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**Swiss Discussion Paper:  
Reviewing the Monterrey Consensus**

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This paper constitutes Switzerland's contribution to the review process of the implementation of the Monterrey Consensus (MC). It has been elaborated by the Swiss "Interdepartmental Group on Financing for Development", which also included representatives from Swiss NGOs. While the latter contributed considerably to the orientation of the paper, the views expressed in the paper reflect the Swiss Government's analysis and interpretation of the development since the MC was put in place in 2002. In doing so, the paper equally highlights emerging issues, which are new or have not been sufficiently addressed in the MC.

## Swiss discussion paper

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## Reviewing the Monterrey Consensus

The Monterrey Consensus (MC) on Financing for Development is a unique multi-stakeholder initiative for building balanced and effective development partnerships. Through its comprehensive approach, the MC highlights relationships and linkages between the main financial flows that impact shared goals of poverty eradication, economic growth, sustainable development and, in particular, the Millennium Development Goals (MDG). It thus provides a valuable platform for all stakeholders – governments, financial institutions, multi- and bilateral development agencies and civil society – to jointly address the coherence, coordination and effectiveness of relevant policies and actions.

As Switzerland's contribution to preparatory discussions for the Follow-up International Conference at Doha, this paper considers each "core area" of the MC as follows: Chapter one reviews key commitments in each of the six "core areas" (A-F), outlining the main changes and progress that has occurred in the past six years, as well as outstanding challenges and relevant Swiss activities in each area. Chapter two discusses the main issues concerned in each area, including key issues that were raised by the MC (Section 2.1) as well as outstanding issues that are not clearly addressed in the MC – and are, in part, new – and which require further discussion (Section 2.2).

Before commencing the review, three general aspects of the "core areas" should be stressed. First, while financial flows in all six intertwined areas are relevant to development processes, the particular role and significance of each flow differs considerably from country to country. Foreign direct investment (FDI) and trade may be the crucial flows in some countries, for example, while official development assistance (ODA) and debt relief may have greater current importance in others. Therefore, improved coherence and effectiveness require not only global principles and actions, but also specific country-level development strategies; there is no "one size fits all" solution.

Second, while all six MC areas are important, domestic resource mobilization is, in a real sense, most essential. This is expressed in the MC statement that "each country has primary responsibility for its own economic and social development". Furthermore, the essential nature of domestic resources derives from their integral relationship to development objectives; effective mobilization and use of domestic resources is an essential condition for – and aspect of – sustainable development processes. Attention should thus be paid to the links between domestic and other financial flows through the promotion of an enabling international economic environment.

The third point concerns ODA, which occupies a critical status in relation to the other, often larger, sources of financing for development. As a policy-driven flow that is specifically dedicated to development goals, ODA must assume a complementary role, enabling, leveraging and/or supplementing the other flows and mechanisms. In this sense, while the *quantity* of ODA is very important, its *quality* – i.e., effectiveness with regard to locally determined development priorities and strategies – is also crucial.

## A. Domestic resource mobilization

### A1. Review

#### A1.1 Summary of MC commitments

The 10 MC paragraphs regarding domestic resources may be usefully grouped under three headings: favourable domestic conditions, fiscal and financial systems and the effectiveness of resources with regard to development objectives (see Box 1).

##### Box 1. Main MC commitments regarding domestic resource mobilization

- Ensure **favourable domestic conditions** for the mobilization of private savings, productive investments and economic growth (§10):
  - macro-economic stability, sound monetary and regulatory policies, (§10,12,14)
  - good governance, including stable property rights, rule of law, democratic processes, accountability, equity and gender equality (§11)
  - investments in economic and social infrastructure; effective services (§16)
  - strengthened domestic financial sector (§17).
- Establish **sustainable fiscal and financial systems** (§15):
  - effective institutional governance, fight against corruption (§13,19)
  - sustainable, efficient and equitable fiscal system (§15)
  - improved public spending (§15)
  - institutional capacity building and human resource development (§19).
- Ensure the **impact of domestic resources on development objectives**: growth, poverty eradication, equity and sustainable development (§10):
  - investment in gender sensitive social services, active labour market policies, social safety nets, etc. (§16)
  - Microfinance, credit for MSE and rural areas (§18)
  - incorporation of the informal sector (§18)
  - education and human resource development (§19).

#### A1.2 Scope and significance

The sustainable mobilization of domestic resources is an essential condition for achieving agreed development objectives. Encompassing both private and public sectors, the MC seeks to promote capacities to generate domestic savings and channel available resources into productive investments. In the public sector, the MC aims to establish sustainable, efficient and equitable fiscal systems while improving budgeting, spending and public administration capabilities.

Adequate fiscal revenues are needed to directly address development objectives – e.g. through infrastructure, social services and efficient public administration – while ensuring enabling conditions for economic growth, decreasing aid dependency and managing public debt in a sustainable manner.

#### A1.3 Changes in the relevant global context

Following the sharp economic downturn of 2001-2002, the global economy experienced its strongest period of sustained growth since the early 1970's, with growth rates reaching 5 percent in 2006. This international context has been generally favourable to developing countries, significantly enhancing their potential for private savings and investment. More recently, however, this favourable environment has shown signs of worsening in the face of financial market instability and rising food and energy prices. World growth is expected to slow to 3.7 percent in 2008. These developments challenge recent gains in the fields of macroeconomic stability, fiscal performance and growth.

#### **A1.4 Progress and challenges**

Progress regarding savings and investment has been uneven, varying considerably between and within countries. Moreover, recent growth in the developing countries is closely correlated with the general economic upswing and high commodity prices. Further improvements in the underlying conditions for private sector activities are necessary to protect recent gains in the face of global uncertainties.

Recent progress in the field of budget management has been mixed. While many countries have reduced their public deficit – some primarily via improved fiscal policies, others through external debt relief – there is still much room for improvement. As a proportion of GNP, fiscal revenues have changed only marginally in recent years, remaining consistently lower in low-income countries as compared to lower-middle-income and upper-middle-income countries.

Assessment of PRSP implementation indicates some progress on the expenditure side, both in terms of allocative efficiency and fiscal governance. There have been specific improvements in budget planning, formulation and execution, as well as reporting and monitoring. Participatory budgeting has significantly enhanced civil society involvement, transparency and democratic process in many countries.

However, at half-time in the MDG endeavour, it is already clear that most countries will not achieve many of the established goals due to an inadequacy of financial resources and, in many cases, limited capacity to absorb higher levels of resources. In this context, the MC constitutes a useful platform in the search for more coherent approaches towards financing that would accelerate progress towards the MDG.

#### **A1.5 Swiss activities in the area**

Swiss development cooperation gives prominent place to the promotion of domestic resource mobilization. In the fields of fiscal management, decentralisation and governance, Switzerland supports several programs which aim at strengthening tax administration and promoting fiscal policies that are conducive to growth. Fiscal strengthening is given particular emphasis in those countries where general budget support is provided (e.g., Nicaragua, Burkina Faso, Tanzania, Mozambique, Ghana, Benin). Support is also provided to strengthen the expenditure side at all stages of the budgetary cycle. Swiss programmes promote fiscal decentralization, local economic development, participatory budgeting and related aspects of governance, including administrative reform, improved conditions for business through service efficiency and reduced red tape. Particular attention is paid to the rights of women and children in these regards.

