Chapter III
Financing for development

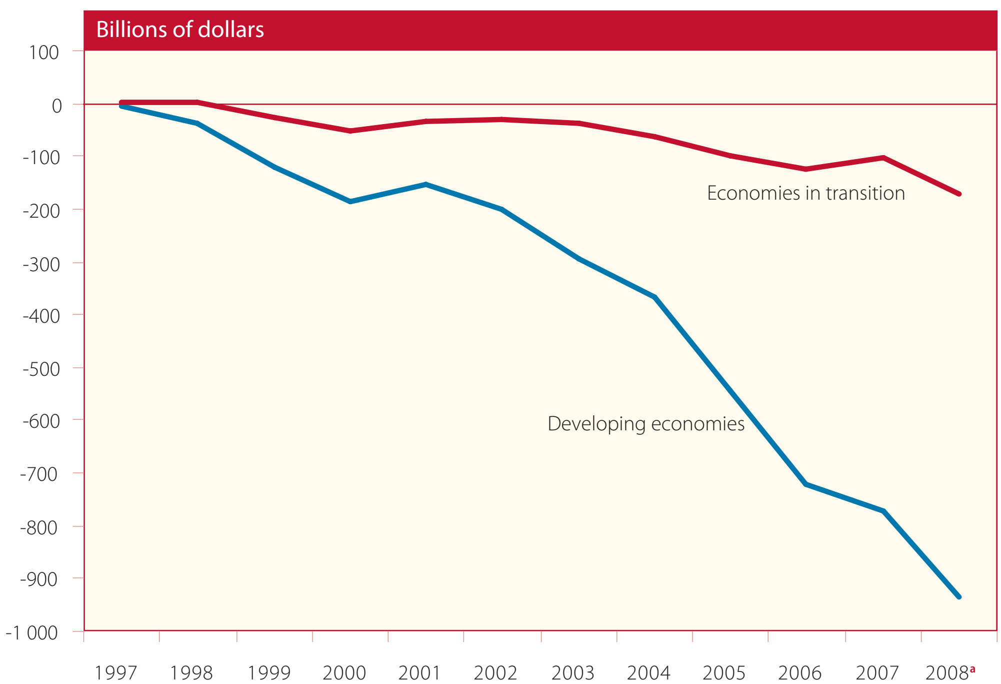
Net resource flows from poor to rich countries

Net resource outflows from poor to rich developing countries reached an all-time high in 2008

Amidst the unfolding global financial crisis, developing countries continued to make increasing substantial net outward transfers of financial resources to developed countries, reaching an all-time high of $933 billion in 2008 (see figure III.1 and table III.1). After a moderation in the rate of increase in 2007, outward transfers increased more rapidly again in 2008. Net financial transfers are defined as net financial inflows less net factor and investment income payments to abroad which have become increasingly negative, implying resource flow out of developing economies. This trend has been continuing for over a decade.

Much of the increase in the outflow during 2008 was concentrated in Western Asia and Africa, as the economies in these regions generated increasing trade surpluses, largely owing to the surge in oil and commodity prices in the first half of the year. As capital inflows also remained relatively strong up until the third quarter of the year, these regions were able to further increase international reserve positions in the aggregate. Net transfers from countries with economies in transition also increased, from $101 billion in 2007 to $171 billion in 2008, owing mainly to the strong increase in the trade surplus of the Russian Federation. In contrast, in Latin America and the Caribbean and East and South Asia, net outward transfers declined in 2008 as a consequence of the financial turmoil, leading to a significant reduction in private capital flows from the third quarter of the year onwards.

Figure III.1
Net financial transfers to developing countries and economies in transition, 1997-2008



Source: Table III.1.

Note: Net financial transfers are defined as net capital inflows less net interest and other investment income payments abroad.

a Partly estimated.

Table III.1
Net transfer of financial resources to developing economies and economies in transition, 1996-2008

Billions of dollars

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008[a]
Developing economies	**20.6**	**-4.1**	**-37.6**	**-118.9**	**-185.4**	**-154.5**	**-200.3**	**-295.8**	**-365.4**	**-545.4**	**-720.8**	**-773.3**	**-933.4**
Africa	-8.4	-7.0	13.0	2.5	-31.4	-16.6	-5.1	-19.6	-36.4	-64.7	-78.8	-67.0	-125.9
Sub-Saharan Africa (excluding Nigeria and South Africa)	5.2	7.0	11.9	9.1	3.0	7.2	4.5	5.8	2.5	0.3	-8.4	-6.0	-28.6
East and South Asia	18.9	-31.1	-128.0	-137.2	-119.8	-116.5	-145.0	-170.4	-177.7	-254.7	-375.2	-485.9	-431.9
Western Asia	10.6	11.5	34.2	6.7	-31.4	-24.4	-19.7	-44.0	-70.7	-136.7	-158.0	-144.9	-315.6
Latin America and the Caribbean	-0.5	22.4	43.1	9.1	-2.8	3.0	-30.4	-61.8	-80.6	-89.4	-108.8	-75.5	-60.0
Economies in transition	**-8.7**	**1.6**	**0.7**	**-25.1**	**-51.5**	**-33.2**	**-28.6**	**-39.2**	**-63.3**	**-100.7**	**-124.6**	**-101.1**	**-171.2**
Memorandum item:													
Heavily indebted poor countries (HIPCs)	6.7	7.1	8.5	10.5	8.2	8.9	12.4	10.1	12.8	14.4	12.8	21.6	26.1
Least developed countries	11.5	10.1	13.5	11.5	6.6	9.7	9.6	8.9	8.1	3.3	-5.4	-4.3	-22.3

Sources: UN/DESA, based on IMF, World Economic Outlook Database, October 2008; and IMF, Balance of Payments Statistics.
Note: The developing countries' category does not include economies in transition; hence, data in this table may differ from those reported for country groupings reported in the IMF sources.
a Partly estimated.

The unwinding of imbalances will affect net flows of financial resources

The effects of the financial turmoil are expected to be felt even more strongly and more widely in 2009, not only through withdrawals of capital from emerging markets, but also through a significant slowing of export prospects as the global economy decelerates. Countries will face lower external surpluses in some cases or wider external deficits in others and will increasingly draw on international reserves. The emerging markets will be hit most directly through financial channels, propelled by declining investor sentiment, which has already led to an unwinding of carry trades. The sell-off in high-yielding currencies and emerging market equities is evidence not only of a broad-based risk aversion among investors but also of weakening growth prospects in the emerging economies. Low-income countries will feel the consequences of the crisis more significantly through trade channels. How strongly this will influence the pattern of net financial transfers will depend on the prospects for private capital flows, official development assistance (ODA) and debt relief, as discussed in the following sections.

Private capital flows to developing countries

Developing countries continued to attract private capital flows until the second quarter of 2008

Developing countries have been attracting high and growing levels of private capital flows (see table III.2) since 2002, and this trend continued until the end of the second quarter of 2008. With the exception of net portfolio investments, all components registered significant gains.

Given the significant change in financial conditions facing developing countries since the beginning of the third quarter of 2008, the ability of a number of them to raise capital has become severely compromised. The current financial turmoil is unlike any other in over three decades. In distinct contrast to the Latin American debt crises of the 1980s and the East Asian financial crises in the late 1990s, financial distress has been

Table III.2
Net financial flows to developing countries and economies in transition, 1995-2009

Billions of dollars	Average annual flow						
	1995-1998	*1999-2004*	*2005*	*2006*	*2007*	*2008*[a]	*2009*[b]
Developing Countries							
Net private capital flows	148.3	79.6	141.7	86.0	379.1	391.1	135.3
Net direct investment	113.0	145.8	207.6	179.7	298.4	350.6	312.7
Net portfolio investment[c]	51.5	-20.3	-23.6	-122.6	47.4	-11.9	-100.7
Other net investment[d]	-16.1	-45.9	-42.2	29.1	33.5	52.6	-76.4
Net official flows	10.7	-15.4	-87.4	-125.1	-133.5	-149.1	-129.5
Total net flows	159.0	64.1	54.3	-39.1	245.7	242.0	5.7
Change in reserves[e]	-70.4	-206.0	-490.6	-609.1	-1054.3	-1123.7	-809.4
Africa							
Net private capital flows	7.5	5.4	29.2	36.8	42.6	52.3	70.0
Net direct investment	5.1	16.7	29.1	29.2	43.9	45.9	47.2
Net portfolio investment[c]	4.7	0.0	4.6	18.6	15.0	5.1	9.5
Other net investment[d]	-2.3	-11.3	-4.5	-10.9	-16.1	1.6	13.5
Net official flows	2.3	0.6	-6.1	-17.8	-2.1	5.0	2.6
Total net flows	9.8	6.1	23.2	19.0	40.5	57.4	72.6
Change in reserves[e]	-7.0	-14.9	-63.2	-76.8	-85.9	-145.1	-116.3
East and South Asia							
Net private capital flows	54.5	45.5	90.8	43.8	155.5	277.6	8.6
Net direct investment	55.8	64.1	105.0	96.2	159.7	223.9	180.5
Net portfolio investment[c]	17.8	-2.3	-9.3	-110.7	13.9	-25.3	-108.4
Other net investment[d]	-19.1	-16.3	-4.9	58.3	-18.1	79.1	-63.5
Net official flows	1.5	-6.7	-20.9	-21.8	-37.4	-10.2	-19.4
Total net flows	55.9	38.8	69.8	22.0	118.1	267.4	-10.8
Change in reserves[e]	-44.9	-165.7	-301.8	-386.9	-684.0	-780.7	-562.1
Western Asia							
Net private capital flows	18.4	-3.4	-16.4	-4.1	83.6	-32.0	-24.2
Net direct investment	6.1	7.7	21.2	26.9	15.3	7.1	14.2
Net portfolio investment[c]	2.2	-10.3	-24.1	-17.1	-14.0	-14.7	-20.4
Other net investment[d]	10.1	-0.8	-13.5	-13.9	82.3	-24.4	-17.9
Net official flows	-0.8	-16.0	-29.5	-66.9	-94.0	-146.3	-114.9
Total net flows	17.6	-19.4	-45.9	-71.0	-10.4	-178.3	-139.1
Change in reserves[e]	-9.1	-16.5	-91.8	-95.9	-153.5	-123.9	-110.7
Latin America and the Caribbean							
Net private capital flows	67.9	32.0	38.1	9.5	97.4	93.2	80.8
Net direct investment	46.0	57.4	52.3	27.3	79.5	73.7	70.8
Net portfolio investment[c]	26.8	-7.8	5.1	-13.4	32.6	23.1	18.6
Other net investment[d]	-4.9	-17.6	-19.3	-4.4	-14.6	-3.6	-8.6
Net official flows	7.8	6.6	-30.8	-18.6	0.0	2.3	2.2
Total net flows	75.6	38.7	7.2	-9.1	97.4	95.5	83.0
Change in reserves[e]	-9.4	-8.9	-33.8	-49.5	-130.8	-74.0	-20.3

