturing and agriculture, barriers to trade and investment in services remain high—including through the temporary movement of service suppliers. These barriers, which impede service exports and reduce the competitiveness of developing countries, should be high on the market access agenda.

39. Gains from reciprocal market access achieved through a new trade round will take time. Given the urgent needs of most low-income countries, a good case can be made for OECD countries to front-load the benefits of trade liberalization for the poorest countries by providing immediate duty- and quota-free access.

B. Realizing the Gains from Expanding Market Access

40. Four major issues are key to the ability of many developing countries to benefit from market access opportunities:

- ◆ National commitment to, and external support for, improvements in the investment climate (including macroeconomic stability and sound governance).
- ◆ Assistance to low-income countries to integrate trade into national development strategies—as already being provided on a pilot basis under the auspices of the Integrated Framework. If proven useful, such assistance should be extended to all low-income countries engaged in the PRSP process.

- ◆ Initiatives to address specific issues of common concern to all developing countries, including middle-income economies. Examples include product standardization, trade facilitation, intellectual property, and service sector regulation. The needs in these ‘behind the border’ areas are great. Efforts to strengthen trade-related private and public institutions in these areas are necessary to enable a coherent approach to developing country policy reforms, negotiated WTO agreements, and the assistance provided by the development community to be ‘coherent.’
- ◆ Sustained technical assistance to help developing countries to participate effectively in multilateral trade negotiations. Though there may be as many as 100 countries requiring assistance (including LDCs), synergies could be realized through networking and collaboration between advisors. For example, the new Global Development Gateway that is being established by the World Bank in cooperation with several public and private sector partners could provide a potentially powerful vehicle for building a trade experts’ community and for sharing expertise.

41. Finally, in moving towards a new trade round, consideration must be given to the burden on many countries of implementing certain WTO agreements—not so much because of the rules themselves, but because of the ancillary investments that are required. Assessing the impacts of agreements *ex ante*, including a costing out of necessary ancillary reforms and investments and mobilizing financial assistance to meet these costs must be an integral part of this effort—and a priority for FfD.

Recommendations

- (9) FfD could re-emphasize the constraints that trade barriers and subsidies impose on developing countries, and contribute to the momentum towards a new, development-oriented WTO trade round.
- (10) Duty- and quota-free access to OECD markets for the exports of the poorest countries could be promoted by FfD as an important element in poverty reduction, and as an interim step toward ensuring that all developing countries share in the benefits of globalization.
- (11) Enhancing the supply response of developing countries to market opportunities is a key area worthy of FfD emphasis. Developing countries need to focus on “behind the border” reforms, and adequate external assistance should be made available to support their efforts. Similarly, MDBs and donors should make sure that resources are available to respond to the requests from developing countries for assistance in building capacity for trade negotiations.

Implications

- *The Bank and the Fund should continue to work in partnership with other agencies to implement the Integrated Framework and should propose avenues for extending similar assistance to other countries that require it.*
- *The Bank, in particular, should continue expeditiously with its work program on “Leveraging Trade for Development” to help developing countries realize the potential gains offered by market opportunities.*

VI. ENCOURAGING HARMONIZATION OF MULTILATERAL AND BILATERAL DONOR POLICIES AND PROCEDURES

42. While it remains essential to increase the volume of resources available for development, it is equally important that the most efficient use of these limited resources—including through better donor coordination and transparency—be made in order to maximize their development impact. This is particularly true for poorer countries which are dependent on ODA and have limited public sector capacity and weak operating policy and procedural frameworks. Moreover, they deal with multiple donors each with differing operating requirements which impose major administrative burdens on them. Harmonizing individual operational policies, procedures, and practices will be a crucial complement to other forms of aid coordination. It will lower the transaction costs of development assistance and will allow recipient countries to better manage aid programs.