Switzerland views access to financial services as a crucial aspect of the fight against poverty. Programmes to support financial sector development operate at four levels: 1) demand side support to strengthen clients' capital and financial literacy; 2) supply side support to institutions and service providers; 3) infrastructure development, including networks and associations, training institutions, auditors, IT capacity; and 4) strengthening of policy, regulatory and supervisory frameworks. Swiss comparative advantages lie in the fields of rural finance (in synergy with rural development activities); multi-partner arrangements at retail, infrastructure and policy levels. Long-term engagement is seen as crucial to successful institutional development processes. To improve the access SMEs to financial markets, Switzerland also invests in venture capital funds (see Box 2).

Natural resource management and cleaner production are two fields in which Switzerland is promoting resource mobilization within a sustainable development approach. Finally, infrastructure systems,

including reliable power and water supplies, are critical components of an enabling business environment. Switzerland supports the technical and institutional modernisation of infrastructure systems in several countries.

#### **Box 2. Case in point: Swiss experience with SME start-up support**

Since 1995, Switzerland has invested some CHF 300 million in the framework of economic development cooperation. Considering about 40 projects, most investments have been made as shares in venture capital funds for SME's. A case study conducted between 2004 and 2007 traced the positive repercussions on the local economies. Based on a sample of 50 SME in Eastern Europe and Latin America, the findings indicate that:

- The number of employees in the companies increased by 25 percent annually following an investment round; employees' wages rose by an average of 26 percent in the period.
- On average, each SME works with 18 producers, 10 distributors and 20 service providers; the growth of one SME thus boosts the entire economy
- On average, each dollar invested in a venture capital fund has generated 12 dollars in the local economy.

## **A2. Discussion of issues**

### **A2.1 MC issues and actions**

#### ***Promoting private sector savings and investment***

Macro-economic stability, including low inflation and fiscal balance, is an essential condition for the mobilization of domestic resources. At the same time, exclusive attention to macro-economic stability should not subvert efforts to promote necessary structural changes and effective recovery measures in the event of economic downturn.

Beside the basic conditions of good governance, including stable property rights, an efficient legal system and democratic accountability, development programmes should promote sound economic and financial governance and efficient, citizen-oriented administration to generate favourable conditions for private savings and investment.

Efficient and reliable infrastructure systems – including transport, utilities and public services – comprise important aspects of an enabling business environment. The capacity to develop and operate these systems depends on the mobilization of investment resources and generation of appropriate levels of user-based fees.

Domestic financial sectors need strengthening in order to improve the absorption capacity for and management of capital flows. Local capital markets can help to increase national savings rates, while more effective management of private and public assets would help to retain more resources in domestic markets. An enhanced variety of demand-driven financial products is required to ensure access to capital by domestic entrepreneurs, with particular emphasis being placed on financing access for women and rural populations. Development of the domestic financial sector also calls for a strengthened regulatory framework in accordance with internationally recognised standards, including provisions against corruption and illegal transactions.

Technical assistance should support efforts to improve entrepreneurship as well as foster administrative reforms. Training as well as human and institutional development (HID) are frequently required in such fields as credit allocation, management information systems, risk management, auditing, liquidity management and capital markets operations. These efforts may be facilitated through linkages between domestic and foreign firms (FDI) that facilitate knowledge transfer as well as access to foreign capital.

Finally, remittances represent an important resource for many countries. Estimated at a total of USD 120 billion in 2002, remittances doubled to about USD 240 billion by 2007. Governments should explore ways to increase the transparency of transfer channels in order to reduce costs and increase the share available for productive investments. Finally, countries, in particular recipient countries, may consider tax incentives for remittance accounts.

### ***Strengthening fiscal and financial systems***

An effective fiscal system is central to the state's role in development processes. Efforts to improve fiscal performance should aim at broadening the tax base, simplifying tax structures and supporting more effective revenue allocation. Fiscal policies should facilitate the integration of the informal sector into the formal economy. Furthermore, governments should attempt to strengthen the social “fiscal compact” by advances in transparency, accountability and governance – to ensure the participation of civil society and the private sector – and improvements in public administration and infrastructure systems – to establish positive links between tax payments and improved service performance. Cooperation on matters relating to taxation could be valuable in serving the technical assistance needs of developing countries for strengthening their tax administration and broadening their tax bases.

Because local governments tend to be more representative and responsive to constituents' needs, developing countries should explore the potential for fiscal decentralization. At the same time, it should be noted that the devolution of fiscal authority can only be effective under conditions of improved accountability of local governments, effective central oversight and appropriate measures to address associated corruption and equity concerns.

Local and regional governments may also play a significant role in resource mobilization and economic development by promoting coordination and interaction among key economic actors, generating a sound business environment fostering public-private partnerships and actively promoting equity – including gender equity – in economic development. The cooperation and appropriate division of labour between central, regional and local governments in the fields of resource mobilization and development promotion needs to be established.

All countries should ensure the enforcement of legal provisions adopted following ratification of the UN Convention Against Corruption, including the fight against political lending.

### ***Ensuring the development impact of domestic resources***

While sound macro-economic policies are necessary for macro-economic stability, they are not sufficient to ensure the contribution of domestic resources towards the objectives of equitable and sustainable development. To this end, the application of domestic resource must be guided by appropriate social and environmental policies as well as being careful prioritised and coordinated with external resource flows. To enable such prioritisation and coordination, authorities need to set clear and feasible objectives within comprehensive, multi-sectoral development strategies which effectively orient the domestic private sector, public development programmes, international trade, FDI and donor support towards desired development outcomes. This is, for example, a main purpose of “Poverty Reduction Strategy Papers”. To date PRSPs have been adopted by over 70 countries, and “interim” PRSPs by about 50 more.

## **A2.2 Outstanding issues**

### ***Fiscal balance and poverty***

In order to contribute effectively to poverty reduction, a fiscal system should: (i) maintain a sustainable aggregate fiscal balance (which may translate into small and temporary deficits depending on circumstances); (ii) improve the allocative efficiency of spending both across and within sectors; (iii) strengthen public financial management systems, including tax administration, with a special focus on transparency and accountability. Spending programs, if well designed and targeted, may be more effective in reducing inequality than tax policies. However, both spending and revenue mobilization policies should be designed with regard to their anticipated overall impact on growth, so that the inhibiting effects of taxation do not outweigh the positive impact of associated spending.

### ***The “fiscal compact” and external debt***

Low income countries in which foreign assistance represents a significant share of the public budget may become caught in a nexus of external debt and poor fiscal performance. In order to enlarge its fiscal space, improve fiscal performance and increase its capacity to repay external debt, the state needs to build a “fiscal compact” with civil society and the private sector, based on democratic processes and accountability. This is a long-term process which requires broad donor support.

### ***Climate change and fiscal instruments***

In view of the increasing urgency of climate change issues, governments should consider the introduction of fiscal instruments which modify incentives to favour lower greenhouse gas emissions and leading investment into sustainable sectors and domains while, at the same time, generating revenues for adaptive measures regarding climate change and development: the “double bottom line”.

### ***Gender and domestic resource mobilization***

In the follow-up process to Doha, the empowerment of women needs to be addressed more pro-actively. Gender equality is, in fact, a cross-cutting issue that arises in most chapters of the MC; key conditions and measures include:

- Incorporating the gender perspective in public financial management and promoting principles of gender responsive budgeting
- Expanding women’s access to markets and trade
- Improving the legal basis for equitable access of women to land and other assets
- Promotion of women’s participation in decision making processes related to regional, national and international trade
- Encouragement of the entrepreneurial role of women through micro-finance, micro-credit, etc.
- Promotion of administrative and legislative reform to give women equal access to education, economic resources, inheritance rights as well as access to natural resources and technology.