Table III.2 (cont'd)

	Average annual flow						
	1995-1998	1999-2004	2005	2006	2007	2008[a]	2009[b]
Economies in transition							
Net private capital flows	-1.1	5.6	42.9	73.1	141.6	41.2	51.5
Net direct investment	5.4	8.2	15.3	29.6	35.8	37.2	47.0
Net portfolio investment[c]	1.4	-0.8	-6.0	12.7	16.5	-0.2	5.7
Other net investment[d]	-7.9	-1.8	33.6	30.8	89.2	4.2	-1.2
Net official flows	0.1	-6.2	-20.0	-29.2	-4.7	-7.0	-3.6
Total net flows	-1.0	-0.7	22.9	43.9	136.9	34.2	47.9
Change in reserves[e]	1.8	-25.5	-80.9	-138.2	-171.7	-131.7	-96.8

Source: IMF, World Economic Outlook Database, October 2008.

a Partly estimated.
b Forecasts.
c Including portfolio debt and equity investment.
d Including short- and long-term bank lending, and possibly including some official flows to data limitations.
e Negative values denote increases in reserves.

exported from the United States to Western Europe, and then to the developing world. While at the onset of the financial crisis net commercial bank lending to emerging market economies was quite stable, despite the weakness in mature credit markets, heightened concerns about the quality of global credit have now affected most developing markets. The deterioration in investor confidence was mainly triggered by the impact of the United States sub-prime mortgage crisis on balance sheets of banks across the global economy, but especially on those in the United States and Europe. With the failure of major financial institutions in developed countries, global interbank funding conditions have deteriorated significantly. As a direct result, emerging market sovereign bond spreads widened dramatically (see chapter I, figure I.5).

The interest-rate spread on emerging market debt has increased sharply

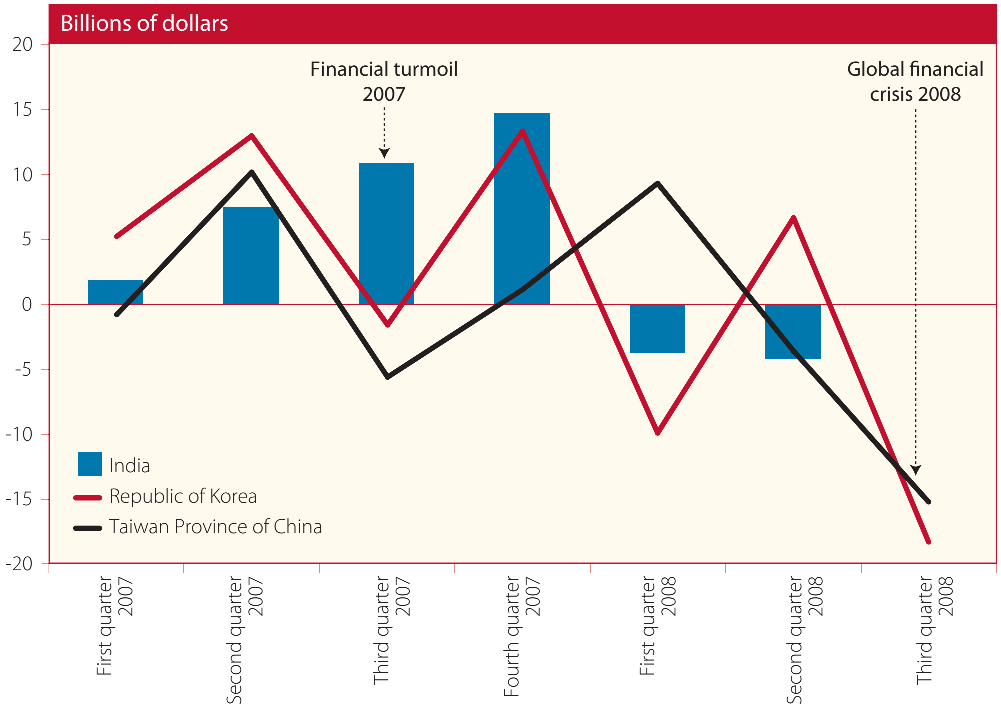
The spread on JPMorgan's emerging market bond index (EMBI) broke 800 basis points in October 2008. This spread, which reflects how much more yield investors demand to hold emerging market debt compared to safe haven United States Treasury bills, was the highest since November 2002. Consequently, the cost and availability of financing have become more difficult in emerging economies and asset prices in equity markets in these nations have declined sharply. The latter development is derived in particular from the fact that institutional investors have withdrawn investments from emerging economies to cover margin and redemption calls at home or in other developed country markets (figure III.2).

Credit default swap spreads are a better sovereign risk indicator in times of distress

In times of distress, when a country loses access to markets, there is evidence that credit default swap (CDS) spreads are a better indicator of sovereign risk than the EMBI.[1] CDS spreads represent the marginal cost of debt, while a country's EMBI is more representative of the average cost of traded debt. During distress, it is the marginal cost that is often more relevant: although CDS spreads are a derivative of the cash bond market, their volatility and absolute levels may lead to a sell-off in the underlying bonds. This distinction is important since the EMBI has a much greater duration owing to the weighted average of all cash bonds. The CDS spreads for a sovereign bond are usually quoted for no longer than a five-year maturity; hence, their duration is much shorter than for cash bonds.

1 Manmohan Singh, "Are credit default swap spreads high in emerging markets? An alternative methodology for proxying recovery value", IMF Working Paper, No. 03/242, December 2003.

Figure III.2
Portfolio investment inflows to selected countries, 2007-2008



Sources: Balance-of-payment data from national central bank websites.

Table III.3
Credit default swap spreads and annual probabilities of default in selected emerging market countries, 31 December 2007 and 23 October 2008[a]

	Credit default swap (annual probabilities of default)	
	31 December 2007	*23 October 2008*
Brazil	103 (1.3)	571 (6.3)
Hungary	57 (0.7)	574 (6.4)
Korea, Republic of	47 (0.6)	620 (6.8)
Mexico	70 (0.9)	580 (6.4)
Russian Federation	86 (1.1)	1 056 (10.1)
Turkey	168 (2.1)	777 (8.1)
Ukraine	238 (2.9)	2 535 (16.3)
Venezuela, Bolivarian Republic of	455 (5.2)	2 224 (15.5)

Sources: Deutsche Bank Research, available from http://www.dbresearch.com for 2007 data and Bloomberg for 2008 data.

a Credit default swap spreads in basis points and annual probabilities of default in percentage.

Higher bankruptcy risk in emerging markets …

As can be seen from table III.3, at the end of October 2008, the bankruptcy risk of emerging market Governments had increased substantially, compared with very low default probabilities for most of 2007. In our sample, Ukraine has the highest CDS premium (16.3 per cent), followed by the Bolivarian Republic of Venezuela (15.5 per cent) and the Russian Federation (10.1 per cent). These premiums compare with Iceland, for instance, whose Government was the first victim of financial market turmoil in 2008 and is rumored to be on the verge of insolvency, with a default probability trading at 25 per cent in October 2008.

… has led to additional capital outflows

As a result, capital outflows from developing countries have intensified, leading to tighter international and, in some cases, domestic liquidity conditions. The pronounced reduction in investors' appetite for risk has resulted in a retrenchment in short-term capital flows to emerging markets, exerting pressure on local markets, and sharply raising costs of credit.[2] Together with slowing global growth, this results in a very challenging environment for several developing countries. The Institute of International Finance (IIF) estimates that for a group of 30 emerging markets, net short-term lending (by both banks and non-banks) was $253 billion in 2007 and $141 billion in 2008, compared to average annual net inflows of just $25 billion for the period 1997-2006.[3] This is a clear indication that this leaves some emerging markets more vulnerable to a reversal of short-term flows than at any time since 1996. The reversal of short-term interbank flows to both the Republic of Korea and the Russian Federation has been a key source of stress in these two economies.

A number of countries face multiple solvency risks

Another group of countries is facing solvency risks, as they are not only relying heavily on short-term foreign financing to meet large current-account deficits but are also compromised in their policy options, owing to low international reserves and a substantial stock of external debt. At the time of writing, Belarus, Hungary, Pakistan and Ukraine have recurred to the International Monetary Fund (IMF) for emergency loans as they are facing increased debt-servicing problems.

Emerging market currencies have come under pressure from a number of sources

The unwinding of carry trades, which has led to a massive reversal of currency positions out of high-yielding assets in emerging markets back into currencies of developed countries, in particular the Japanese yen, is another indicator that enormous liquidations by international investors have had a widespread impact in the developing world. An enduring credit crunch and a declining global economy have clearly affected several emerging market currencies, even those that are running a large aggregate current-account surplus. A broader group of currencies is suffering as investors have withdrawn money from their markets. Moreover, plunging raw-material prices are weighing on currencies in commodity-producing nations from Latin America and the Caribbean to sub-Saharan Africa to the Russian Federation.

Capital flow reversals make net private capital flows difficult to forecast

Amidst the current turmoil, any forecast of net private flows in 2009 will involve a delicate balancing act, as it will not only be necessary to consider the current stop and reversal in net private flows, but also to make assumptions about a possible recovery in flows that might be expected as the year progresses. The fact that key economic indicators in several developing countries (economic growth, prospective returns and nominal interest-rate spreads) continue to appear more attractive than in mature markets suggests a rebound of the current trend in private flows during 2009. At present, the correction in world markets is characterized by a general flight from risk rather than by economic fundamentals, with equity markets and interbank flows experiencing some of the biggest declines. Farther down the road, the focus of international investors on economic growth differentials between developed and developing countries may reverse this trend, although this will depend on how developing countries are able to stimulate domestic demand to offset weakening foreign demand. In this regard, those developing countries that have large current-account deficits and are financed by short-term financial flows will be the

2 International Monetary Fund, *Global Financial Stability Report—Financial Stress and Deleveraging: Macrofinancial Implications and Policy* (Washington D.C.: IMF, October 2008).

3 Institute of International Finance, report on "Capital flows to emerging market economies", 12 October 2008.

most vulnerable, and investors will differentiate among emerging markets by paying more attention to economic fundamentals.

Africa's exposure to the crisis has thus far been limited …

From a regional perspective, the impact of the global financial turmoil on Africa has thus far been limited, as the risks of the majority of financial markets in the region are not correlated with those in mature economies. However, during the course of 2008, portfolio inflows have come under some pressure as global liquidity has tightened (see table III.2). According to the IMF, issuances of foreign currency-denominated bonds by African countries ceased in the first half of 2008, after doubling yearly from $1.5 billion in 2005 to $6.5 billion in 2007.[4] An additional concern in Africa is the indirect effect of volatile and falling commodity prices, particularly that of crude oil, on export revenue and the inflow of capital into the region. In the short term, countries such as South Africa are financing a very large current-account deficit, about 8 per cent of gross domestic product (GDP),[5] with private capital flows. If the capital flows dry up, South Africa will have to contract this deficit.