43. Following calls for harmonization from the Development Committee, the G7 Ministers of Finance, recipient countries through discussions of PRSPs, and others, a consensus has emerged on a program of concrete actions and on a framework to implement it. On the multilateral front, the Development Committee concluded in April 2001 that the priority areas for attention were procurement, financial management, and environmental assessments. Since then a time-bound work program for three MDB working groups examining financial management, procurement, and environmental assessments has been prepared, in addition to proposals for changing World Bank procedures and practices to facilitate harmonization.⁶

44. Meanwhile, on the bilateral front, the OECD-DAC established a Task Force in January 2001 whose two-year mandate focuses on producing good practice reference papers in the areas of financial management and accountability, the pre-implementation stages of the project cycle, and reporting and monitoring. The work program on each of these areas involves activity at both the institutional and country levels. The first stage has taken place at

⁶ Harmonization of Policies, Procedures and Practices: First Progress Report to the Development Committee (September, 2001).

the institutional level, as donor agencies have taken stock and identified key differences in need of harmonization. The second stage is focusing on deliverables and action, and much of this action has involved working toward agreements on standards or good practice principles in identified priority areas. This is a critical and difficult challenge, and it will take time for consensus on technically complex and institutionally sensitive issues to emerge.

45. Meanwhile, at the country level, the challenge is to develop standards or good practice principles that developing countries can pursue as they build their own capacity and systems and that donors can rely upon. Donors and developing countries have also begun to look at the interaction of donor and recipient systems. To this end, much action has focused on mainstreaming donor collaboration in country diagnostic work on financial management and procurement. As work proceeds, among the key challenges going forward will be the need for donors and recipients to identify opportunities to implement harmonization pilots at the country level. Coordination and consolidation of the numerous initiatives (including bilaterals, IFIs and UN Funds and Programs) is critical to ensure consistency and efficiency in the overall result.

Recommendations

- (12) FfD could urge all donors and international institutions to place the goal of aid effectiveness above their immediate procedural concerns and to collaborate closely to lessen the burden on recipients and reduce the transaction costs of aid delivery.
- (13) FfD could urge development agencies to accelerate the harmonization of their operational policies, procedures, and practices focusing on financial management, procurement, and environmental assessment systems as initial priorities.
- (14) FfD could urge recipient countries and donors to join forces to build capacity and systems that recipient countries can administer and donors can rely upon.

Implications

- *The Bank should continue to support international efforts on harmonization and ensure that its own procedures evolve in parallel with such efforts.*
- *The Bank should stand ready to provide support and promote partnerships to help developing countries build capacity on operational policies and procedures at appropriately high standards.*

VII. FINANCING FOR GLOBAL PUBLIC GOODS

46. An important part of the Bank and the Fund's agenda is to use global collective action to make globalization more inclusive—bringing the interests of developing countries and their peoples more centrally into the evolution of the global economy. The Development Committee welcomed at its last meeting the Bank's progress in supporting global public

goods (GPG) in areas it had previously endorsed (i.e., communicable disease, trade integration, financial stability, knowledge and environmental commons).

47. The GPG dimension is a rapidly growing feature of the development challenge. The issue of additionality of resources must be examined carefully in light of this. Moreover, given the scarcity of resources available for all development activities, it is important to maintain a rigorous approach to the definition of GPGs lest the concept lose meaning and gradually become a synonym for development itself.

48. Additionality is important where the benefits go mainly to developing countries but are not confined by country borders; and the case for new financing rather than diversion of scarce development assistance is particularly strong where global programs confer evident (and sometimes preponderant) benefits on industrial countries. Ensuring full participation by all affected countries is also critically important—to avoid GPG activities becoming top down international initiatives driven from outside of developing countries.

49. Different types of approaches can be employed to generate the required resources without crowding out traditional funding for national development programs. They all involve attempts to expand the base for resource mobilization—such as through partnerships, value creation, or efforts to generate international public revenue. The mobilization of additional official and philanthropic resources in developed countries and the creation of markets and other public-private partnerships offer promise in specific areas of global action. Long-standing proposals for global taxes and fees are unlikely to be a significant source of financing in the medium term.