## B. International financing

### B1. Review

#### B1.1 Summary of MC commitments

##### Box 3. Main MC commitments regarding international financing

- **Creating domestic conditions** that are conducive to foreign direct investment FDI (§20):
  - build transparent, stable investment climate (§21)
  - establish public/private sector financing mechanisms (§23).
- **Orientation of foreign investments** towards domestic development goals (§23):
  - encourage businesses to address social, gender and environmental implications of investment (§23)
  - increase support for infrastructure development (§22)
  - promote public private partnerships (§24).
- **Regional and international institutions** to support FDI (§22):
  - increase transparency and timely information on financial flows and markets (§25)
  - provide export credits, co-financing, venture capital, etc. (§22)
  - implement measures to mitigate the volatility of short-term capital flows (§25)
  - provide technical assistance and capacity building programmes related to policy frameworks, regulation, financial management, etc. (21).

#### B1.2 Scope and significance

Private international capital flows are vital complements to domestic and international development efforts. Besides directly impacting investment, economic growth and employment, they transfer knowledge and technology, boost productivity and enhance competitiveness and entrepreneurship.

Private international capital flows include private investments (FDI and portfolio investments) as well as private credits (obligations, bank and other credits). Over the past four years these flows have increased more than threefold from USD 154 billion in 2001 to USD 490 billion in 2005. Of the 2005 total, FDI takes the largest share (48 percent), followed by short-term credits, bank credits, obligations and portfolio investments (which range between 12-15 percent of the total). Portfolio investments have been most dynamic, expanding by a factor of 10 from USD 6.4 billion in 2001 to 61.4 billion in 2004.

#### B1.3 Changes in the relevant global context

In the context of a rapidly growing international economy, FDI to developing countries has risen strongly in recently years. After a period of stagnation between 1998-2003, FDI has roughly doubled since 2003, to reach USD 325 billion in 2006. This amount includes significantly increased South-South investment.

#### B1.4 Progress and challenges

The developmental impact of FDI has, however, been limited by high geographic concentration. In 2005–06, about half of FDI went to only five countries; most poor countries have had very limited access to these inflows. Furthermore, FDI tends to be concentrated in a small number of high-yield sectors such as extractive industries (mainly oil and gas), telecommunication, the financial sector and real estate. In general, private investment funds have neglected infrastructure sectors, where they would provide a welcome complement to domestic investment for the alleviation of growth bottlenecks.

The past decade has witnessed the emergence of a new group of active investors from developing and emerging countries, including an increasing number of successful trans-national companies

based in emerging economies. According to the OECD, South-South FDI reached USD 133 billion in 2005, representing a 17 percent share of world outward flows. Emerging global investors include sovereign wealth funds (SWF) – state-own investment funds comprising various financial assets that have been accumulated by a number of countries. In recent years, SWF have sought to diversify their portfolios, including a certain geographic diversification in the form of South-South investments. The potential resource flow is considerable.

## **B1.5 Swiss activities in the area**

Switzerland attaches particular importance to fostering private capital flows and investments to those developing and transitional countries which are particularly dependent on external aid. It has introduced several instruments and supported initiatives which employ ODA to leverage private know-how and capital for sustainable investment in developing countries by:

- improving the business environment (legal framework, regulatory authorities, rule of law, etc.)
- developing business services for entrepreneurs and companies through regional projects
- improving capital access, particularly for SMEs, via participation in financial intermediaries
- promoting appropriate conditions for public-private partnerships in infrastructure development and other specific needs such as access to drugs
- exploring potentials for brokering public-private development partnerships (PPDP) between government agencies of developing countries and international firms.

Switzerland has also contributed to the formulation and dissemination of relevant “tools” (Box 4).

### **Box 4. Case in point: Swiss experience with FfD tools**

**Government-Investor Networks.** The GIN is a secure intranet communication platform, which enhances the capacity of governments to collaborate with the private sector. It contributes to an enabling business environment by identifying critical investment impediments, formulating possible solutions and catalyzing their implementation. The GIN includes Performance Reports indicating government’s progress in resolving issues. Donors may have access to first-hand accounts of problems and possible solutions, thus promoting aid effectiveness.

The first National GIN Pilot was launched in Nicaragua in 2004. More than 50 success stories have since been reported, ranging from open government consultations with investors on regulations and laws that improve the business climate to enhanced intergovernmental coordination for improving infrastructure systems. Based on the Nicaraguan GIN success, a Central American Network for the integrated advancement of regional tourism was approved in 2006 by seven Ministers of Tourism from the Central American Council of Tourism and seven National Presidents of National Chambers of Tourism. It was launched in early 2008.

**INFRADEV Network.** To be launched in fall 2008, the INFRADEV Network aims at leveraging official sector risk mitigation services to enable greater access to private sector capital for developing country infrastructure projects. INFRADEV brings together leading experts and practitioners from public and private sectors, and includes info-enabling resources on services, projects, and financial structures. The Network will include an Intranet enabling 24-7 communication and access, as well as global conference calls and in-person meetings. INFRADEV builds on four years’ work by the Infrastructure Experts Group, launched at the 2002 FfD Conference at Monterrey with over 200 members.

**Global Info Portal.** A free public website ([www.globalclearinghouse.org/gch](http://www.globalclearinghouse.org/gch)), the Global Info Portal provides one-stop-shop access to over 42,000 on-line resources on developing country investment opportunities, risks, and transaction services for over 160 developing countries. The Portal is the only available free service that centralizes the major standard reports produced by international development agencies and provides information links to sites of developing country governments (investment promotion agencies, finance ministries, etc), as well as private sector companies. Governments can recommend content for inclusion on the Portal, and mail Portal pages to interested investors (i.e. information on country competitiveness, risk assessments, success stories, regulations, etc.).

## **B2. Discussion of issues**

### **B2.1 MC issues and actions**

#### ***Expanding FDI flows***

Recent efforts of many developing countries to improve their domestic investment climate should be actively supported. Particular attention should be given to steps which improve reciprocity, reduce administrative burdens, strengthen legal mechanisms and combat the corrupt practices which weaken the investment climate in many countries. Further progress in these areas would lower the costs of doing business, reduce risks and provide the long-term predictability that is crucial to investors' confidence.

#### ***Linking FDI to development objectives***

Concerted efforts are required to mobilize international private resources and foster private investments in presently underserved markets and economic sectors. This is typically an area where development agencies can achieve greater effectiveness by catalysing and complementing other financial flows and private investments, both local and international. Well-targeted ODA may be employed to demonstrate the viability of private investments which yield a strong "triple bottom line" of financial, social and environmental benefits.

The concept of corporate social responsibility (CSR) may help to link FDI more closely to development objectives. The UN Global Compact comprises an important initiative in this regard. Capacity building in CSR concerns not only companies but also authorities responsible. Promotion of CSR is also required in FDI source-countries, of course.

Multilateral and Regional Development Banks should scale up official sector guarantees – such as partial risk guarantees and first loss coverage, as well as targeted guarantees of regulatory and currency risks – to promote the advance of private sector resources into areas that are vital for development objectives. They should also expand their support for local currency financing in order to promote local capital markets. Capacity building activities may support improved investment pipelines through the preparation of well designed development projects.

A rising risk appetite has been observed among private and institutional investors, which – in spite of recent curtailment – includes the general willingness to explore investment opportunities in frontier markets and emerging asset classes. The concept of "corporate citizenship" may favour this tendency. There is also increasing interest in socially relevant investment opportunities on the part of high-net-worth individuals. These developments imply an increased potential to leverage ODA flows through public-private partnerships in which risks and returns are shared with a new group of private investors.