… while East and South Asia have experienced more direct effects

In East and South Asia, Governments are more adversely affected by the global financial crisis. The dramatic reversal in portfolio equity flows (see table III.2) reflects the net selling of equities by foreign investors. This selling pressure has been both a cause and an effect of sustained weakness in emerging equity markets through 2008. The equity sales have been particularly pronounced in the Republic of Korea, where investors have withdrawn a massive net $45 billion in 2008.[6] Despite the enormous accumulation of foreign-currency reserves in all major East and South Asian countries over the past few years, the widespread wave of currency weakness experienced in the region and the rise in dollar-funding pressures for banks show that vulnerabilities remain. These developments are also an important indicator of the high degree of interconnectedness within the global financial system. While the recent fall in oil and food prices has reduced the upward pressure on inflation in many Asian countries, food prices remain at a very high level relative to last year's record.

Strong financial positions help Western Asian economies weather the storm

The largest expansion of credit flows to Western Asian borrowers on record in 2007[7] was sharply reversed in 2008 (see table III.2). Along with the global credit crunch, Kuwait, Saudi Arabia and the United Arab Emirates, in particular, have experienced a severe contraction of interbank liquidity and rising spreads on corporate debt. While foreign-asset growth of oil-exporting countries in the first half of 2008 was well above 2007 levels, oil prices are no longer rising faster than domestic spending and investment, thus lowering the accumulation of international reserves. However, as both the Governments and the central banks remain in strong financial positions, tighter credit conditions are likely to have only a limited effect on investment activities in the region. Governments have started to stimulate domestic credit flows and investment.

Latin America is facing an increasing number of downside risks

While economic growth prospects remain positive for Latin America and the Caribbean, the economic and financial crisis in the United States has clearly heightened uncertainties in the region. The region has witnessed a slowdown in portfolio flows (see

4 International Monetary Fund, *World Economic and Financial Surveys—Regional Economic Outlook: Sub-Saharan Africa* (Washington D.C.: IMF, October 2008).

5 See "South Africa releases the 2008 International Monetary Fund's Article IV Report and Financial System Stability Assessment Report", National Treasury of the Republic of South Africa, press release, 22 October 2008, available from http://www.finance.gov.za/comm_media/press/2008/2008102201.pdf.

6 Institute of International Finance, op. cit.

7 Bank for International Settlements, "International banking and financial market developments", *BIS Quarterly Review*, June 2008.

table III.2), large declines in stock price indices and significant currency adjustments. While financial conditions have not deteriorated more than in other regions in the current global economy, Latin America and the Caribbean's surplus is waning and will most likely turn into a modest deficit in 2009.[8] The stagnation in economic growth of mature economies will affect Latin America and the Caribbean through several channels: a decline in the world's demand for the region's exports, falling remittances, weakening commodity prices, higher borrowing costs and the impact of tight monetary policies that the region has been pursuing to tame inflation. Thus, the cyclical downturn in Latin America and the Caribbean is now envisaged to be more pronounced and subject to a widening of downside risks in comparison to other regions.[9] In Mexico, for example, remittances fell by 6.9 per cent year on year in July.[10] Of further concern are oil prices, as oil exporters such as Ecuador, Mexico and the Bolivarian Republic of Venezuela are exposed to the effect of any further retreat of crude prices on fiscal balances.

The Russian Federation has seen a sharp reversal in short-term interbank flows

Falling oil prices, selling pressure in equity markets and a major pullback in net bank lending (see table III.2) provide a combination of factors affecting economies in transition. As a result, economic growth is set to slow in these countries, in particular in the Russian Federation. Most significantly, the sharp reversal of short-term interbank flows to the Russian Federation has been a key source of stress, and they are predicted to stay at low levels in 2009.

The sharp reversal in capital flows is putting an end to a phase of strong growth

In summary, the flow of foreign capital in recent years has become the main driver of the business cycle in quite a number of emerging market and other developing economies. That the process is driven primarily by variations in the availability of foreign capital rather than by developments in the host countries is strongly indicated by the significant size of variations in the overall flow of capital. When foreign investors develop an appetite for risk, there is a boom in capital flows; the bust is marked by a "flight to quality" (or risk aversion). Despite the fact that key economic indicators in several developing countries continue to appear more attractive than in mature markets, the sharp reversal in capital flows is now putting an end to a period of strong global economic growth and ample availability of liquidity in these countries. This development is already posing severe credit restraints, in particular in developing economies that are running current-account deficits. While the development of local-currency debt markets has led to progress in the reduction of currency mismatches in many developing countries, these markets are nevertheless characterized by short-term biases and have not solved problems of market liquidity. Most developing countries still lack sufficiently developed markets for corporate and government bonds, which further limits their scope for conducting counter-cyclical marcoeconomic policies.

Foreign direct investment

More cautious business sentiment is leading to slowing FDI flows …

Foreign direct investment (FDI) has historically been the more stable component of cross-border private capital flows over the past few years, buoyed by strong economic growth and improvements in the investment climate in a number of countries. While many devel-

8 Institute of International Finance, op. cit.

9 See Chapter IV of the present report, as well as World Bank, "Latin America and the Global Crisis", report prepared by the Office of the Chief Economist for the Latin America and the Caribbean region, 8 October 2008, available from http://siteresources.worldbank.org/LACEXT/Resources/GlobalEconomy.pdf.

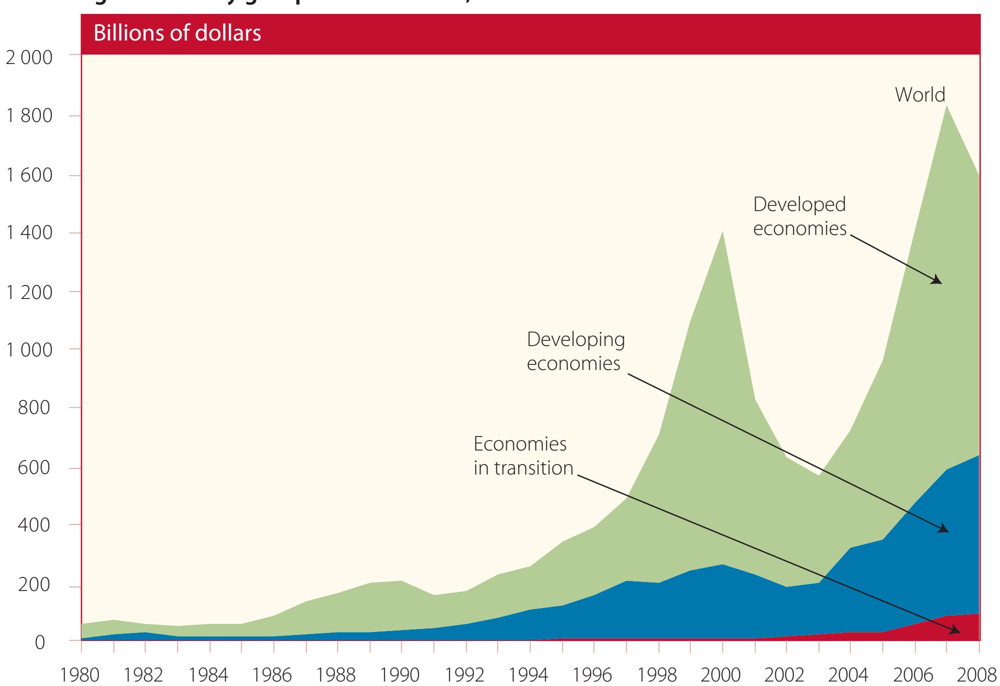
10 Data from Banco de México, the central bank of Mexico.

oping countries have attracted FDI through privatizations and mergers and acquisitions (M&As), funding for these activities will become harder to obtain in the coming months. The United Nations Conference on Trade and Development (UNCTAD) *World Investment Report 2007* predicts that FDI flows to emerging markets in 2008 will decline by 10 per cent.[11] Since global business sentiment will become far more cautious in the coming months, FDI flows may slow even further in 2009. The Organization for Economic Cooperation and Development (OECD) has estimated that outflows of FDI from OECD countries in 2008 could fall by about $680 billion, or 37 per cent, from their 2007 levels.[12] Based on the historical relationship between developing country inflows and changes in OECD outflows, the OECD estimates that this could result in a decline in 2008 of about 40 per cent for developing country inflows from 2007 levels.

… but the effects vary by region

Worldwide, FDI inflows reached an estimated $1.6 trillion in 2008 (figure III.3). In the three major groups of economies (developed countries, developing countries and economies in transition), the global economic slowdown and intensifying financial turmoil have had different impacts on FDI inflows. While the decline is more distinct in developed countries, several developing markets are still continuing to experience increasing FDI inflows (table III.4). Net FDI inflows are forecast to accelerate slightly to emerging European markets, the Middle East and Africa in the coming quarters. An increasing proportion of these flows takes the form of reinvested earnings.[13] Up until the first half

Figure III.3
Inflows of foreign direct investment, global and by groups of economies, 1980-2008



Source: UNCTAD FDI/TNC database and UNCTAD estimates for 2008.

11 United Nations Conference on Trade and Development, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* (United Nations publication, Sales No. E.07.II.D.9).

12 Organization for Economic Cooperation and Development, *Investment News: Results of the work of the OECD Investment Committee*, issue 7, June 2008.

13 Institute of International Finance, loc. cit.

Table III.4
Inflows of foreign direct investment and cross-border mergers and acquisitions, by region and major economy, 2007-2008

Billions of dollars

	Foreign direct investment inflows			Cross-border mergers and acquisitions			
	2007	2008[a]	Growth rate (percentage)	2007		2008	Growth rate (percentage)
Region/Economy				*First 10 months*	*Full year*	*First 10 months*	*First 10 months only*
World	**1 833.3**	**1 594.4**	**- 13.0**	**1 297.2**	**1 637.1**	**1 081.1**	**- 16.7**
Developed economies	1 247.6	959.8	- 23.1	1 147.4	1 454.1	896.2	- 21.9
Europe	848.5	693.0	- 18.3	633.3	825.0	475.6	- 24.9
United States	232.8	175.6	- 24.6	313.7	379.4	328.4	4.7
Japan	22.5	15.0	- 33.6	20.9	21.4	14.9	- 28.6
Developing economies	499.7	540.9	8.2	124.2	152.9	161.4	29.9
Africa	53.0	62.3	17.5	7.9	10.2	25.8	226.6
Latin America and the Caribbean	126.3	147.5	16.8	25.9	30.7	26.0	0.6
Asia and Oceania	320.5	331.1	3.3	90.4	112.0	109.5	21.1
Western Asia	71.5	57.6	- 19.5	23.7	30.3	30.6	28.8
South, East and South-East Asia	247.8	272.5	9.9	66.7	81.5	78.6	17.9
Economies in transition	85.9	93.7	9.0	25.7	30.1	23.6	- 8.1

Source: UNCTAD.
Note: World FDI inflows are projected on the basis of 103 economies for which data are available for part of 2008, as of 10 November 2008. Data are estimated by annualizing their available data, in most cases the first two quarters of 2008.
a Preliminary estimates.

of 2008, FDI was bolstered by buoyant profits of transnational corporations (TNCs) and high commodity prices. Now that commodity prices have started to decline, commodity-related sectors will be somewhat less attractive. This could hurt Latin America and the Caribbean and Africa in particular in the months ahead.

