Challenges of International Finance for Development and Attempts by the Commonwealth Secretariat to Address Them

by
Ransford Smith
Commonwealth Deputy Secretary General
at the
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Thank you Dr Kaul.

Mr Chairman, Rt. Hon Stephen Timms, Hon. Bogollagama, José Antonio Ocampo, Under Secretary-General of UNDESA, Ladies and Gentlemen,

I welcome everyone to Marlborough House, the headquarters of the Commonwealth Secretariat. Let me also express appreciation to UNDESA and to the CBC, partners in organising this workshop.

Mr Chairman, the Monterrey Consensus covers six areas of Finance for Development (FfD) and is itself a major reference point for international development cooperation. The six areas are:

i. Mobilising domestic financial resources for development
ii. Mobilising international resources, in the form of private capital flows (including FDI) for development.
iii. Increasing international financial and technical cooperation for development.
iv. External debt.
v. International trade as an engine of development.
vi. Addressing systemic issues for enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development.

This is indeed a wide spectrum and I propose to outline for each of these, some issues and how we at the Secretariat have been involved both at the international and national levels in helping to overcome these challenges. I very much hope that our deliberations here today will result in practical solutions regarding both issues and constraints.

(i) Mobilising Domestic Financial Resources for Development requires domestic resource mobilisation policies. Thus the scope for intervention by international development partners, including the Commonwealth Secretariat, is limited. Nevertheless, the Secretariat has been supporting governments' efforts to reform and improve the efficiency of their banking systems, which is critical for domestic resource mobilisation. For example, we are helping member countries ensure that the capital adequacy of banks is in line with the Basle Accord and we have also been engaged in capacity building in the areas of combating money

laundering and the financing of terrorism. Our advocacy work has also sought to highlight the unintended and adverse effects of indiscriminate application of international regulatory initiatives intended to combat money laundering and the financing of terrorism. Many of those affected are small island states with international financial centres, who are diversifying, or have already successfully diversified their economic base and are now finding that the bar is set higher for them than for their onshore counterparts.
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(ii) In the second area, **Mobilising International Resources,** Global private capital flows to non-OECD countries continue to grow at a rapid pace, with total flows increasing steadily from US$172 billion in 2002 to US$490 billion in 2005. There is a rising trend of South-South flows, with developing countries increasingly becoming a significant source of FDI, bank lending and even ODA to other developing countries.

However, there are a number of challenges and negative aspects of the existing volume and pattern of capital flows to developing countries. One major challenge is the high degree of geographical concentration and lopsidedness of FDI flows, with low-income countries (LICs) accounting for only about 10 percent of FDI flows and a much smaller percentage of non-FDI components of private capital flows.

Another challenge posed by the surge in capital flows is the risk posed to the recipient countries. For instance, the recipient countries have to undertake more proactive management of increased foreign reserves caused by the increased capital flows. As is known, a surge in portfolio capital flows raises the risk of asset price bubbles just as the resulting current account deficits and real exchange rate appreciation raises risks relating to macroeconomic management.

I hope in you deliberations you will come up with practical solutions to these issues. For our part, the Commonwealth Secretariat has been at the forefront of assisting member countries, particularly two key constituents, Sub-Saharan Africa and small states, address some of these challenges. Given the time constraints, I will recall just a few of these initiatives.

- Under what we call “Lowering the Threshold” (LTT) programme, we are assisting Members to mitigate “endowed” handicaps that affect their attractiveness as a destination for private investment. There is little that domestic policy interventions can do to surmount the “endowed” handicaps such as being landlocked or being a small state. There is however scope for international policy actions to recognise these challenges and to assist such economies minimize the adverse impact of such factors. The Secretariat has sought to assist by bringing together multilateral development partners, Regional Development Banks, and domestic commercial banks for the purpose of reducing the risk associated with long-term finance in these Small Vulnerable Economies.

- The **Commonwealth Private Investment Initiative (CPII)** was launched in 1995, with the objective of promoting commercial investments in private sector businesses including SMEs in those countries that have had difficulty in attracting FDI. It has promoted foreign direct investment flows in the form of private equity funds. A number of these funds have been liquidated, after achieving their objectives with considerable success, and successor ones are in the pipeline.