#### ***Establishing a positive international framework for private capital flows***

At the international level, the availability of private capital for development related investments may be promoted through improved transparency and information access. Cross-country comparisons are useful in this regard. Several relevant "tools" have being developed to promote investment decision-making and its relevance to development. (Three Swiss-supported tools are described in Box 4.)

The growing importance of South-South FDI has been noted. This trend should be encouraged, with more emphasis being given to those countries which may play a hub function for regional development. Here, as in the case of FDI in general, attention must be paid to international safeguard policies and standards in the social and environmental fields.

The growing importance of SWE has also been noted. Further efforts are required to clarify the investment profiles and policies of these funds, with a view towards greater transparency and accountability.

## **B2.2 Outstanding issues**

### ***Quality and development impact of FDI***

While access to FDI may be associated with positive development effects in recipient countries, this is not always the case. Efforts are required to ensure a positive and sustainable impact and mitigate associated risks with regard to the following issues:

- Compliance with international standards and “good practices” regarding social and environmental factors varies considerably; this may result in serious negative externalities, particularly in extractive industries, for which the responsible firms are not held responsible.
- The developmental impact of FDI can vary considerably with the nature of the engagement (e.g. merger and acquisitions or green-field investments); moreover, growing international competition, notably in the manufacturing sector, increasingly influences the length of business cycles, which again may have an impact on the volatility of FDI.

### ***Attracting FDI***

Many countries grant tax and regulatory exemptions in order to attract foreign investors. To prevent such measures from leading to a “race to the bottom”, countries need to build their competitive advantage upon a transparent regulatory environment which reflects clear standards and policy objectives. Efforts are required to coordinate such policies at regional and sub-regional levels in order to ensure a level playing field.

## C. International trade

### C1. Review

#### C1.1 Summary of MC commitments

##### Box 5. Main MC commitments regarding international trade

- Reduce **barriers to international trade** (§28):
  - Establish a universal, rule-based, non-discriminatory, equitable multilateral trading system; trade liberalisation (§26)
  - Accession of all developing countries to the WTO (§30, 31).
- Improve **market access for exports** from developing countries (§33, 34):
  - Address marginalisation of LDCs in international trade (§31)
  - Duty-free and quota-free access for all LDC exports (§34)
  - Full participation of developing countries in multi-lateral trade negotiations (§38).
- Reduce **supply-side constraints** to trade (§36):
  - Develop trade infrastructure (§36)
  - Trade-related training, capacity/institution building and trade-supporting services (§36)
  - Multilateral assistance to mitigate the consequences of depressed export revenues of countries heavily dependent on commodity trading (§37).

#### C1.2 Scope and significance

For many developing countries, increased integration into the world economy has contributed towards economic growth, expanded job opportunities, higher standards of living and poverty reduction. Competition in international markets stimulates advances in technology and productivity. For smaller countries, in particular, international trade offers the potential to expand the scale of production beyond limited domestic markets.

Earnings from exports are by far the most important source of the foreign exchange resources required for imports, development financing and debt servicing. In quantitative terms, the total export earnings of developing countries – about USD 3'630 billion in 2006 – are roughly 13 times higher than FDI, and 35 times ODA.

#### C1.3 Changes in the relevant global context

The strong growth of international trade – and, in particular, the expansion of exports from developing countries – is a significant feature of the world economy since the Monterey Conference. However, trade patterns have been quite uneven. While exports from middle income countries have expanded strongly as a proportion of GNI, advancing from 26.7 percent in 2001 to 35.1 percent in 2006, exports from low-income increased only marginally from 20.4 to 20.7 percent in the period.

#### C1.4 Progress and challenges

By 2006, the share of developing countries in world trade reached 34 percent, up from 29 percent in 1996. This promising development includes a strong expansion of South-South merchandise trade, which advanced from 11 percent of world merchandise trade in 1995 to 15 percent in 2005. Average tariffs applied to imports from developing countries have been decreasing in recent years. Excluding arms, 76 percent of exports from developing countries entered developed countries duty free; for LDCs, the duty free proportion is over 82 percent.

However, recent changes in the geography of world trade flows have largely bypassed the group of least developed countries (LDCs) which still account for only 0.5 per cent of overall trade. Moreover, the composition of export products from developing countries has changed very little: a limited range of natural resources and low value-added manufactured products make up the bulk of exports.

The recent rise in commodity prices has been a boon for large commodity exporters, while at the same time confronting other countries with serious difficulties. The alarming rise of food prices in many countries has focused attention on relationships between energy policies and food prices; problematic links between domestic agriculture, commodity trade and global financial mechanisms; and the role of open trade policies in relation to food and energy prices.

While world trade has expanded greatly since Monterrey, it has not yet been possible to conclude the WTO-Doha Development Round.

### **C1.5 Swiss activities in the area**

Appreciating the importance of internal (supply-side) constraints in undermining competitiveness, Switzerland has long been active in the provision of trade-related technical assistance. Programmes aim mainly at increasing the export potentials of SME by building their capability to meet international norms and standards (SPS/TBT) and enhancing their productivity and competitiveness through marketing, market research, quality management, procurement, access to trade finance, etc. To facilitate access to European markets, SMEs in partner countries receive comprehensive market assistance (e.g. at trade fairs) through the Swiss Import Promotion Programme (SIPPO).

Multilateral trade rules have been adapted to the particular situation and needs of developing countries, granting special and differential treatment according to the level of development. Since April 2007 Switzerland has employed the General System of Preferences (GSP) to grant least developed countries full zero-tax access to the Swiss market. Other developing countries benefit from preferential treatment, including tax-free import of all industrial goods except textiles and significant reductions for agricultural products and textiles.

Switzerland strongly supports the principle mainstreaming trade into the wider framework of development and poverty reduction strategies and enhancing coordination in the field of trade related technical assistance, as specified by the Paris Declaration. In the areas of trade policy and regulation, Switzerland supports successful conclusion of the Doha round. It contributes to capacity strengthening within WTO accession processes and trade reform, as well as providing support in “new” trade topics such as intellectual property, services, competition and government procurement.

## **C2. Discussion of issues**

### **C2.1 MC issues and actions**

#### ***Reducing barriers to trade***

Successful conclusion of the Doha Round remains a crucial condition for realising the potential development impact of expanded international trade, particularly for low-income countries. While larger and more advanced developing countries have managed to consolidate and widen their market access through bilateral and regional preferential trade arrangements, LDCs risk being left behind by these vigorous regional liberalization forces.

It is important, furthermore, to: 1) strengthen the rules and discipline of the WTO, in order to control abuses, particularly with regard to dumping; 2) secure full implementation of all commitments made at the Uruguay Round, and; 3) assure that accession processes of developing and transitional countries willing to join the WTO are carried out without unnecessary delay.

### ***Improving market access for exports***

Multilateral trading rules need to consider the actual conditions of each developing country, providing special and differentiated treatment according to their level of development. As noted, the General System of Preferences (GSP), makes it possible for developing countries to grant LDCs zero-tax access to their markets without modifying tariff provisions for other countries – i.e. through exemption from the Most Favoured Nation principle. This provision should be applied where ever appropriate.

Growing importance is being attached to environmental and social criteria within trade. In this context, it is important to support industrial processes that are compliant with international environment and social conventions related to trade. Environmental and labour standards should be employed, not as non-tariff measures, but as criteria for the development of trade-oriented production. Based on the rising social and environmental consciousness of consumers in the industrialised countries there is a potential to open “niche” markets for developing countries’ products. Socially and environmentally based restrictions need to be carefully designed and applied. Specific market instruments such as labels, declarations of origin and declaration of content may have a similar effect without risking undue distortion of export potentials.