Investors are facing limited financing options

Private equity firms, which account for one fifth of global cross-border M&As, are highly dependent on bank loans and will be severely limited in their financing options in the months to come. While the global outlook for the international expansion of TNCs still looks positive, particularly given the higher prospective economic growth rates in developing countries, a lower level of investor confidence and more prudence may influence investment plans in forthcoming quarters. As in previous financial crises, falling asset prices and the tightening of credit conditions will lead to insolvency problems for corporations and thereby to further asset deflation.

East, South and South-East Asia remain the preferred regions for FDI

East, South and South-East Asia remain the most preferred regions for foreign investment, followed by the European Union (EU), North America and emerging European markets. China is the most preferred investment location, according to a recent UNCTAD survey.[14] Although, the overall environment for FDI remains positive, the Chinese Government has become more selective with respect to approving foreign involve-

14 United Nations Conference on Trade and Development, *World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge* (United Nations publication, Sales No. E.08.II.D.23).

ment in investment projects.[15] The Chinese authorities are giving priority to projects in the interior of the country and those that promise a high degree of technology transfer.

Manufacturing represents a declining share in global FDI flows

While the services sector still accounts for the largest share of global FDI flows, there has been a significant increase in FDI flows to the primary sector, mainly in the extractive industries. The share of manufacturing in global FDI flows has continued to decline. The share of TNC investments in extractive industries has more than doubled since the 1990s. These industries account for a significant share of total FDI inflows in some economies, and for the bulk of inward FDI in a number of low-income mineral-rich countries. One of the challenges facing commodity-exporting countries, in particular those in Africa, is how to channel revenues obtained from commodity exports towards the areas of education, human resource development and infrastructure development, which are essential for productivity improvements and for industrialization in general, as well as for attracting FDI to the manufacturing sector.[16] The current reversal in commodity prices will magnify these challenges.

International financial cooperation

Official development assistance

Net ODA has declined in absolute terms since 2005

There has been a significant turnaround since the United Nations International Conference on Financing for Development held in Monterrey, Mexico, from 18-22 March 2002, when total net ODA was $57.3 billion, or $54 billion excluding debt-relief grants. The impulse for a revival in assistance from OECD countries provided by the Monterrey Consensus has weakened significantly in recent years. Net ODA has in fact declined in absolute terms from $107.1 billion in 2005, to $104.4 billion in 2006, and further to $103.7 billion in 2007, representing a fall of 8.4 per cent in real terms. Excluding debt-relief grants, ODA to developing countries totalled $95 billion in 2007, compared with $82 billion in 2005 (figure III.4).

Only five countries have met the United Nations target for ODA

As a share of gross national income (GNI) of the member countries of the Development Assistance Committee (DAC) of the OECD, ODA remained unchanged compared with 2006, at 0.25 per cent; this share is only slightly higher than the pre-Monterrey share of 0.23 per cent, but is well below the 0.33 per cent level of the early 1990s, and well short of the intermediate target of 0.35 per cent set for 2010, to which DAC members have committed themselves.[17]

Only five countries—Denmark, Luxembourg, the Netherlands, Norway and Sweden—have met the United Nations target of 0.7 per cent of GNI, reaffirmed through the Monterrey Consensus. ODA provided by the Group of Seven (G7) countries, in contrast, averages no more than 0.23 per cent of their combined GNI, with the United States and Japan (despite being the largest donors in absolute amounts) providing the least ODA in relative terms (0.16 per cent and 0.17 per cent of GNI, respectively).

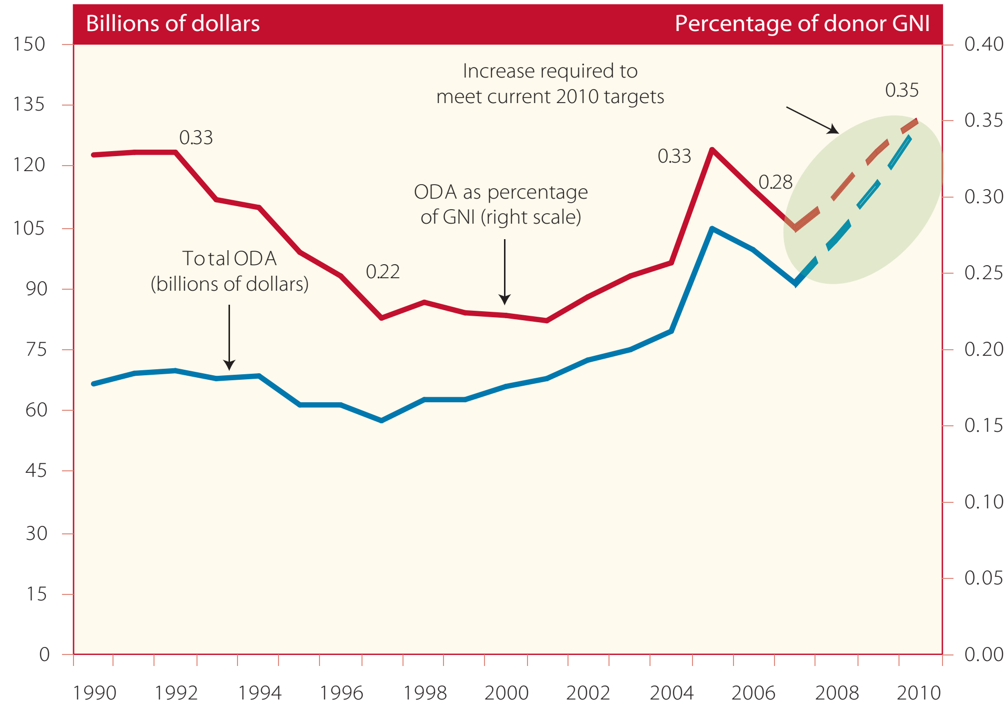
Japan's share in global ODA had declined from 14 per cent in 2002 to just 8 per cent by 2007, and the United States share is projected to fall from the current 23.5 per

15 World Bank, *Global Development Finance 2008: The Role of International Banking* (Washington, D.C.: The World Bank, June 2008).

16 United Nations Conference on Trade and Development, *World Investment Directory, Volume X: Africa 2008* (United Nations publication, Sales No. E.08.II.D.3).

17 See United Nations, MDG Gap Task Force Report 2008, *Delivering on the Global Partnership for Achieving the Millennium Development Goals* (United Nations publication, Sales No. E.08.I.17).

Figure III.4
DAC members' net ODA, 1990-2007, and DAC secretariat simulations to 2010



Source: OECD/DAC database and United Nations, *MDG Gap Task Force Report 2008.*

Note: Figures are in 2004 prices. Data for 2008-2010 are based on DAC Secretariat simulations.

cent to below 19 per cent by 2010, compared with a forecast increase of the EU share to 64 per cent, up from 55.6 per cent in 2007. ODA by the EU-15 countries, which accounts for 60 per cent of the total, currently amounts to 0.40 per cent of their GNI, with a commitment to reach the 0.7 per cent target by 2015.

The least developed countries receive about one third of all aid

Landlocked and small island developing countries, whose special needs were recognized in the Monterrey Consensus, received about \$2.5 billion and \$12 billion of ODA in 2007, respectively. The 49 least developed countries (LDCs) continue to receive about one third of all aid. Although their share of ODA, excluding debt relief, had increased from a low of 15 per cent in 1998 to 38.5 per cent by 2006, the total DAC aid of \$29.4 billion to these countries constitutes only 0.09 per cent of their GNI, far short of the target of 0.15-0.20 per cent of GNI to be achieved by 2010 in accordance with the Brussels Programme of Action for the Least Developed Countries for the Decade 2001-2010. By 2006, only 8 countries had met this target: Belgium, Denmark, Ireland, Luxembourg, the Netherlands, Norway, Sweden and the United Kingdom of Great Britain and Northern Ireland. Achieving the target of 0.16 per cent of GNI, on average, for DAC donors would require increasing the aid volume to LDCs to about \$62 billion per annum, that is to say, double the current level.

ODA needs to be stepped up to meet agreed targets

The rate of growth of ODA will have to increase markedly if the international community is to meet the targets that they set for financing the internationally agreed development goals, including the Millennium Development Goals (MDGs). If the commitments at the 2002 Monterrey Conference and the 2005 Group of Eight (G8) Summit at Gleneagles are taken as the benchmark, ODA (at constant prices) from major donors would have increased by more than 60 per cent over the six years from 2004 to 2010. However, halfway through this period, ODA from OECD donors has risen by only 15 per cent.

In order to meet the overall target of \$130 billion by 2010 confirmed at the 2005 Gleneagles Summit, net ODA needs to increase by nearly \$13 billion in constant

2004 dollars, or about $18 billion per year between 2008 and 2010 at July 2008 exchange rates.[18] Aid to sub-Saharan Africa has increased at a faster rate, but still not fast enough to double to the $50 billion in real terms by 2010 pledged at Gleneagles. Net ODA to Africa needs to increase by over $6 billion per year in 2005 prices to reach the targeted increase of at least $25 billion a year by 2010. So far, only about $4 billion of this has been programmed into donors' spending plans.

Some developing countries are becoming an important source of ODA

Some developing countries have become important sources of aid for other developing countries in recent years. Development cooperation provided by such donors has grown strongly, even though the total volume is still small. Disbursements by non-DAC donors have reached an estimated $8.5 billion, or 7.5 per cent of total aid flows in 2006, of which about $7.1 billion came from other developing countries. Recent studies, however, put the latter's disbursements between $9.2 billion and $11.8 billion, which means their share in total aid flows would have increased to between 7.6 and 9.6 per cent as of 2006.

Currently, the largest donors from the South, each providing at least $1 billion per year, are China, India, Saudi Arabia and Venezuela (Bolivarian Republic of), and if recent large pledges materialize, the total flows might grow to about $15 billion by 2010. Saudi Arabia and the Bolivarian Republic of Venezuela have achieved the target of 0.7 per cent, and the average grant element of all loan commitments by China, Brazil and India was about the same as other countries, one third in 2005-2006. In addition, some non-DAC countries have made substantial progress in 2007, although the increases have come from a relatively small base; for instance, Lithuania raised its aid by 74 per cent, the Republic of Korea by 43 per cent, and Latvia by 23 per cent.

