

Intergovernmental Group of Twenty-Four on
International Monetary Affairs and Development

**REPORT ON THE G-24
WORKSHOP ON
FINANCING FOR
DEVELOPMENT**

Workshop held at the Nigeria House, New York City
September 6 and 7, 2001

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G-24 Liaison Office

**G-24 Workshop on Financing for Development
September 6-7, 2001
New York**

REPORT ON THE WORKSHOP

At the last meeting of the G-24, ministers emphasized the need for “full engagement of the G-24 in the preparatory process” for the UN International Conference on Financing for Development (FfD), to be held in Monterrey, Mexico, March 18-22, 2002. Towards this end, the G-24 Liaison Office* organized the Workshop on Financing for Development at the Nigeria House in New York on September 6-7, 2001. The chair country of the G-24, Nigeria, hosted the Workshop. A grant from the OPEC Fund for International Development financed the preparation of papers and of this report.

The principal goal of the workshop was to bring together high-level developing country officials from national capitals and their representatives at the United Nations in New York and the Bretton Woods Institutions (BWI) in Washington. The aim of the Workshop was to generate ideas on approaches and options that developing countries might consider in the context of the UN conference. This report summarizes the key issues that emerged during the two days of deliberations.

The workshop program, list of participants, and the titles of the papers, together with the names of the authors, are annexed to this report.

THE CONTEXT

From the start of the preparatory process – some three years ago – there was a consensus among the UN membership on the need for a “holistic” approach in addressing the issue of finance for development, which required involvement of all key stakeholders in the process. Towards this end, an elaborate process of consultation between the governments and stakeholders was launched. Experts were invited to address the UN Second Committee (which is concerned with economic and financial issues), hearings were held for the non-governmental organizations (NGOs), formal and informal contacts were established with different official institutions, and the Internet was used to canvass the views of those that did not otherwise have access to the process in New York.

These initiatives notwithstanding, the process suffered from a number of weaknesses from developing countries’ perspective. For one thing, it proved to be a struggle to reach agreement on the agenda, format, venue and level of representation for the proposed event. This took up a good share of the time for preparation. It was indeed only early this year that the attention of the UN membership turned to substantive issues.

* The Workshop was organized by Mr. William Larralde, Director, G-24 Liaison Office, Washington DC, and preparation of this report and coordination of papers presented was commissioned to Mr. Irfan ul Haque.

Developing countries were also handicapped by the strained capacities of their Permanent Missions in New York to cope with the demands of the FfD process, while attending to all their other business at the UN. They do not have a secretariat or institution of their own (a la OECD for the industrial countries) that could provide them with independent analysis and information they needed to negotiate their way through the UN procedures and meetings. An absence of close collaboration between the ministries of foreign affairs (which are in charge of the New York process) and finance ministries and central banks in the capitals and between the country representatives at the UN and at the BWI was another handicap.

The G-24 Workshop was intended, in part, to remedy the last of the above-mentioned difficulties, though the selection of topics for the commissioned papers, aimed to address the second handicap, i.e., the absence of independent analysis of FfD issues.

The Workshop's Scope

The provisional agenda for the UN conference contains six elements: domestic resource mobilization; mobilizing international resources (private capital flows) for development; trade; international financial cooperation for development (official development assistance); debt, and systemic issues. However, in designing the workshop program, a more thematic approach was considered more suitable for discussion and arriving at conclusions. The discussions in the PrepCom have ranged widely, but four themes can be identified as being of special interest to the developing countries and where the UN conference could be expected to adopt important decisions. These are:

- Finding ways to increase the volume and effectiveness of foreign resource flows (private, bilateral and multilateral) in support of development;
- Establishing a satisfactory, transparent and more representative procedure and institutional framework for resolving external debt problems;
- Making global economic governance more participatory and accountable to a broader community of nations; and,
- Creating an international trading environment that is more supportive of growth and development of developing countries.