Regional trade agreements (RTAs) and South-South integration mechanisms have received considerable attention in recent years. From a development perspective, RTAs may offer improved market access while providing a testing ground for new rules and disciplines which may later be introduced at the multilateral level. It is important to actively involve LDCs in these new regional integration schemes, enabling them to become fully integrated into international value chains and compensate possible negative effects related to eroding preferences in the context of further trade liberalization. Involvement of the poorest countries in international value chains may best be promoted by strengthening the exchange of goods and services between the poorest countries and the “emerging South” – India, China, South Africa, Brazil, etc. The role of these poles of international trade and access by neighbouring countries need to be strengthened. South-South integration is often hindered by tariff and non-tariff barriers that are, in many cases, more stringent than those affecting North-South trade. Greater emphasis should be placed on easing South-South trade restrictions while, at the same time, addressing existing constraints and distortions in South-South and North-North trade.

### ***Reducing supply-side constraints***

Supply-side constraints to expanded developing country exports include many factors, ranging from logistic and administrative processing capacities, on the one hand, to technical production capacity and structural conditions in the domestic economy, on the other. Government trade reform and expansion policies must therefore be correspondingly broad, encompassing social, ecological and economic aspects as well as financial, fiscal and administrative measures. The Integrated Framework for trade related technical assistance and the PRSP provide useful instruments for the coordination of action programmes.

The Paris Declaration on Aid Effectiveness also stresses the importance of mainstreaming trade promotion within the wider framework of development and poverty reduction strategies, while enhancing coordination in the field of trade-related technical assistance. Increasing support to trade promotion and related instruments should be closely integrated in the overall development assistance

framework. International financial institutions, in particular the World Bank, are important actors in this field. Other aspects of supply-side constraints need to be addressed through measures relating to Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Standards (SPS), to enable exporting countries to meet standards of international markets. Relevant measures were outlined in the Aid for Trade (Aft) initiative at the WTO Ministerial Conference (Hong Kong, December 2005).

## **C2.2 Outstanding issues**

### ***Climate change and trade***

International trade may, in principle, promote an optimal use of the world's resources and production capacities. Under conditions of adequate knowledge and control of externalities, trade may contribute to the development and propagation of environmentally friendly technologies. In particular, trade should be liberalised for goods and services with a potentially positive impact on climate change. Switzerland, together with nine other countries, has tabled a proposal to liberalize 153 such environmentally friendly products.

Investment in low-carbon technologies generally depend on the long-term predictability of the relevant trade and climate policy framework. Long-term commitment periods should thus be agreed in a post-Kyoto agreement. The flexible mechanisms of the Kyoto Protocol – and, more specifically, the clean development mechanism (CDM) – are innovative instruments which may play an important role as market-based financing mechanisms and tools which enable technology transfer in the global climate regime. The CDM allows industrialized countries to achieve emission reductions at lower costs and contributes to sustainable development of developing countries, while attracting investments and new technologies. The CDM mechanism needs to be further strengthened to enable more efficient achievement of these objectives in a broader range of developing countries.

International emissions trading schemes should be expanded to all major greenhouse-gas emitting countries while remaining open towards developing countries. It would thus be important to determine whether the supplementary rule of the Kyoto-Protocol, which restricts the use of emission certificates for the fulfilment of the Kyoto commitments, is still adequate, and whether it should be abrogated.

### ***Intellectual property rights***

While compulsory licensing provides an opportunity of making life saving drugs affordable in crisis situations in developing countries, excessive use of this instrument by some countries may also have the undesirable effect of hampering necessary research in such drugs. At the same time, appropriate forms of protection should be provided for the traditional plant-based medicines of the poor countries. It should be noted, however, that work on TRIPS needs to be related to the work of other forums such as WHO and WIPO (World Intellectual Property Organisation).

## D. International financial and technical cooperation

### D1. Review

#### D1.1 Summary of MC commitments

##### Box 6. Main MC commitments regarding development cooperation

- Promote the essential **role of ODA** as a complement to other sources of financing (§39)
  - recognise national leadership and ownership of development plans (§40)
  - orient ODA towards domestic resource mobilization (§39)
  - aim at improved environment for private sector activity, including FDI (§39).
- Maximise the effectiveness and **poverty reduction impact** of ODA (§40, 43)
  - harmonise operational procedures, untying aid, etc. (§43)
  - focus on MDGs (§40)
  - enhance absorptive capacity and financial management of recipient countries (§43).
- Substantially increasing the **volume of ODA** (§41)
  - Build support for ODA (§41)
  - Promote the role of multi-lateral and regional development banks, mitigating volatility of financial markets, ensuring long-term resources available to IFIs (§45, 46)
  - Explore innovative sources of financing (§44).

#### D1.2 Scope and significance

ODA is complementary to other sources of financing for development, and thus particularly relevant in countries with limited capacity to attract private direct investments. While the different financial flows treated in the MC are driven by various economic and other interests, ODA occupies a unique position as a policy driven flow, which – as defined under Swiss law, for example – is anchored in the principle of solidarity. The widely accepted purpose of ODA is to support the efforts of developing countries to improve the living conditions of their populations. The ultimate goal of ODA, of course, is to achieve a situation in which no further development assistance is required. In the meantime, development assistance is required to support achievement of the MDG by 2015

Total annual ODA flows from multilateral organisations and bilateral aid agencies have, in recent years, measured slightly more than USD 100 billion. This amounts to about 20 percent of FDI, 3 percent of developing country exports and 40 percent of remittances, for example. While relatively small in global terms, ODA represents a high proportion of the financing available for public goods and national budgets in many developing countries, and even a significant share of the national economy in certain poor countries.

#### D1.3 Changes in the relevant global context

The overall growth of the international economy, expanding international trade and rising FDI, noted in previous sections, have comprised relatively favourable conditions for ODA effectiveness. From a total of USD 75 billion, or 0.23 percent of GNI in 2002, ODA had risen to USD 104 billion, or 0.28 percent of GNI by 2007. It experienced a brief jump in the period 2005-2006 – reaching USD 106 billion or 0.33 percent of GNI – due to the inclusion of large debt relief operations effected in that period.

Several developments have affected the context of ODA since the Monterrey Conference, including the expanding presence of emerging countries in the field of development assistance, mounting commodity prices exacerbated by growing demand in the emerging countries, raising awareness of the impact of global climate change and conditions related to general security.

## D1.4 Progress and challenges

The MC made important contributions to the debate on aid effectiveness, preparing the way for the Rome and Paris Declarations. The latter comprises an agreement between donors and partner countries to enhance aid effectiveness based on five main tenets: 1) fostering local ownership of country policies; 2) alignment of donors behind national strategies; 3) harmonization of donor efforts; 4) results-oriented efforts to raise the productivity of aid; and, 5) mutual accountability of donors and recipients. The recently established ECOSOC Development Cooperation Forum (DCF) comprises an inclusive venue for addressing issues of aid effectiveness.

Cooperation between donors and recipient countries has produced significant progress with regard to the five Paris tenets. In particular, improvements may be observed in the effectiveness of aid delivery; aid programs are generally better aligned and there has been some reduction in programme fragmentation and transaction costs. The Third High Level Forum on Aid Effectiveness to be held in Accra this September will continue the periodic assessment of mutual progress regarding the implementation of partnership commitments and related improvements in aid effectiveness, constituting an important stage on the road to Doha.