Sharp increases in aid budgets are needed

Overall, most donors are not on track to meet their commitments to scale up aid unless they make unprecedented increases in their aid budgets. This implies an average annual growth rate of ODA of over 14 per cent in real terms over the remaining part of the decade, compared with the 4.6 per cent observed since the 2002 Monterrey Conference. ODA to sub-Saharan Africa will have to increase by an average annual rate of 18 per cent, compared with 9 per cent in 2002-2006, if donors are to honour their pledges to Africa. These pledges were reconfirmed at the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, held in Doha, Qatar, from 29 November to 2 December 2008, where donors promised to honour their commitments and emphasized that the financial crisis should not stand in the way of their doing so. A further challenge for international development cooperation is the additional resources required to meet the costs of dealing with climate change and improving energy and food security (see box II.1 for estimated investment requirements to deal with the food crisis; for innovative sources of financing, including those needed to address climate change, see below).

Aid effectiveness

The Paris Declaration marked an important step in improving aid effectiveness

Important steps towards improving the quality of aid were made by the Paris Declaration on Aid Effectiveness in 2005 and the subsequent efforts aimed at its implementation. The 2003 Rome Declaration on Harmonization and the 2005 Paris Declaration reflected a commitment by over 100 Governments and international organizations to improve the quality of aid as called for in the Monterrey Consensus. The signatories recognized the principles of country ownership and acknowledged that development could not be imposed from above, and that aid therefore had to be aligned to national development strate-

18 Ibid.

gies. The Third High Level Forum on Aid Effectiveness, which took place in Accra from 2 to 4 September 2008, adopted the Accra Agenda for Action (AAA), which made only fitful progress in realizing the Paris Declaration commitments.

Aligning aid to national development goals remains a challenge

A multitude of challenges exist in aligning aid to national development and ensuring aid effectiveness. In the context of the conceptual acceptance of "national ownership", action on this principle would require a decoupling of development assistance from conditionality and giving countries the policy space to choose their own development path. The DAC Working Party on Aid Effectiveness and Donor Practices has set out indicators to monitor aid delivery and improve aid delivery mechanisms. As indicated by the 2006 and 2008 surveys conducted by the DAC secretariat, progress in each of the areas of national ownership, harmonization, alignment, results and mutual accountability has been slow and has fallen short of expectations. In Africa, for example, the greatest progress was made in the areas of donor coordination and the alignment of technical assistance with country programmes; planned programmable aid is expected to increase by 38 per cent between 2005 and 2010. However, transaction costs associated with aid remain high and only 46 per cent of aid flows were disbursed according to schedule in 2007.

Significant progress has been made on increasing untied aid

The amount of resources reported as untied had reached 95 per cent of bilateral aid by 2006, with some countries untying all of their aid, signalling considerable progress on the 2001 DAC agreement to untie aid to LDCs. However, a major issue is the transparency of donors' untied aid programmes. Currently, data do not cover important countries, such as the United States, or certain forms of aid, such as technical cooperation or the administrative costs of delivering aid. Many countries striving to reach the MDG goals did not receive sufficient aid in spite of improved macromanagement, debt management and increased capacity for aid flows.

The smoothing of aid flows can help to avoid a multitude of problems

Selectivity is still a defining feature of the present system of allocation of aid flows, creating a situation where a few countries have a very large share of total flows. At the same time, donors have not been able to resolve the problems of predictability, volatility and herding. Aid surges in selected countries have led to a mistaken belief that low-income countries may not have the capacity to absorb aid effectively and may suffer from Dutch disease. These issues would not have arisen if the aid flows had been better distributed among countries and if sudden surges were avoided by stretching out the inflow over a longer time frame.

Even developing countries at more advanced stages of development have problems managing a surge of flows within a short timespan. Short-term difficulties should not be interpreted as indicative of long-term absorptive capacity. Lessons can be drawn from countries which have had aid surges involving budgetary support. The conditions attached to the aid inflows did not allow countries to use the excess liquidity generated for productive investments. The failure of the international financial institutions (IFIs) to correctly gauge the implications of an expenditure framework generating excess liquidity led to costly sterilization policies and an ensuing build-up of domestic debt. Lack of flexibility in allowing countries to allocate the inflow based on their own priorities proved costly as it reduced the fiscal space for development expenditure.

Development resources are only a part of overall aid

In actual practice, the resources released for development have been smaller than aid statistics have indicated. The decomposition of aid-flow statistics gives a more realistic estimate of the resources available for development. For instance, debt relief accounted for a substantial part of the increase in ODA in 2005-2006; this included the large debt-relief packages for Iraq and Nigeria. Total net aid statistics also include emergency and technical assistance. In order to assess programmable resources, an emerging priority is the setting-up of an accounting framework to correctly report the resources available for development. The United Nations provides a platform for working towards a multilaterally agreed concept. The outcome document for the Doha conference on financing for development adopted on 2 December 2008 calls for a more universal and accountable framework for aid accounting and requests the Secretary-General, in cooperation with OECD-DAC and IFIs, to report on the matter to the Development Cooperation Forum of the United Nations Economic and Social Council.

Innovative sources of development financing and the new aid "architecture"

Exploring new sources of innovative financing for development remains a challenge

There has been considerable progress in implementing initiatives to finance development through innovative channels under the rubric of "innovative sources of financing" in the 2002 Monterrey Consensus. An important challenge will continue to be the building of consensus around pilot projects and, more generally, how to implement the reform agenda for the aid architecture. Moreover, further exploration of new sources of innovative financing is expected. The Fourth Plenary Meeting of the Leading Group on Solidarity Levies to Fund Development, held in Dakar on 22 and 23 April 2008, addressed the following issues: the feasibility of taxing currency transactions; the stemming of illicit financial flows from developing countries (a working group on which was established under the chairmanship of Norway); remittances; and innovative financing mechanisms for environmental protection. Senegal and the next rotating Presidency, Guinea, were given the mandate to prepare the Group's contribution to the Doha follow-up conference to Monterrey. At the Fifth Plenary Meeting of the Group, held in Conakry in October 2008, a Declaration on Innovative Financing for Development as a new mode of development aid was adopted and presented to the Doha conference.

In the context of the broader aid architecture, innovative sources of financing have thus far raised only a relatively small amount of funds. Other potentially more significant sources of innovative financing need to be developed. For example, there is renewed interest in a currency-transaction tax in the light of the fact that such transactions can be tracked in the same way that international transactions are monitored for anti-terrorism and anti-drug money-laundering purposes. There are other proposals for internationally coordinated taxes, such as on carbon emissions and arms purchases.

By providing resources in a stable and predictable manner, such taxation schemes would efficiently complement ODA, which suffers from swings and fluctuations in its levels due to donors' politically dependent budget considerations. They could also have the advantage of correcting certain negative externalities, in addition to providing significant sources of development financing. For instance, a carbon tax could be justified on environmental-efficiency grounds. Some members of the Leading Group on Solidarity Levies to Fund Development have also expressed interest in expanding efforts to combat tax evasion and capital flight under the rubric of innovative sources of financing.

Complementarity is an important characteristic of innovative financing

It is important to stress that innovative financing should generate resources complementary to traditional official development aid, without prejudice to the manner in which these resources are reported. It should also be part of efforts to improve the quality and efficiency of existing official development aid, especially with regard to predictability and stability of funding to address long-term needs, early mobilization of funds for urgent action and tailoring aid to the repayment capacity of countries. In addition, the new funding sources should explicitly address market failures, including through means of advanced market commitments, development investment funds and counter-cyclical facilities.

New sources of aid and an increased number of donors have emerged without systematic coordination

With the proliferation of new sources of money for aid, the landscape in development cooperation has changed. As mentioned above, non-DAC donors, including those from the South, private foundations and philanthropic channels, are growing in significance. It is estimated that these sources now constitute roughly one fourth of global aid flows.

This recent proliferation of donors and alternative sources of development financing has created a new challenge for international development cooperation: to ensure adequate checks and balances for the provisioning and use of aid from all sources. The new arrangements have evolved without systematic coordination among donors, international financial institutions and recipient countries. The resultant number of donor missions in each recipient country is burdensome, leaving little time, space or human resources for independent policymaking. In view of these new actors and institutions, aid architecture has become an even more complex, uncoordinated and fragmented system that lacks a centrally directed political or technical framework.

Recipients hold little power in influencing development guidelines

There is a clear imbalance in development cooperation relations, as recipients have very little power to influence development cooperation guidelines. "Ownership" is closely linked to "representation", but recipients of aid have very little voice in the governance of aid. The actual role of parliamentarians in the governance of aid is often trumped by that of civil society. Aid recipients have a limited voice in the IMF and the World Bank, both of which provide decisive access to aid. The World Bank's Country Policy and Institutional Assessments, which have been found to be unpredictable and subjective, play a major role in aid allocation, while developing countries themselves have little voice in how they are being rated.

Bilateral flows dominate the composition of aid but offer no formal mechanism for the voice of recipient countries to be heard, as bilateral donors are answerable only to their legislative bodies. The changing landscape makes reform more urgent, and the Doha conference provided an ideal opportunity to review and rebalance international development cooperation.

External debt relief

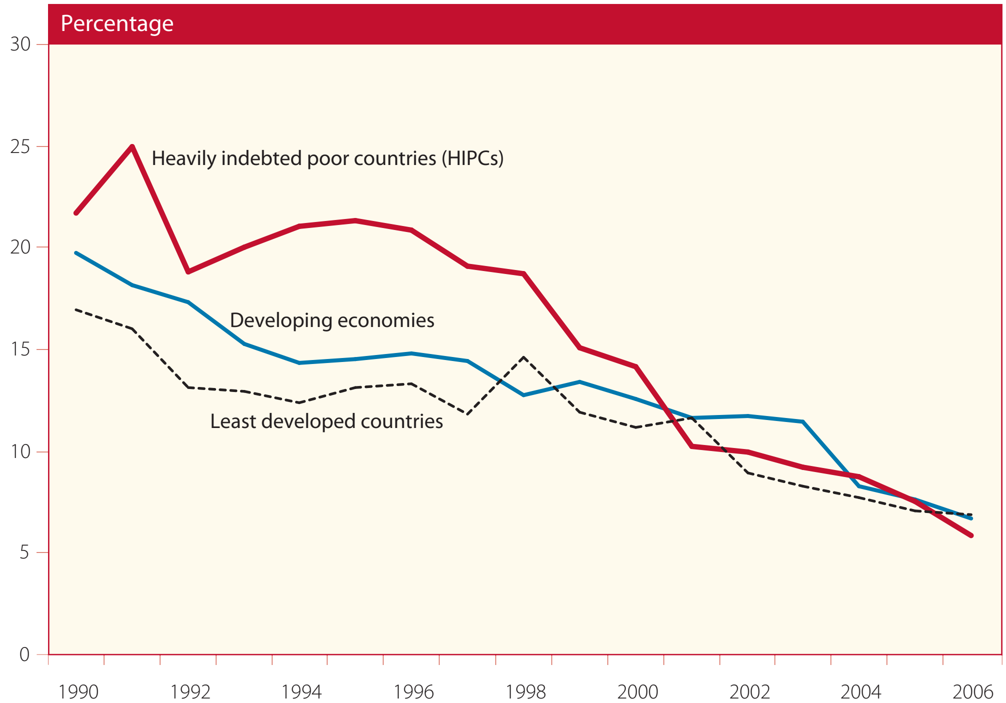
Lower debt levels have led to a reduction in debt-service payments

The Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) have provided countries with an opportunity to reduce their external debt-service burden. Along with these major debt-relief initiatives, the shift from bilateral ODA loans to grants has significantly reduced the debt burdens of many low-income countries, particularly those that have reached the HIPC completion point and received additional debt relief from the MDRI. The HIPC status report of March 2008 estimated that debt relief in all forms, including HIPC, MDRI, traditional debt relief and other "voluntary" bilateral debt relief, would reduce debt stocks for the 33 post-decision-point countries from $105 billion to $9 billion, a reduction of more than 90 per cent. The debt service-to-export ratio for all developing countries declined from almost 12.5 per cent in 2000 to 6.6 per cent in 2006, and to about 3 per cent in 2007 (figure III.5).[19] The average debt-service payment relative to GDP has been halved as a result of the initiatives, falling from 3.2 per cent of GDP in 2001 to 1.5 per cent of GDP in 2007. For the HIPCs, the reduction in debt burdens has created a better environment for investment and future growth.