- The **Commonwealth Initiative on Public-Private Partnerships (PPP)** seeks to promote PPPs, mainly in infrastructural facilities, in Commonwealth developing countries, in general, and post-conflict ones, in particular. Our activities in this area, some of which are in collaboration with the Commonwealth Business Council, are aimed at bringing would-be private investors into contact with officials in the potential host developing countries; raise awareness of member countries on opportunities for and benefits of PPP; enable member countries to share experiences on PPP; and building the capacity of government institutions and officials on PPP matters.

- And fourthly, we are doing work on **Foreign Remittances.** International development policy fora, including the 2002 Monterrey Summit, have not accorded this source of private resource flows the prominence it deserves. However, there are many challenges facing remittance-related activities. Notable among such challenges are the high cost of making remittances; regulatory barriers; absence of ancillary financial services; lack of awareness of available channels for remittances; and less-than-optimal use of proceeds of remittances, particularly for developmental purposes.

(iii) In the area of **Increasing International Financial and Technical Cooperation for Development,** there are recent developments relating to official resource transfers which deserve comment. These include:

- Changes in the terms of ODA by donors through provision of more grants but lower levels of concessional loans. Regrettably, some donors are using this as an excuse to reduce the volume of aid. This has had the effect of putting countries at a disadvantage, as they do not have access to the volume of concessionary resources needed for the attainment of MDGs within the time frames set.

- Efforts to develop a framework that includes tangible indicators and targets to assist in monitoring the development impacts of aid over time. This has resulted in the *Paris Declaration on Aid Effectiveness.* However, there are still many challenges with the implementation of the principles contained in this Declaration, many of which donors are in breach of. The voice of developing countries also has not been given the prominence that it deserves in international debates on reform of the international aid architecture.

- The third issue relates to the commendable initiatives to provide higher proportions of ODA to the poorest countries, particularly those in Africa. However, this has raised the question of whether low-income recipient countries have the capacity to absorb the resulting volume of aid flow. This view, which is contentious, can have the unintended effect of dampening donors' enthusiasm in providing assistance, and negatively affect poor countries. We agree with the World Bank's view (in 2006 issue of its *Global Development Finance)* that empirical evidence on the macroeconomic consequences of aid surges is inconclusive. Calculations on our part also show that, even in the very unlikely event that the donors meet their pledge to double aid to Africa to US$50 billion by 2010, the aid absorptive capacity indicator (viz: aid as a percentage of GDP) of the region would be about 7 percent. This absorptive capacity indicator of about 7 percent compares favourably with what was attained in early 1990s. It is important that this problem, to the extent that it exists, should not be couched in a form that would provide a rationale for donors to reduce aid. Instead, it should energize countries into action to enhance the capacity to absorb aid, and donors to endorse modalities such as delivery of higher proportion of the aid in the form of direct budgetary support.

We should therefore deliberate on how to address the practice of reducing aid volume as a result of changing from loan to grants; how to enhance implementation of the Paris Declaration and enlist voices of the south in reforming the aid delivery system; and how to minimise adverse macroeconomic effects of aid surges in recipient countries.

The Secretariat for its part has taken an active interest in promoting aid flows both in terms of improved quality and enhanced volume. Our activities have focused on how to give developing countries a voice in the ongoing debate about reform of the international aid delivery system. Accordingly, the Secretariat, working in collaboration with other like-minded organisations, has been at the forefront of the discussion on the international aid architecture. In this regard, we have held a series of consultative meetings in different regions of the Commonwealth to canvas recipient governments and civil society on their perceptions of various multilateral and bilateral aid agencies as well as the international aid architecture. Very interesting results, though still preliminary, have come out so far and we are holding further consultations with recipient country representatives on this.

(iv) External Debt of developing countries has been an issue of concern in international development since the 1980's. Despite the debt relief "Initiatives" since then, debt burdens of LICs still remain a challenge. Implementation seems bedeviled by a lack of goal congruence between the promoters (especially, the G8) of the MDRI and the implementing IFIs. While the former are pre-occupied with getting resources transferred to assist beneficiaries attain the MDGs, the latter are concerned with minimising the implementation costs. A major reason for the lack of goal congruence is the absence of credible assurance that donors will compensate the IFIs fully for the costs of MDRI implementation. Your suggestions on how to harmonise these apparently conflicting goals would be welcome.