## D1.5 Swiss activities in the area

Swiss international development cooperation focuses on resolving conflicts, fostering social development and good governance, promoting employment and protecting natural resources, as well as providing humanitarian aid. Switzerland also implements economic and trade policy measures relating to international cooperation through involvement in such areas as macroeconomic support; financing of infrastructure; trade promotion and private sector promotion.

Switzerland's commitment to increase its ODA to 0.4 percent of GNI by 2010 made at the Monterrey Conference, was met between 2003 and 2005, when Swiss ODA (including debt relief operations) reached 0.44 percent of GNI. While the rate dropped to 0.37 percent in 2007 with the conclusion of debt relief operations, Switzerland remains on target to meet its commitment by 2010. With a reputation as reliable donor, Switzerland attaches great importance on delivering on its commitments. Recognising that many development challenges can best be tackled through combined efforts, Switzerland channels its ODA through both bilateral and multilateral institutions.

Switzerland is committed to the Paris Declaration on aid effectiveness, acknowledging the need to align to national priorities and poverty reduction strategies, while working within existing national implementation processes. At the same time, it views democratic governance and public administrative reform as important elements of the development agenda.

Switzerland has carefully considered innovative financing mechanisms. While following their implementation with interest, Switzerland presently does not support the introduction of global taxes or the establishment of a global IFF for financing development.

### Box 7. Case in point: Swiss experience in Laos – ODA and domestic resource mobilization

Since 1990, Switzerland has been supporting a national research and training programme for rice production in Laos, which is implemented together with the International Rice Research Institute (IRRI). While researchers have developed more productive and resistant rice varieties, farmers have learned new farming techniques. The combination of know-how, improved seeds and production skills has enabled Laos to increase its rice output by 70 percent over the past 17 years, thereby achieving rice self-sufficiency. Through a total investment of USD 16 million the programme has contributed to increased rice production valued at about USD 200 million annually in 2006. In the context of massive increases in the price of rice, this achievement has recently taken on heightened significance for Laos.

## **D2. Discussion of issues**

### **D2.1 MC issues and actions**

#### ***The complementary role of ODA***

The complementary role of ODA in relation to other sources of financing for development – and the extent to which assistance can become truly demand-driven – depends ultimately upon the formulation of pertinent and comprehensive development strategies by partner countries. To this end, developing countries require sufficient policy space as well as suitable capacities and instruments. National development programmes such as the Poverty Reduction Strategy Paper (PRSP) – which aims to establish the essential links between national public strategies, donor support, and development outcomes – are important instruments in this regard.

#### ***Aid effectiveness***

While some progress has been achieved with regard to aid effectiveness, further efforts are required to reduce the volatility of aid flows through multi-year programme commitments; reduce imbalances in the allocation of aid flows through improved donor coordination mechanisms; and, build absorption capacity by strengthening governance mechanisms, transparency, institutional capacities and effective control of corruption.

As noted, several emerging donors are rapidly increasing their contributions toward development funding. To ensure the positive impact of these contributions, they should be integrated into ongoing discussions on aid effectiveness and aid architecture. New private donors are also entering the field, with large and highly focused thematic programmes (e.g. health) along with new global initiatives in such fields as water supply, Aids/HIV and climate change. Although they embrace the aid effectiveness agenda, these activities are not always consistent with comprehensive development strategies. The proliferation of new funds and policy instruments complicates oversight and ODA programme management; the issue warrants attention within discussions on aid architecture.

Finally, the Paris Agenda on aid effectiveness needs to be actively supported as an overarching framework for achieving the IADG, including the MDGs.

#### ***The volume and availability of ODA***

While ODA has risen much faster than GNI, its growth rate lies well below the 12% annual increase that was projected – by the G8 at Gleneagles in 2005 – to be required in order to achieve the promised level of USD 130 billion (0.35 percent of GNI) by 2010.

Discussions regarding “Financing for the Mitigation of Climate Change” are proceeding in parallel to those regarding “Financing for Development”. It would be important to distinguish – methodologically as well as substantially – between these two endeavours, to ensure that future increases in the funding of climate change programmes do not result in a reduced funding of traditional ODA activities. The Bali Meeting of the UNFCCC in December 2007 identified several action clusters – mitigation, adaptation, technology transfer and financial mechanisms – that will require additional sources of financing.

### **D2.2 Outstanding issues**

#### ***Quantitative aid targets***

The MC’s recognition that “substantial increase in ODA and other resources will be required if developing countries are to achieve internationally agreed development goals” (§41) remains valid.

### ***Aid effectiveness***

While the MC has cited the main steps required to improve and ensure aid effectiveness (see Section 2.1), further efforts are required in several areas:

- Volatility: ODA is often quite volatile, fluctuating more with the economic cycle of donor countries than with the needs of the recipient countries; this hinders development planning and limits the long-term effectiveness of ODA. The Paris Declaration calls for greater legal certainty regarding donor obligations.
- Country ownership: Tied aid, conditionality and donor-driven agendas still limit domestic ownership in many countries. More efforts are required to expand the participation of stakeholders – including civil society representatives – in the design of development programme, including closer adherence to the OECD/DAC agreement on untying aid.
- Monitoring and performance reporting: Improvements are required in the way that aid is monitored in order to improve targeting, coordination and impact measurement, and to account for the links between reform of aid modality and development outcomes.

ODA effectiveness may be enhanced by leveraging private investment resources through risk mitigation instruments of regional development banks. However, donor's interest in such programmes may be limited by the fact that guarantees are not counted as ODA by the DAC monitoring system. Renewed discussions on classification of guarantees as ODA could be reopened within OECD.

### ***Innovative financing mechanisms***

The MC generated increased interest in the potential of innovative sources of financing to augment development assistance funds. Following Monterrey, there have been launches of mechanisms such as solidarity levies on air travel and the International Finance Facility for Immunization (IFFIm), which commenced as a pilot initiative in 2006. The Leading Group on Solidarity Levies to Fund Development, established in 2006 in Paris, has been instrumental in promoting these initiatives.

Recognising their potential, the UN Secretary-General has recently appointed a Special Advisor on innovative financing for development. In preparation for Doha, it would be useful if UNDESA were to prepare an overview of current implementation status and available experience concerning such initiatives.

## E. External debt

### E1. Review

#### E1.1 Summary of MC commitments

##### Box 8. Main MC commitments regarding external debt

- Implement strategies for the **relief of unsustainable external debt** (§48):
  - Reduce outstanding indebtedness; cancel debt where appropriate (§48)
  - Share responsibility between borrowers and creditors for preventing future unsustainable debt (§47)
  - Consider reduced debt sustainability in cases of natural catastrophes, trade shock, etc. (§50).
- Build national strategies and capacities for **managing external liabilities** (§47):
  - Establish preconditions for debt sustainability, including economic and fiscal policies
  - Provide technical assistance to strengthen external debt management.

#### E1.2 Scope and significance

The origins of high levels of external debt of developing countries are complex. Contributing factors include: the failure of borrowing to produce expected development and growth due to civil conflicts, natural catastrophes or unsound economic policies; poorly designed projects; slowed growth that undermines debt servicing capacity; external factors relating to exchange rate and/or interest rate changes.

In 2005, the total debt of developing countries amounted to USD 2'740 billion, or about 28 percent of their GDP, down from 38 percent of GDP in 2002. For LICs, total external debt in absolute terms dropped from USD 520 billion to USD 380 billion in the period. The MC's objective to relieve countries of their unsustainable debt burden has been largely achieved in the last years, in particular after the MDRI.