The total assistance allocated to HIPCs so far amounts to $117 billion in nominal terms, including $49 billion under the MDRI, representing on average about 50 per

19 Ibid., pp. 28-29.

Figure III.5
Debt-service payments as a proportion of export revenues, 1990-2006



Sources: UN/DESA, based on data from Millennium Development Goals Indicators, available from http://mdgs.un.org, and World Bank Global Development Finance database.

cent of these countries' 2007 GDP. The total cost to creditors of HIPC Initiative debt relief for all eligible countries is estimated at $71 billion in end-2007 net present value (NPV) terms. Nearly half of the cost represents irrevocable debt relief to the 23 post-completion-point countries. Thus far, 33 out of 41 countries that have been found eligible or potentially eligible for debt relief under the HIPC Initiative have received debt reduction.

Post-conflict countries have been encouraged to make efforts to become eligible for HIPC. Thus, the Comoros, Côte d'Ivoire, Eritrea, Kyrgyzstan, Nepal, Somalia, the Sudan and Togo are pre-decision-point countries, and some could receive debt relief. The estimated cost of HIPC Initiative debt relief to these eight interim countries is estimated to be $20 billion, most of which is attributable to three countries: Côte d'Ivoire, Somalia and the Sudan. Among the above-mentioned countries, the Comoros, Côte d'Ivoire and Togo are making progress towards the decision point. This year, Côte d'Ivoire and Togo cleared arrears to major creditors and could reach their decision points by the end of 2008.

Some recipient countries have shown remarkable efforts in reducing poverty

The principal aim of the HIPC Initiative was to release resources for development and thereby reduce poverty. Some low-income countries that received debt relief have demonstrated remarkable efforts in this regard, increasing their public expenditures on social sectors and poverty reduction programmes. In nominal terms, total poverty-reducing expenditures amounted to about $21 billion in 2007, which represents an increase of almost $15 billion since 2001. Poverty-reducing expenditures have increased in sectors such as health, rural infrastructure and education. For the 33 post-decision-point countries, such expenditures have increased on average from 6.7 per cent of GDP in 2001 to 8.8 per cent of GDP in 2007.

Considerable challenges remain in achieving the implementation of the HIPC Initiative

The success of the implementation of the HIPC Initiative requires sustained efforts on behalf of the international creditor community. Important challenges are still to be met to fully implement the HIPC Initiative and enable the remaining 18 precompletion-point countries to reach their completion points. These include ensuring full participation by all creditors and mobilizing additional resources to finance debt relief to all remaining HIPCs. Although most multilateral financial institutions have provided debt relief under the HIPC Initiative and the MDRI, some small multilateral institutions still need to be encouraged to participate in the HIPC Initiative.

While Paris Club members have made strong efforts in their debt-relief commitments, the participation of non-Paris Club official creditors has been low, delivering only about 40 per cent of their expected share in debt-relief operations for HIPCs. So far, only 8 non-Paris Club creditors have delivered full relief and 22 creditors partial relief, but 21 creditors have not yet delivered at all on HIPC Initiative debt relief. The participation of commercial creditors also remains low. They are estimated to have provided 33 per cent of their commitments in 2008, which is better than only 5 per cent the preceding year. Another issue related to the implementation of the HIPC Initiative concerns the litigation actions by commercial creditors against low-income countries. Even though the amounts involved are small in relation to total debt, the costs of litigation or resolution are significant in relation to debtor countries' export earnings and public budgets.

Risks of debt distress remains high among HIPCs

Reducing debt to a sustainable level remains an issue for many HIPCs. These countries are far from achieving debt sustainability. Risks of debt distress remain high among them, including those that have received full debt relief. Only 10 out of the 23 post-completion-point HIPCs could be classified as being at "low risk" of debt distress, highlighting the fact that many countries continue to be vulnerable. Indeed, several middle- and low-income countries are suffering from debt distress but are not eligible for the HIPC Initiative. These countries have no access to debt relief or to orderly sovereign debt workouts, as granting debt relief is conditional and only countries with unsustainable levels of debt are eligible.

Rehabilitating the global financial system

A lack of institutionalized mechanisms and deficient global governance structures hamper better policy coordination

As analysed in chapter I, policymakers in developed countries fell behind the curve in dealing with the emerging global financial crisis, having underestimated the depth and breadth of the problems in financial markets and their link to the global imbalances. During October 2008, piecemeal approaches were shed and policymakers in developed countries moved to manage the crisis in a more coordinated fashion. However, the path towards swift and improved policy coordination is hampered by the lack of institutionalized mechanisms to this end and by deficiencies in global governance structures. During 2008, further discussions have taken place on how to improve the regulation and supervision of a globalized financial system; how to improve the governance structure of the international financial institutions; how to strengthen the foundations of surveillance and policy cooperation on key systemic issues; and how to address the role of official financing of emerging market and developing countries. These issues remain far from being resolved, but the current crisis has increased the urgency of making further progress in this regard.

Regulating the global financial system

Addressing the crisis requires more fundamental changes to the financial system

While tackling the financial fallout is an immediate priority, measures to address the underlying causes of the disarray need to be taken. The final report of the Financial Stability Forum (FSF) on this issue was presented in April 2008 and was endorsed by the G7

Finance Ministers and the International Monetary and Financial Committee (IMFC).[20] The guiding objectives of the report are to recreate a financial system that operates with less debt and more capital, that is more transparent, that is immune to the kind of misaligned incentives at the root of the current crisis, and that boasts stronger prudential and regulatory oversight. There are policy recommendations on key areas, including prudential oversight of capital, liquidity and risk management; transparency, disclosure and valuation policies; the role and uses of credit ratings; and the authorities' responsiveness to risks and their arrangements for dealing with stress in the financial system.

The G7 accepted a number of FSF recommendations

The G7 accepted a number of FSF recommendations that had been identified as immediate priorities for implementation by the end of 2008. These include prompt and robust risk disclosure; improvement of the accounting, disclosure and valuation standards for off-balance sheet entities; the strengthening of risk management practices, including liquidity risk management; and the revision of the code of conduct for credit-rating agencies.

The FSF also called for additional measures relating to international interaction and consistency of national emergency arrangements and responses to address the current financial crisis; the scope of financial regulation, with a special emphasis on unregulated institutions, instruments and markets; and better integration of macroeconomic oversight and prudential supervision.

FSF proposals are not going far enough to deal with the pro-cyclicality of the financial system

The FSF-inspired measures to strengthen the global financial system, which are basically confined to improved disclosure, prudential controls and risk management, are now generally seen as not going far enough to address the inherent pro-cyclicality of the financial system, which tends to foster asset price bubbles. Regardless of the specific source of disturbance, almost all episodes of systemic financial distress have at their root very rapid credit growth, excessive risk-taking and overextension of balance sheets in good times, all masked by the strength of the real economy and extraordinary increases in asset prices.

The build-up of buffers in good times can provide a cushion in a downturn

As also argued in chapter I, recent developments have highlighted the importance of expanding the macroprudential tools of current regulatory frameworks. The approach would be to encourage the build-up of sufficiently high buffers (capital requirements, for example) in good times, when the market price of risk falls and imbalances might develop, in order both to restrain expansion during upswings and to provide a greater cushion against losses when disruptions occur. While financial leverage is a key ingredient of the private risk-taking necessary for investment and economic growth, it also tends to amplify both booms and downturns. By developing policy instruments to lower or raise capital requirements depending on the specific situation, authorities would be better equipped to utilize market incentives to reduce systemic risk.

The FSF report did not address pro-cyclicality per se because of the urgency of making concrete recommendations in other areas. However, the Forum has alluded to some aspects of pro-cyclicality from a longer-term perspective, including the capital regime, loan-loss provisioning practices, compensation arrangements, and the interactions

20 See Financial Stability Forum, "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience", 7 April 2008, available from http://www.fsforum.org/publications/r_0804.pdf. Based on the original proposals, the Financial Stability Forum submitted a follow-up report on 10 October 2008 which reviews the implementation of the recommendations set forth by the April report in five areas: (a) strengthened prudential oversight of capital, liquidity and risk management; (b) enhanced transparency and valuation; (c) changes in the role and uses of credit ratings; (d) strengthened responsiveness of authorities to risks; and (e) robust arrangements for dealing with stress in the financial system.

between valuation and leverage.[21] To this end, assessing the potential pro-cyclical impact of the New Basel Capital Accord (Basel II) is considered one of the most important priorities for supervisory authorities and central banks.

Global financial integration has been accompanied by a lack of international governance

The crisis has also highlighted the importance of greater international cooperation in financial sector monitoring and regulation, which are still basically national in nature. There is growing tension between global financial integration and deficits in international governance inconsistent with current global realities. There is a need to move towards an international macroprudential and regulatory architecture that is more integrated in its approach, has coordinated standards and structures, and that involves greater clarity of respective responsibilities and objectives as well as closer and more effective cross-border coordination and collaboration among supervisors, regulators, central banks and fiscal authorities. This global system of financial regulation, based on credible international rules, may require an international body (or bodies, such as the colleges of supervisors for systemically important financial institutions, as proposed by the FSF) that would have an explicit mandate for financial oversight and monitoring, as well as early-warning capabilities and the force and authority to ensure that those warnings are acted upon.