The program of the workshop was designed to address each of these themes in turn. Under "resource transfers", a distinction was made between the issues involving official development assistance (ODA) and private capital flows, as they are driven by altogether different considerations. Similarly, external debt was approached from two different angles, i.e., methods to resolve the problem of the sovereign external debt and dealing with the problem of moral hazard and "socializing" of private debt. The third theme – global economic governance – covers a broad range of issues, but was narrowed

to focus on the role of the United Nations in economic matters and the issue of accountability and transparency in the BWI. A separate session was devoted to discuss trade issues.

In all, therefore, seven papers were commissioned from experts. The papers were intended to provide the participants with a careful analysis of the issues, a critical review of existing proposals and ideas on how to deal with those issues, and suggestions on what strategies and options developing countries might consider as they approached the final stages in the preparation for the UN Conference. The authors were requested to be forward-looking in their approach and aim to define the issues and options sharply, taking into account the recommendations contained in the Secretary General's report and the report of the High-level Panel under President Zedillo.

REPORT ON THE DISCUSSIONS

In what follows, each of the workshop session is discussed separately.

(i) Resource transfers: official capital flows

Issues considered:

- The case for official development assistance (ODA).
- Financing of global public goods (GPG).
- The use of ODA to leverage private capital flows.
- Prospects for augmenting ODA and increasing its effectiveness.
- Innovative sources of financing.

ODA can be distinguished from other capital flows by the fact that it takes place at the discretion of the donors and is not driven by market considerations, even as it is often aimed at promoting market liberalization and privatization. Humanitarian considerations are obviously important, but ODA flows are inevitably driven by the donors' own development and political agenda. There is little question that the industrial countries have a stake in the growth of developing economies since, apart from offering expanding markets, rising incomes help to reduce social and political tensions. At the same time, some have linked the need for concessional flows to the process of globalization, which has generally failed to benefit the developing countries commensurately. The idea here is that as economies integrate into the global economy, the better-off regions should transfer resources to less well-off regions, similar to the income transfers within an economic union. More recently, the need for ODA has been linked to the need for financing global public goods (GPG), i.e., goods and services whose benefits are not confined to individual countries but extend to entire regions or to mankind generally. Examples of GPG are the protection of environment, control of disease, and preservation of peace.

The overall magnitude of ODA in recent years has remained below 0.35 percent of industrial countries' GNP, i.e., less than half of the target of .07. Although the political support for ODA in industrial countries other than the United States does not appear to have waned, a number of factors have contributed to a general disenchantment ("aid fatigue" as it has been called). These include budgetary constraints, disappointment with aid effectiveness, and the sheer enormity of the development challenge. At the same time, a considerable portion of aid flows has been diverted to the servicing of past debt and coping with such humanitarian concerns as fighting hunger, malnutrition and disease. Important as all these areas are, they leave only a small amount for financing development as conventionally understood, i.e., investment in increasing a country's productive capacity.

Given these facts, the workshop focused attention on ways to augment public transfers and to improve their effectiveness. There was a general sense that in order to attract more resources, the developing countries must offer something in return. This search for a quid pro quo was described as a "grand bargain" or "development compact" that individual countries might make with the donors. Basically, this would involve, on the part of the individual aid recipient, adopting suitable policies in support of development (accepting and respecting conditionality) and improving their governance and human rights record in exchange for its donors carrying out jointly agreed programs and projects. (A concern was expressed over having a universal definition of what human rights might cover.)

It was noted that such bargains or compacts would be between political unequals, but stress was placed on their execution being monitored by independent groups of experts, rather than by the BWI. In this connection, donor performance came under scrutiny. The donors' policy advice was not always sound or realistic in terms of implementation capacity, while the "transaction costs" of aid delivery tended to be high, most egregiously in the technical assistance area. It was proposed that the concept of "ownership" of policy reform should be broadened to include an independent evaluation of donor performance at the level of individual recipient country. This did not have to wait upon a global agreement, since individual donors – or a "like-minded" group of them – could offer themselves for such an evaluation.