#### E1.3 Changes in the relevant global context

The main debt relief measures of recent years comprise the Heavily Indebted Poor Country Initiative (HIPC), launched by the IMF and the World Bank, and the Multilateral Debt Relief Initiative (MDRI) instigated by the G-8. Both initiatives have been largely implemented.

#### E1.4 Progress and challenges

The above mentioned initiatives have resulted in a substantial reduction of unsustainable external debt in participating poor countries and a sizable drop in the debt servicing burden. Rising expenditures for social programmes in these countries indicate a positive development impact. Many middle-income countries have also reduced their levels of debt in recent years.

The provision of technical assistance to improve debt management has also risen through activities of the HIPC Capacity Building Program/Debt Relief International, UNCTAD's Debt Management and Financial Analysis Program, the Debt Management Training Program of UNITAR and IMF technical assistance activities, all supported by Switzerland. On the other hand, excess cash in the international economy have encouraged creditors – including emerging economies – to extent lending, thus weakening incentives to sustainable debt management.

## **E1.5 Swiss activities in the area**

Switzerland has been a prominent and consistent supporter of debt relief to heavily indebted poor countries (HIPC) and has participated actively in the Multilateral Debt Relief Initiative (MDRI). Through cancellation of the bilateral debt of more than 20 poor countries, participation in debt arrears financing operations, significant contributions to the IDA debt reduction facility, support to the HIPC initiative from the launch and participation in the MDRI, Switzerland has played an active role in alleviating the debt burden of poor countries. Switzerland notes with concern that some private and public creditors, including emerging donors, are taking advantage of the debt relief provided by others (i.e. free-riding issue).

## **E2. Discussion of issues**

### **E2.1 MC issues and actions**

#### ***Implementation of debt relief programmes and measures***

Ownership of debt strategies by the borrowing countries is crucial to success. In this context, the elaboration of sound Medium-Term Debt Strategies by debtor countries should be encouraged. These strategies should be based on the national priorities as defined in the budget and guided by the PRSP or similar national development strategies, as well as by results of Debt Sustainability Framework (DSF) analysis.

Steps are also required to ensure that other private and public creditors, in particular emerging donors, do not take advantage of debt relief initiatives to extend new and possibly unsustainable new loans. New lenders should be encouraged to carefully analyse domestic conditions and to make their lending decisions and conditions transparent.

Many countries with significant external debt are also facing large domestic debts. In this case, large debt servicing payment may undermine confidence and reduce investment and growth. Care should be taken that domestic debt does not crowd-out private investment.

Solutions need to be found to the problem of litigating commercial creditors and vulture funds against HIPC countries. These practical aspects of the “free rider” problem are receiving increasing attention from the World Bank, the IMF and the Paris Club. In this regard, it may also be useful to fund legal advisors to assist HIPC countries with debt-related legal issues.

There is some concern that new borrowing by post completion HIPC or post-MDRI relief countries may cause renewed debt distress. With regard to future debt management, the IFIs should adopt reasonable lending strategies and refrain from “pushing loans” in situations where they may be excessively risky. Internal incentives of IFIs – and bilateral donors – should thus be revised to reduce the tendency to strive for high volumes of credits. The countries concerned are urged to establish sound financing strategies with the necessary degree of concessionality to ensure consistency with the DSF. Finally, it is important for new emerging creditors to be more transparent about their official lending policies and to participate in the existing international framework (Paris Club, OECD/DAC, etc.) regarding international debt relief.

#### ***Building capacity to manage external liabilities***

Debt can only be sustainable if governments are able to finance themselves on a long-term basis through sufficient flows of domestic resources. Instruments such as the Debt Sustainability Framework should be employed by debtors – as well as by creditors – to assess and promote these conditions. Debt management should be embedded in a wider macro-economic and financial context based on a

coherent Medium-term Debt Strategy, the results of the DSA and sound investment appraisal within the PRS framework. This is particularly important in countries that have benefited from debt relief and gained access to international financial markets.

Debt relief should result in a measurable impact on poverty reduction. To this end, resources freed through debt relief should be employed to finance well-designed and locally owned programs. While the increase in social expenditures is undoubtedly important, policy measures are also required to create conditions amenable to growth, private sector development, diversified exports and the inflow of foreign investments.

Most importantly, debt relief measures must be accompanied by efforts to improve debt management capacity in developing countries. These efforts should be coordinated on an international level, building on existing networks to provide the required technical assistance and capacity building. Clear commitment by partner countries to introduce the necessary institutional reforms and provide a favourable environment through accompanying public sector reforms is crucial for building a sustainable debt management capacity.

Moves to foster developing countries' access to the international financial markets should be encouraged, taking into account national priorities and internationally coordinated efforts should be made to establish and strengthen domestic capital markets.

## **E2.2 Outstanding issues**

### ***Justification and benefits of debt relief***

Donors need to analyse calls for extended debt reduction in relation to the alternative benefits that might be achieved by applying scarce resources to other development projects or investments. Certain conditionality must be associated with debt relief in order to insure that the gains are translated into effective poverty reduction and development programmes. This is also important to counteract potential impact of moral hazard with regard to future borrowing.

## F. Systemic issues

### F1. Review

#### F1.1 Summary of MC commitments

##### Box 9. Main MC commitments regarding systemic issues

- Enhance the **coherence of international monetary, financial and trading systems** (§52):
  - improve global economic governance (§52)
  - reform the global financial architecture (§53)
  - enhance financing for poverty eradication (§53).
- Strengthen instruments and resources for **crisis management and global stability** (§59):
  - support coordination of macro-economic policies (§54)
  - improve identification and prevention of potential crises (§55)
  - ensure a suitable array of financial facilities and resources to respond to crises (§59)
  - accommodate the social costs of adjustment programmes (§56).
- Improve **governance** and broaden the basis of decision making (§62):
  - strengthen participation of developing countries in international decision-making and norm-setting (§62).
  - repatriation of illegally acquired public assets (§65)
  - implementation of measures to combat corruption (§65).

#### F1.2 Scope and significance

The MC stressed the importance of promoting the coherence, governance and consistency of the world's monetary, financial and trading systems.

#### F1.3 Changes in the relevant global context

Several international agreements have emerged since the Monterrey Conference, including the Rome Declaration on Harmonisation and Alignment, the Paris Declaration on Aid Effectiveness and the upcoming Accra high level forum on aid effectiveness. The major multilateral institutions – the UN, World Bank, IMF and WTO, as well as the regional development banks – continue to re-think their role in finance and development. The current financial turbulences demonstrate that financial crises are not a thing of the past.

Some developing countries have accumulated high levels of foreign reserves, which may serve as buffer in the case of an economic crisis. However, high reserves also involve opportunity costs regarding growth and development. The accumulation of reserve is associated with the defense of an undervalued fixed exchange-rate and the promotion of an export-led strategy, but it also contributes significantly to global economic imbalances.

#### F1.4 Progress and challenges

Modernization of the governance of global financial institutions commenced in 2006 with a two-stage reform process at the International Monetary Fund (IMF), with increased quota and voting shares for under-represented countries. Agreement on the second stage of reform was reached in April 2008. The World Bank has also started a quota reform process.

Surveillance is the main pillar of the IMF's mandate, and the institution is presently sharpening its focus on global issues and spill-over effects. Together with the World Bank, the IMF has developed the Financial Sector Assessment Program (FSAP), as a key instrument for financial sector surveillance. The IMF issued early warnings regarding risks associated with the US housing sector,

financial markets and current global imbalances, and has coordinated a first round of multilateral consultations.