Consistent principles for international cooperation in crisis management need to be agreed in advance

It is equally important to develop ex ante agreed and consistent principles and practical guidelines for cross-border cooperation and contingency planning for crisis management. Indeed, much of the preparatory work to facilitate management of the international financial crisis has not yet been carried out.[22] Nevertheless, national authorities now better understand the need to have pre-existing plans for dealing with strains involving cross-border financial institutions, including large funding needs. Another important issue is clarifying the arrangements for coordination of deposit insurance for cross-border institutions.

International consultations on the financial crisis have intensified

The idea of a series of global summits on the reform of the international financial system—dealing with basic principles, regulations and institutions—has gained currency. On 15 November 2008, the United States convened the first such summit in Washington, D.C. in the form of the Group of Twenty (G20), plus the United Nations, the IMF and the World Bank. At this summit, there was still conflict, even among major economic powers, over the extent to which international financial regulation should be reformed, and the outgoing United States Administration could not accede in this regard. However, a work programme, which includes accounting standards, supervision and regulation and information exchange, was set out for consideration in a follow-up meeting to be held in April before the Spring 2009 meetings of the Bretton Woods institutions. At the same time, the President of the United Nations General Assembly created a Commission of Experts on Reforms of the International Monetary and Financial System, led by Professor Joseph Stiglitz of Columbia University, to report on proposals to reconfigure mechanisms and institutions of global economic governance based on lessons learned from the financial crisis. The outcome document of the 2008 Doha conference, which enjoys the consensus of all Member States of the United Nations, also stresses the need for a strengthened and more effective intergovernmental structure that would carry out the

21 Statement by Mario Draghi on the "Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience: Follow-up on implementation", at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from http://www.imf.org/external/am/2008/imfc/statement/eng/fsf.pdf.

22 See, for example, "International governance for the prevention and management of financial crises", speech by William R. White, Economic Adviser and Head of Monetary and Economic Department of the Bank for International Settlements, at the Bank of France International Monetary Seminar, Paris, 10 June 2008, available from http://www.bis.org/speeches/sp080708.htm.

financing for development follow-up and would review progress in the implementation of commitments, identify obstacles, challenges and emerging issues and propose concrete recommendations.

Equity contributions have increased the visibility of sovereign wealth funds

The series of substantial equity contributions to troubled financial institutions in industrialized economies has led to the sudden visibility of sovereign wealth funds (SWFs) from emerging and developing countries and to numerous calls for the regulation of their activities. The IMF International Working Group (IWG) of Sovereign Wealth Funds, comprising 25 member countries, was established in May 2008. It was set up to produce principles that properly reflect the governance and investment practices of SWFs.

In October 2008, the IWG published a set of 24 principles (the Santiago Principles) designed to ensure an open international investment environment. The purpose of the Santiago Principles is to establish a transparent and sound governance structure; to ensure compliance with applicable regulatory and disclosure requirements; to ensure that SWFs invest on the basis of economic and financial risk and return-related considerations; and to help maintain a stable global financial system and free flow of capital. The OECD has been undertaking parallel work in drawing up a similar set of guidelines for recipient countries. It is important that the guidelines for SWFs are no more onerous than those for other large institutional investors and that they do not introduce an element of bias and lack of evenhandedness in financial surveillance.

Governance reform at the Bretton Woods institutions

Voice and voting power

Progress on reforming governance of the IMF and the World Bank has been disappointing

During 2008, only a disappointing amount of progress was made in reforming the governance structures of the IMF and the World Bank in line with twenty-first century economic realities. On 28 April 2008, Governors from 180 of the 185 member countries of the IMF did, however, cast their vote on the proposed resolution on the quota and voice reform package. Of these, 175 countries, representing 93 per cent of total voting power in the Fund, voted in favour of the package. Three countries voted against, two abstained, and five did not participate in the vote.[23]

The package includes a second round of ad hoc quota increases of close to 10 per cent based on a new quota formula, the tripling of basic votes and the appointment of a second Alternate Director for constituencies consisting of at least 19 members. The resolution also requested the Executive Board to recommend further realignments of members' quota shares in the context of future general quota reviews, beginning with the Fourteenth General Review of Quotas, to ensure that members' quota shares adequately reflect their relative position in the world economy.

The realignment of quota and voting shares will lead to a net increase of 2.7 percentage points in the voting share of emerging markets and other developing countries as a whole. This very modest increase was only made possible owing to the use of a compression factor; the application for several emerging market and developing countries of a weight to the purchasing power parity (PPP) GDP measure greater than that for other countries; and, most importantly, the willingness of several advanced countries to forgo part of the quota increases to which they would have been eligible by a straight application of the proposed formula.

23 See "IMF reform secures backing by wide margin", *IMF Survey Magazine*, 29 April 2008, available from http://www.imf.org/external/pubs/ft/survey/so/2008/POL042908A.htm.

These ad hoc adjustments suggest that the new formula per se has not achieved the stated goal of providing a simpler and more transparent means of reflecting members' relative positions in the global economy. Indeed, without alterations, the voting shares of developing and emerging market countries would actually have declined by 1.6 percentage points. It is hardly rational to utilize, as an appropriate foundation for periodic reviews over the longer run, a formula that produces changes in shares that move farther away from a closer alignment of the voting power with economic realities.

The agreed changes are too modest to achieve significant change

The reform package recognizes the need for changes to the formula. According to the Executive Board, further work is necessary on measuring trade openness; addressing the treatment of intra-currency union flows; developing a method of capturing financial openness; and measuring variability to adequately capture members' potential need for Fund resources.[24] The agreed changes in members' quota and voting shares are too modest to influence the operation of the Fund.

The institutional framework determines the legitimacy and effectiveness of governance

Quotas and voting shares are only one aspect of IMF governance. Its legitimacy and effectiveness depends importantly on the institutional framework through which members' voting power is exercised. In this regard, there is a proposal to reduce the number of chairs on the Executive Board from 24 (of which 9 are currently being held by Europeans) to 22 in 2010 and, further, to 20 in 2012, while preserving the present number of developing country and emerging market country ones.[25] A more balanced composition and smaller-sized Board is considered important for transforming the Fund into a more effective global institution. In September 2008, the Managing Director announced the appointment of a Committee of Eminent Persons to assess the adequacy of the Fund's current framework for decision-making.

The current IMF deficit prevents it from playing a credible role in the international financial architecture

The IMF is currently running a deficit as a result of the decline in demand for Fund resources since the late 1990s. This jeopardizes its ability to play a credible role in the international financial architecture. Before the full scale of the global financial crisis became generally recognized, agreement had been reached at the IMF on both expenditure and income measures, including an expenditure reduction in the order of 14 per cent ($100 million) in real terms over the next three years. A new income model[26] that moves away from primarily lending-based income sources towards more predictable and sustainable investment-based ones was part of the package. The new income and expenditure framework is expected to cover the $400 million shortfall projected in the medium term.

Institutional reforms at the World Bank continue

The World Bank has launched its own process of voice and participation reform. The first phase of the exercise will include the creation of an additional seat for sub-Saharan Africa on the Bank's Board of Executive Directors and the doubling of basic votes. The dilution of the voting power of larger developing and transition countries will be mitigated through an exceptional allocation of unallocated shares. Further realignment of Bank shareholding will be taken up by the Board in a shareholder review, with the ultimate goal of moving over time towards equitable voting power between developed and developing members. At its 2008 Annual Meeting, the Development Committee asked

24 International Monetary Fund, "Report of the Managing Director to the International Monetary and Financial Committee on Reform of quota and voice in the International Monetary Fund", 7 April 2008, p. 3, available from http://www.imf.org/external/np/pp/eng/2008/040708.pdf.

25 Statement by Henry M. Paulson, Jr., Secretary of the Treasury of the United States of America, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from http://www.imf.org/external/am/2008/imfc/statement/eng/usa.pdf.

26 See "IMF Board of Governors approves key element of IMF's new income model", International Monetary Fund press release No. 08/101, 6 May 2008, available from http://www.imf.org/external/np/sec/pr/2008/pr08101.htm.

the Board to develop proposals by the 2010 Spring Meeting, and no later than the 2010 Annual Meeting, with a view to reaching consensus on realignment at the subsequent meeting in 2011.[27]

Multilateral surveillance

The IMF has been sidelined in handling the present crisis

As regards its assigned responsibility for multilateral surveillance, there remains a strong perception that the Fund has been sidelined in the handling of the present crisis. The IMF reacted to events as they occurred, endorsing the actions taken by major developed countries. Since it is indisputable that the global financial crisis requires global solutions, the world economy now more than ever needs a credible IMF with a governance structure that is more representative of developing country interests, and one which can exercise strong policy leadership.

New and better analytical instruments are needed to detect emerging risks

The major thrust of the ongoing reform of IMF surveillance mechanisms, which has assumed greater urgency in the light of the crisis, is to strengthen the analysis of macrofinancial linkages, integrating multilateral perspectives in bilateral surveillance, and enhancing the work on financial markets. It is recognized that the Fund will need to develop new and better analytical instruments to enhance its ability to detect emerging risks, including the extension of the vulnerability exercise to advanced countries, in order to improve the understanding of transmission mechanisms both within global financial markets and between financial markets and the real economy.

Surveillance of mature financial markets needs to be improved

Since the 1980s, the IMF has mainly been focused on problems in emerging markets and developing countries, devoting insufficient attention to major financial centres and vulnerabilities in global financial markets. The ongoing financial crisis underscores the need for the Fund to maintain a sharp focus on risks in the major developed countries, especially the reserve currency-issuing countries, and their potential spillover effects. Consequently, much work still needs to be done to improve surveillance over the mature financial markets and advanced economies. This will be essential for ensuring that a reformed IMF remains relevant and properly discharges its mandate in promoting global economic and financial stability.

While exchange-rate assessment lies at the centre of bilateral surveillance …

One of the most important areas of the Fund's work is surveillance over the exchange-rate policies of its members. In June 2007, the Executive Board approved an updating of the 1977 surveillance decision.[28] The update puts exchange-rate assessment at the centre of IMF bilateral surveillance, while external stability becomes the overarching principle of the surveillance framework.

The 2007 decision aims at providing a coherent framework within which exchange-rate issues can be assessed in the overall context of external stability. However, an over-reliance on quantitative models may divert attention away from a meaningful analysis of external and internal stability as well as from consideration of economic policy as a whole.

… there remains a need for a comprehensive approach

The assessment of a member's external stability should not be restricted to exchange-rate developments. The Fund's analysis should remain comprehensive, taking into account the overall macroeconomic situation, with emphasis on the consistency and

27 Communiqué of the Development Committee, the Joint Ministerial Committee of the Board of Governors of the Bank and the Fund on the transfer of real resources to developing countries, Washington, D.C., 12 October 2008, available from http://siteresources.worldbank.org/DEVCOMMINT/NewsAndEvents/21937474/FinalCommunique101208.pdf.