There is also the issue of how the LICs can guard against a borrowing binge and how creditors can be discouraged from reckless lending. These two factors led to the unsustainable debt accumulation in the past. Under what conditions should new borrowing and new lending be advisable? How can opportunistic creditors be made into responsible corporate citizens? How can debt management capacity in the borrowing countries be enhanced? Again, we look forward to your recommendations on these issues.

But external debt problems are not confined to LICs alone. Other developing countries, including middle- and high-income developing countries are not exempted, and many small states are facing acute debt vulnerability. Some years ago, the IMF came forward with a proposal for addressing this issue under the name Sovereign Debt Restructuring Mechanism (SDRM). Should the SDRM be revived? What are workable alternatives to it? How can the special needs of small states be catered for under such proposed arrangements? These are some of the issues that I hope you will also seek to address.

The Secretariat, I am proud to say, has been in the forefront of international debt issues. We moved the idea of HIPC debt relief, despite the opposition then by the BWIs that it would be unacceptable to subject debts owed to them to reduction. But events have proved us right. Also, since the launching of the HIPC Initiative in 1996, we have been at the forefront in advocating for its reform. Our activities continue unabated even after the inauguration of MDRI about a year ago. We also empower, unify and strengthen the voice of the HIPCs through our organisation of Commonwealth HIPC Ministerial Forum (CHMF) Meetings twice a year, starting from 2002. We also established last year a HIPC Debt Clinic to assist member countries involved in debt litigation.

We are also at the forefront in the area of debt management. The Secretariat offers an integrated programme of assistance on debt management, with the benefit of its own debt recording and management software (CS-DRMS), which is in use in some 54 Commonwealth and non-Commonwealth countries. This is in addition to provision of advisory services aimed at building institutional capacity in debt management in Commonwealth countries. All of this I might add with very limited resources.

(v) In the area of **International Trade as an Engine of Development,** export earnings constitute one of the primary sources of development financing. Therefore, it is not surprising that international trade is accorded an explicit recognition as one of the areas of the FfD.

While it is understandably outside the scope of this meeting to deliberate on all areas of the Doha Development Round, and we welcome too the resumption of the talks, it is hoped that you would cover aid for trade issues and come up with some concrete suggestions on the way forward. There remains a wide gulf between public statements of support for the idea of aid for trade and practice on the ground.

As discussions on aid for trade have unfolded in Geneva, it has become clear that on the key question of how to operationalise such a package, major divisions remain. Even after the adoption in December 2006 of the WTO Task Force Report on aid for trade, it is not clear that we will see substantive outcomes. The emphasis at the moment seems to be on evaluation and monitoring of trade-related assistance.

The Secretariat is very proactive in the areas of trade and time constraints do not permit me to highlight the entire scope of our activities on this. I would only point out that we have been assisting Commonwealth developing countries improve their understanding of international trade rules and regulations and helping them strengthen their effectiveness and participation in WTO and other negotiations. This is achieved by providing policy advice on international trade developments (including aid for trade issues), the WTO, ACP/EU relations and regional economic integration.

(vi) The sixth and final area is **Addressing Systemic Issues: Enhancing the Coherence and Consistency of the International Monetary, Financial and Trading Systems in Support of Development**

In this era of globalisation, international and domestic monetary and financial systems have become more integrated than ever before. This calls for adequate rules to guard against malfunctioning of a part of the system, which would transmit adverse repercussions on the entire international system. This raises several questions. Which bodies should be responsible for promulgating the rules? Which should implement or enforce the rules? How can financial crises be guarded against in future? What should be the role of the existing IFIs – including the IMF, World Bank and Bank for International Settlements – and how are they to be governed so as to give due voice to developing countries?

On the unsustainable global macroeconomic imbalances that manifests itself in the form of large current account deficits in the US, with counter-balancing surpluses in a number of countries (Europe, Japan, China and other emerging Asia, OPEC countries, etc), there is an urgent need to address this. How can disorderly adjustment of these imbalances be avoided? How can the countries involved co-ordinate their respective domestic policy interventions?

Ladies and gentlemen, the above are some issues and challenges. Here, at the Secretariat, we take keen interest in the foregoing issues, particularly those that directly affect low-income countries and small states. It is my hope that we will be able to advance solutions to meet these challenges and come forward with recommendations that meet a high bar in terms of their relevance, applicability, and innovativeness.

In concluding, I want to once again welcome you to Marlborough House and wish you success in your deliberations. Thank you for your attentiveness.

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