It was suggested that aid effectiveness could be improved by using official assistance to leverage private capital flows, especially in countries that are currently bypassed by foreign investors. Another suggestion was that individual industrial countries might accord domestic treatment to manufactures produced in developing countries by investors from those countries. However, it was pointed out that this might come into conflict with WTO provisions. Another idea related to the use of tax incentives in home countries to investors investing in developing countries, but the experience of tax incentives given by host countries was not altogether encouraging. However, ODA channeled into financing social and physical infrastructure is likely to be more promising, since the inadequacies in this sphere are usually a major deterrent to foreign investment.

Obtaining at least a rough notion of needs was seen as a precondition for finding the means for additional ODA, which in turn required a reasonably accurate picture of net resource flows to developing countries. For one thing, money for humanitarian assistance, meeting the millennium targets, financing of GPG, debt servicing, should be taken out of the estimates for development assistance. It was observed that the official data were often misleading, as they did not take adequate account of unrecorded, often illegal, outflows from developing countries. A sharp change in the terms of trade was another factor that could distort the picture on real resource transfers.

In general, the prospects of bilateral ODA were not considered good, though donor performance could be expected to vary significantly across countries and over time. It is primarily because of this that there is a need to develop new sources of financing for development. Here several ideas have been suggested. The best known, though also perhaps most controversial, is the so-called Tobin tax, which is basically a very small tax on short-term currency transactions across countries. Despite considerable doubts on its feasibility and effectiveness, the idea continues to be the center of attention in different world forums. Other innovative sources of financing include a “carbon tax” (which would be imposed on carbon emissions, and has been recommended by the Zedillo Report) and taxes on the exploitation of global commons, industrial country exports, or the sale of pharmaceuticals earmarked for the provision of cheap drugs in poor countries. Of these the last one – a small tax on the sale of pharmaceuticals – has the advantage that it does not require a global agreement and could be adopted by individual industrial countries, perhaps even on a voluntary basis. However, there remain thorny issues of organization and implementation of such schemes. Global taxes were probably most appropriate for financing GPG and would have to be clearly separated from ODA and debt relief operations.

(ii) Resource transfers: private capital flows

Issues considered:

- Developing countries’ policies and environment and the inflow of FDI: additional resources or simply “race to the bottom”?
- FDI and development: why is FDI more supportive of economic development in some settings than in others?
- Portfolio investment and the issue of capital account liberalization.
- The role of multilateral development banks as financial intermediaries to aid private resource flows to developing countries.

Private capital flows were seen as imperative if developing countries ever expected to emerge from the poverty trap and to catch up with the richer countries for there is never likely to be enough concessional finance to support investment needed for accelerated growth. If humanitarian assistance, etc. were excluded, official flows for

development have amounted barely to about \$15 billion a year, compared to private flows of \$150 billion, the average during the 1995-2000 period.

The central issue is how to attract private flows to the vast majority of developing countries that have so far been bypassed. Both the Secretary General's Report (SGR) and the Zedillo Report (ZR) contain ideas, but lack specificity. Basically, the developing countries are urged to clean their house, improve governance, control corruption, abide by the established codes and standards regarding banking, insurance and accounting, and grant foreign investors equal treatment with domestic investment. Foreign investors are exhorted to comply with the UN's Global Compact, which is concerned with principles of "good corporate citizenship", covering human rights, labor standards, and environment. The multilateral development banks are urged to provide partial risk guarantees in order to direct FDI to developing countries.

The factors that drive foreign portfolio investment (FPI) are rather different to those for FDI, even though there is a tendency to overplay the distinction between the two. FPI is seen as inherently volatile and unproductive (i.e., it does not finance new or "greenfield" investment) in contrast to much of FDI. But, at least in the more advanced developing countries, the two are intimately linked, as corporate treasurers concerned with minimizing corporate exposures risks and/or realizing capital gains (from appreciated investments) tend to seek exit strategies that have implications for host countries not much different from FPI (e.g. borrowing against fixed assets and quickly shifting capital abroad if warranted by deteriorating conditions in the host country). It is thus the case that FDI tends to move to countries that also attract FPI because their more developed capital markets permit such exit strategies to be implemented.