28 See, "IMF Executive board adopts new decision on bilateral surveillance over members' policies", International Monetary Fund, Public Information Notice (PIN), No. 07/69, 21 June 2007, available from http://www.imf.org/external/np/sec/pn/2007/pn0769.htm.

sustainability of the overall policy mix. The surveillance should be focused on the relevant challenges in individual countries and should avoid exchange-rate issues' crowding out attention to other important elements which determine macroeconomic stability in specific contexts. In this regard, it has been argued that more needs to be done in this field to ensure effective and evenhanded implementation of the decision.[29]

It is also considered important that surveillance over exchange-rate policies strike the right balance between candor and confidentiality of advice. It is essential that the Fund remain cautious and nuanced in presenting its exchange-rate assessments in view of the large margin of error and market impact.

In addition to the new surveillance decision, the IMF Executive Board reached agreement on a "Statement of Surveillance Priorities" in the context of the 2008 Triennial Surveillance Review (TSR). The four key policy objectives identified in the Statement are: to resolve financial-market distress; to strengthen the global financial system; to adjust to sharp changes in commodity prices; and to promote the orderly reduction of global imbalances. The fundamental goal of this effort should be to strengthen the spirit of cooperation by reaching a consensus among all members on the role of surveillance in assisting governments in dealing with the challenges of the integrated global economy.

Liquidity provisioning both during and for the prevention of crises

The provision of liquidity has become a key aspect of dealing with the crisis

Amidst the current financial market turmoil, the need for providing official liquidity has once again become the primary focus of Governments around the world. In its turn, the IMF has activated its emergency procedures—a mechanism to speed up lending in a crisis. As of mid-October 2008, several countries (Hungary, Iceland, Pakistan and Ukraine) had asked the IMF for financial assistance. According to the Managing Director of the Fund, the conditions of the loans will be fewer and they will be more targeted than in the past.[30] While the IMF has more than $200 billion worth of funds available for loans and can raise more money, if necessary, by tapping agreements to borrow from several member countries, the expected volume of the rescue packages could exhaust IMF resources given the current state of financial markets.

Assistance is also needed to address the food crisis

In addition to the financial crisis, the international community has had to deal with the food crisis. At its Spring 2008 meeting, the Development Committee requested the Fund and the Bank to be ready to provide timely policy and financial support to vulnerable countries dealing with negative shocks, including those from food prices.[31] As of October 2008, 11 countries had received about $200 million in additional assistance under existing lending programmes supported by the Poverty Reduction and Growth Facility (PRGF). Five new PRGF arrangements for about $274 million to help in part with commodity-price shocks were also approved. The IMF Executive Board also approved changes to the Exogenous Shock Facility (ESF) to make it more useful to low-income members. The changes are aimed at enabling the Fund to provide more rapid and effective assistance in

29 See, for instance, statement by Stefan Ingves, Governor of Sveriges Riksbank, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from http://www.imf.org/external/am/2008/imfc/statement/eng/swe.pdf.

30 "IMF in talks on loans to countries hit by financial crisis", *IMF Survey Magazine*, 22 October 2008, available from http://www.imf.org/external/pubs/ft/survey/so/2008/new102208a.htm.

31 Communiqué of the Development Committee, the Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the transfer of real resources to developing countries, Washington, D.C., 13 April 2008, available from http://siteresources.worldbank.org/DEVCOMMINT/NewsAndEvents/21728301/Apr_2008_DC_Communique_E.pdf.

the event of shocks, with faster disbursement based on up-front policy commitments and streamlined procedural requirements. However, further revisions of the ESF are considered necessary to increase the level of access and to streamline conditionality.[32]

The World Bank announced in May 2008 that it would support international efforts to overcome the global food crisis with a new $1.2 billion rapid financing facility to address immediate needs, including $200 million in grants targeted towards the vulnerable in the world's low-income countries. The $1.2 billion funding ceiling should be reached by May 2009.[33]

The IMF has launched a review of its lending role

Along with addressing immediate member needs, the Fund has launched a review of its lending role with a view to reaching decisions before the 2009 annual meetings. The priorities of the review include finalizing a new crisis-prevention instrument, re-examining lending facilities for low-income countries and reviewing access limits and financing terms for using Fund resources.

At least in part, the review has been a response to recent low demand for IMF facilities. The decline in demand for IMF credit over the last decade can be attributed to some extent to a rather long period of positive international economic conditions. At the same time, the Fund's lending toolkit might have failed to keep pace with the evolution of the global economy.

The review of the IMF's financial facilities should lead to a more coherent, transparent and predictable framework that will allow the institution to fulfill its mandate adequately. The IMF needs to move beyond its traditional stance of offering rigid instruments, with low access levels in comparison to countries' needs and with burdensome conditionalities. The reform should also aim at simplifying and streamlining the lending framework in order to provide clear signals to the markets, reduce its complexity and strengthen its effectiveness, while also enhancing the flexibility and adequacy of IMF financing.

The food crisis has led to increased interest in mechanisms to protect developing countries from external shocks

The onset of the food crisis reignited interest in mechanisms to protect developing countries, particularly low-income countries, from external economic shocks. Existing compensatory facilities have high levels of conditionality and do not provide sufficient resources relative to the shock, thus limiting their effectiveness for events beyond the control of affected countries. Countries have responded to shocks either by non-concessionary borrowing or by tightening fiscal and monetary policy, thereby undermining their own reform processes in order to avoid the onerous conditionalities associated with existing facilities.

The recent crisis has highlighted the need for a lender of last resort

Over the past decade, developing and emerging economies have made significant progress in consolidating fiscal balances and improving macroeconomic policy frameworks. Many of them have also built buffers against external shocks in the form of significant reserve accumulation. However, the recent financial market developments have demonstrated that no country is immune to crisis and, hence, there is a strong need for a lender of last resort. In the face of an exogenous and sudden stop in external funding, emerging market and developing country domestic central banks are unable to inject sufficient liquidity in the form of domestic currency, since this will not only be inflationary but can also cause the domestic currency to depreciate, the domestic interest rates to rise considerably, or both. There is also no guarantee that, during a major capital reversal or global liquidity crunch, domestic central banks will have sufficient reserves to provide emergency

32 Communiqué of the Intergovernmental Group of Twenty-Four on international monetary affairs and development, 10 October 2008, available from http://www.g24.org/10-08ENG.pdf.

33 "Update on key issues and World Bank Group activities", statement on behalf of the World Bank Group, at the eighteenth meeting of the International Monetary and Financial Committee of the International Monetary Fund, 11 October 2008, available from http://www.imf.org/External/AM/2008/imfc/statement/eng/wb.pdf.

liquidity assistance in foreign exchange. Indeed, the current crisis has demonstrated how quickly a cushion in the form of foreign-exchange reserves could evaporate.

For these countries, the IMF, along with regional reserve-pooling arrangements and swap agreements with developed country central banks, could potentially play the role of international lender of last resort. Since the late 1990s, due to unusually benign global conditions, demand for IMF lending has almost evaporated, while many borrowers have made early repayments. However, it would be unrealistic to suggest that the need for an international lender will never resurface again. The Fund should stand ready to help its emerging market and developing country members cope with liquidity problems in an environment of large and volatile capital flows. To this end, both appropriate facilities and amounts of financing relevant to members' needs are required.

There have been proposals to increase normal access limits …

In this regard, there have been proposals to increase normal access limits significantly above the current 300 per cent of quotas. Over the past 10 years, access limits—either measured as a share of GDP, trade or capital flows—have declined for emerging market and developing countries. This has led to a more or less permanent need to provide exceptional access, at exceptional financial and political costs, for countries experiencing capital reversals. Despite the quota and voice reform package, the limits for non-exceptional access will likely continue to shrink further in comparison to members' potential needs. Accordingly, there is a view that quotas are not an appropriate metric on which to base access to the Fund's resources and that alternative ways could be explored.

… but the design of instruments for quick liquidity provision also needs to be considered

In addition to increased normal access, there have been suggestions for examining the possibility of providing the IMF with mechanisms for the rapid granting of short-term or very short-term loans, probably with the participation of reserve currency-country central banks, to member countries affected by sudden international liquidity crunches. When systemic financial crisis occurs, speed is critical for the restoration of confidence in the financial system. The faster the access to funds, the smaller the amount of money needed. The creation within the Fund of instruments for quick provisioning of liquidity, similar to those used by central banks of advanced economies to cope with the current turbulence, may be worth studying. This, together with much higher normal access, could be the best response to the current crisis.

The IMF Executive Board approved the Short-Term Liquidity Facility

On 28 October 2008, the IMF Executive Board approved the Short-Term Liquidity Facility (SLF).[34] The new facility comes with no conditions once a loan has been approved, and offers large upfront financing to help countries restore confidence and combat financial contagion. To be eligible, countries should have a good track record of sound policies borne out by the most recent regular country assessment of the IMF. Disbursements of IMF resources can be as much as 500 per cent of quota, with a three-month maturity. Eligible countries are allowed to draw up to three times during a 12-month period.

Well-functioning regulatory systems are the best way to deal with moral hazard

As in the case of national central banks, an international lender must deal with the problem of moral hazard. There is almost a consensus that the best way to limit moral hazard is to develop a well-functioning prudential, regulatory and supervisory system. At the international level, moral hazard concerns could be addressed through existing mechanisms: the Financial Sector Assessment Program (FSAP); the preparation of Reports on the Observance of Standards and Codes (ROSCs); and the publication of Financial Soundness Indicators (FSIs). This surveillance, if performed diligently, should enhance the effectiveness of central bank-like emergency liquidity provisioning by the Fund.

34 See "IMF to launch new facility for emerging markets hit by financial crisis", *IMF Survey Magazine*, 29 October 2008, available from http://www.imf.org/external/pubs/ft/survey/so/2008/POL102908A.htm.

Since IMF emergency lending in large volumes is meant mainly to respond to situations of capital reversals, policy conditionality should include measures to stem the size and volatility of capital inflows. The Fund should support government policies to exercise prudential regulations for managing the impact of external flows on domestic balance sheets, thereby minimizing financial injections in crisis situations.

The Doha follow-up conference on financing for development and broader reforms

The United Nations General assembly should expand its involvement in reforming global economic governance

The financial crisis has broadened the consensus on the urgency of far-reaching reform of global economic governance and the international financial architecture. This effort is not likely to be completed at one meeting or in one specific forum. The G20-sponsored process will involve a series of meetings that will consider technical reports. Actual progress and effective reforms will depend on the political consensus that can build upon proposals that have already been discussed in many circles. It is therefore important that a genuinely political decision-making process, and one which is well-supported technically, provide the basis for the reform of the international system. Notable progress in this direction was achieved at the Doha follow-up conference on financing for development, but the process has only begun. As a genuinely universal body, capable of eliciting political commitment, the United Nations General Assembly should expand its participation in efforts towards this end.