50. To achieve progress pragmatically on GPG financing in the short- and medium-terms, five objectives are of particular importance:

- ◆ developing analytically-based and realistic estimates of medium-term financing requirements for each GPG priority area to provide a better basis for discussing funding options (and the additionality required, as determined by the mix of national and externality benefits);
- ◆ mapping of resources and financing mechanisms to ensure better and more flexible use of existing resources and their matching to urgent needs while avoiding costly rigidities;
- ◆ ensuring that existing funding mechanisms have the financial robustness and flexibility to deal with GPG funding needs appropriate to their basic mission, while continuing to seek additional resources (e.g., additionality for specific GPG purposes could come from increased concessionality in MDB windows along with a commitment by donors to fill the resulting financing gap later on—as donors are discussing with IDA13 grants);
- ◆ finding the right balance between developing specific mechanisms to fund and coordinate different types of GPGs and the inefficiencies of having many separate funds and separate initiatives for global public goods pursuits; and

- ◆ broadening the potential role of markets and the private sector in addressing GPG needs by changing incentives and correcting market failures to encourage private sector participation.

Recommendations

- (15) FfD could provide a vehicle for identifying GPG priority actions for which a concerted effort of coordination and resource mobilization needs to be undertaken—as intended with recent initiatives on health/AIDS. The key is to focus on specific priority activities while consolidating initiatives to achieve efficient use of resources and assigning clear institutional responsibilities.
- (16) FfD could usefully stress the complementarity of national and international components in the pursuit of GPGs, to help ensure that GPG activities are anchored in national as well as global strategies. In some cases this requires ensuring additionality in the funding, while in others (such as with concessional financing by MDBs) it calls for flexibility and financial reinforcement of existing mechanisms—to help countries to own and implement GPG-related national programs.

Implications

- *The Bank should continue to participate in partnerships, including with the private sector, to identify priority needs and innovative mechanisms for GPG provision.*
- *The Bank should continue to be ready to lead and cooperate, as appropriate, in GPG-related activities in its five areas of priority.*
- *The Bank should explore with donors IDA's role in expanding the supply of GPGs, including greater flexibility in its financing instruments.*

BACKGROUND: THE FfD PROCESS

A Working Group established by the General Assembly of the UN to explore FfD issues presented its report in 1999 and recommended that a high-level intergovernmental event be convened to address national, international, and systemic issues relating to FfD in light of globalization and growing interdependence. In particular, the Working Group recommended addressing the mobilization of financial resources for the full implementation of the outcome of major UN conferences and summits of the 1990s, as well as for poverty eradication. Finally, it recommended that both the preparatory process and the event itself should involve all relevant stakeholders and have as active partners the International Monetary Fund, the World Bank, and the World Trade Organization.

A Coordinating Secretariat for FfD was subsequently established in the UN's Department of Economic and Social Affairs. It undertook to coordinate an inter-agency task force on the agenda agreed at the PrepCom in June 2000: (i) domestic resource mobilization; (ii) trade; (iii) private flows; (iv) ODA; (v) debt; and (vi) systemic issues. This work led to a report by the Secretary General which has provided the basis for discussion by substantive sessions of the PrepCom in February and May, 2001.

The Bank and the Fund have been involved throughout the FfD process. Bank and Fund staff have participated in the work of the FfD secretariat and, in particular, contributed many inputs to the report of the UN Secretary General on FfD. They also participated in the regional consultations organized by each of the five UN Regional Commissions, as well as in other official and unofficial events, including sessions with the business community and with NGOs.

In addition, Bank and Fund staff and management have participated actively in PrepCom discussions, have had numerous informal exchanges with UN delegations, and have also briefed and supported the work of the panel, chaired by former Mexican President Ernesto Zedillo, that was convened by the UN Secretary General (the Panel issued a report at the end of June 2001 which provides a useful input into the FfD process). To add a further level of engagement in the process, Bank and Fund Executive Directors had separate, back-to-back meetings with the UN Bureau of the FfD PrepCom in February 2001. Bank Executive Directors also met with the FfD Bureau in March, 2000.

The Secretary General's report, the PrepCom discussions to date, and the report of the Zedillo Panel have all provided a solid foundation on the basis of which FfD can consolidate policy convergence and identify a few key priorities for consensus on international action. These could become the key potential components of the outcome of the FfD Conference in Monterrey (Mexico)—that is expected to consist of a ministerial segment (March 18-20), with extensive participation of NGO and business representatives, and a "summit-level" segment (March 20-22). Following the October 15-19 PrepCom meeting, only one more PrepCom meeting is planned, for January 14-25, 2002.