## **F1.5 Swiss activities in the area**

In the interest of improved coherence between monetary, financial and commercial policies, Swiss development cooperation programmes have sought improved balance between the efforts of partner countries with regard to internal governance and those of the international community to improve the international economic environment in fields of financial stability, investment and trade.

As a member of the Financial Stability Forum (FSF) Switzerland is actively involved in discussions to promote international financial stability, improve the functioning of markets and reduce systemic risk. It contributes to discussions concerning countries with important financial centres. Switzerland has ratified the OECD Tax Model Convention on Combating Bribery of Foreign Public Officials, the Council of Europe Conventions against corruption, the UN Convention against Transnational Organised Crime and will ratify the UN Convention against corruption. Switzerland is leading international efforts to deter, freeze and return assets of politically exposed persons. It actively supports other countries in their efforts to find, block and repatriate illegal assets (see Box 10).

Switzerland is a full member of the Financial Action Task Force (FATF), whose work has had a significant impact on the global detection and prevention of money laundering and terrorist financing (AML/CFT) and has been critical to foster the implementation of more robust AML/CFT systems worldwide. In 2005, the FATF assessed Switzerland's AML/CFT framework, which it judged to be effective and efficient systems for combating money laundering and terrorist financing that are compliant with revised FATF recommendations. Switzerland is improving its framework through a reform package, which includes a revision of the AML legislation and an update of several ordinances.

### **Box 10. Case in point: Swiss experience with asset recovery**

Recognising the importance of the problem of illegally acquired public assets and the potential role of donor agencies, Switzerland has contributed actively in three main areas:

#### ***Technical assistance***

Switzerland has funded and participated in the launching of the "International Centre for Asset Recovery" (ICAR), a competence centre which assists developing countries to build capacities, establish relevant procedures and institutions and make effective use of international legal assistance in criminal matters relating to the recovery of stolen assets. A primary goal of ICAR is to assist countries to implement the provisions of Chapter V on asset recovery of the UN Convention against Corruption (UNCAC).

#### ***Monitoring returned assets***

Donors can also play an important role in monitoring the use of repatriated funds. Switzerland arranged the repatriation of CHF 458 million from Swiss financial institutions to the central budget of Nigeria. The use of these funds are being monitored by the World Bank. Switzerland has also signed an agreement with the Angolan government establishing a framework for the use of USD 21 million that have been identified and blocked in Swiss bank accounts. These funds will be applied to social and humanitarian programmes under the supervision of the Swiss Development Cooperation.

#### ***Payment of lawyer fees***

Asset recovery investigation and litigation is a cumbersome, expensive and time-consuming exercise, requiring lawyers, forensic accountants, expert opinions and translators. Yet, the rate of return can be very high, as the recovered sums normally substantially exceed the costs of the lawyers. It therefore makes sense for donors to help requesting States to finance such costs. Switzerland has had experience of this in relation to several cases. Only recently, it has decided to give technical assistance to the Republic of Haiti by paying the fees of a lawyer mandated to find a solution for the destiny of the currently frozen assets of Jean-Claude Duvalier.

## **F2. Discussion of issues**

### **F2.1 MC issues and actions**

#### ***Coherence of international monetary, financial and trading systems***

It is the primary responsibility of member states to secure consistency and coherence of the international monetary, financial and trading system in international fora. The international system cannot be more consistent and coherent than national policies and it is thus important for each national administration to speak with one voice.

A more effective and coherent international development and financial architecture is required in which each international forum and organisation (IDA, WTO, IMF, UN, etc.) focuses on its core mandate and comparative advantages, thus minimising overlaps and exploiting potential synergies. While respecting the need for efficient decision-making, an effective multilateral system requires further attention to insuring adequate representation in these bodies.

#### ***Crisis management and global stability***

The stability and integrity of the international financial system are of foremost importance. The FSF has published a report identifying the main factors and systemic weaknesses which underlie recent financial turmoil and proposing measures to increase the resilience of financial markets and institutions. The report stresses the importance of close international cooperation and recommends the involvement of all major actors in resolving the underlying problems. Switzerland supports these recommendations.

Refocusing of the IMF and strengthening of its surveillance portfolio is appropriate, particularly in view of the 2007 surveillance decision regarding exchange rates, which addresses the external stability of countries in a broader context. To ensure equality of treatment, bilateral surveillance should remain at the centre of the Fund's activities. The IMF should further increase its analysis of linkages between the financial sector and the real economy, as well as cross-border spill-overs and regional impacts. Each international institution should remain an important provider of technical assistance in its main field of competences. Coordination in this regard is paramount.

Strict and objective criteria are required for the qualification of assistance to MICs and LICs. To ensure equality of treatment, clear monitoring modalities and an adequate division of labour are also required, based on each international institution's core mandate. Switzerland encourages the renewed consideration of a sovereign debt restructuring mechanism. The difficulties involved in sovereign defaults demonstrate the need for a predictable framework.

The tax sovereignty of each state must be recognised. In less developed countries, there is often insufficient mobilization of domestic resources and a legal environment which hinders the effective use of resources and may contribute to or facilitate capital flight, which tends to be most extensive in countries with high macro-level imbalances. It is crucial for countries to establish sound macroeconomic fundamentals, including low inflation, sustainable budget deficits and a stable currency. Continuing endeavours of FATF to set standards, ensure effective compliance and identify money laundering and terrorist financing threats should be supported.

#### ***Governance and participation in decision making***

The quota and voice reforms of the IMF, outlined in the Singapore resolution, bring important improvements regarding the legitimacy of the institution. The main result of the reform is to distribute quotas in ways that reflects the relative economic weight and role of each member country. Increase

of basic votes and additional resources for large multi-country constituencies are supported as effective measures for enhancing the voice of LICs.

To advance its agenda on voice and representation, the World Bank will have to carefully assess the reform proposals emerging at the Fund, while taking into consideration its own development mandate. Besides enhancing the voice of developing and transitional countries, it is crucial to improve mutual accountability and the effectiveness of the Bank's operations, while consolidating its legitimacy and credibility. Valuable work has been initiated by the Bank to facilitate consensus-building regarding enhanced participation. A reformed governance structure should strengthen the voice of the poorer countries while duly reflecting the role of the Bank's contributors.

## **F2.2 Outstanding issues**

### ***International financial and monetary reform***

Some developing countries have accumulated high levels of foreign reserves. The investment of these funds in treasury securities instead of in growth-supporting domestic investment entails large opportunity costs in the fields of development and social services.

### ***Voting Rights Reform***

The governance reform at the IMF could secure renewed trust and a deeper engagement of emerging and low-income countries in the global economic and financial system.

### ***Illicit capital flows***

Total public assets of developing and transitional countries that are illegally acquired and deposited abroad are estimated at between USD 0.5 - 0.8 trillion per annum; asset recovery is an important mechanism, which should be put to the use of promoting development. Developing countries need to establish appropriate procedures and institutions to prevent flight of illegal capital and make more effective use of international legal assistance in criminal matters relating to the recovery of stolen assets. Furthermore, return of illegal assets should be linked to monitoring schemes in order to ensure the developmental impact of such recovered funds.

### ***Follow-up***

Participants at the 2002 Monterrey Conference agreed that they would "stay engaged", contributing to a follow-up process leading to the Doha Follow-up Conference. A post-Doha follow-up process should also be confirmed which improves, where possible, identified weaknesses. It would be desirable to agree on regular and periodic meetings as well as negotiating procedures which guarantee the participation not only of high level government representatives but also of high level representation of international financial institutions and the WTO.