All the same, for the great majority of developing countries (especially the smaller economies), establishing domestic capital markets of sufficient depth might be impracticable in the short-run and opening their capital accounts might prove premature until a proper prudential regulatory framework is in place. It was noted that there was a real dilemma here. Too quick or abrupt an opening of capital accounts can lead to an increased risk of financial instability. But not doing it at all or too slowly could provide cover to vested interests that resist needed reforms of the domestic financial sector.

That developing countries must have a congenial environment for foreign investment is axiomatic, but not particularly helpful advice, as many of the things that developing countries are expected to do are a result of development itself. The danger is that countries might compete for foreign investment by offering incentives, which would simply divert investment from one location to another. It was pointed out that at least in terms of labor and environment standards, there were indications that foreign investors' adherence to them tended, if anything, to be better than that of domestic investors. However, there was evidence of the "race to the bottom" in terms of offering fiscal or monetary incentives to foreign investors, with the result that the net benefit to the host country was considerably reduced. Where countries have relied heavily on foreign investment, dualistic economies have arisen. This is particularly the case among smaller, resource-based economies. At the same time, there are examples of countries (notably,

Korea and Japan), which as a matter of policy, pursued self-reliance and shunned FDI in the earlier stages of their development process.

Various ideas were considered to make the multilateral development banks – notably, the World Bank – serve as catalysts to mobilize FDI in developing countries. The central problem is that risks in developing countries are perceived to exceed what private investors are willing to accept. What is therefore needed is the design of both project-specific and generic schemes for risk-sharing that pave the way for private investors to go to developing countries. In addition, there is enormous scope for involving foreign investors in completing privatization programs. It was noted, however, that the World Bank offer of partial risk guarantees had failed to attract many investors. Similarly, Multilateral Investment Guarantee (MIGA) and the International Center for the Settlement of Disputes (ICSID) had only limited impact in encouraging private capital flows. This failure could be partly attributed to “bureaucratic inertia”, but changes in the Articles might be required if the institutions are to play a more aggressive role in mobilizing private capital. It was also suggested that the World Bank should leave most conventional lending operations to the regional development banks and turn into an apex institution, with its functions confined to galvanizing private flows, promoting and financing privatization, and improving domestic financial systems in developing countries.

The special problems faced by the smaller developing countries were discussed. One view was that these countries were too small to have their own currencies or capital markets, and that they should seek to create regional arrangements for that purpose. It was, however, pointed out that capital markets are required to mobilize domestic savings for longer-gestation infrastructure projects and that dependence on FPI for such projects came up against the difficulty of finding hedging instruments of the requisite maturities at reasonable cost.

It was pointed out that while encouraging private flows is an important issue, there is also the question of how to make foreign investors take a longer-term view and support national development in poorer countries. Search for profit is certainly important, but it is often not an adequate basis for promoting economic development and equity. Two separate issues are involved here: the difference in private and social returns and factoring the risk private investors face in the cost of capital. Risk could, of course, be insured against through various instruments (including derivatives), but this could have prohibitive costs, even if the developing countries had the capabilities to devise and manage such instruments. The fact that any risk can theoretically be insured against does not mean that the insurance is affordable.

In order to ensure that foreign investment is supportive of national development, the question of corporate responsibility was raised. Private foreign investment could obviously contribute to economic growth by providing finance, physical capital, technology, and, not least, good business practices. But this is not always the case. Within the UN, there was a great deal of work done on establishing a “code of conduct” for transnational corporations. Because of industrial country resistance, the effort yielded

no result. It was suggested that this issue might be broached in the context of the FfD conference.

(iii) Sovereign External Debt

Issues considered:

- Current debt settlement arrangements, notably the Paris and London Clubs.
- Review of various ideas on orderly debt workouts: standstill arrangements, “constructive defaults”, and mediation or arbitration schemes.
- The feasibility of the FTAP (Fair and Transparent Arbitration Process) proposal.

The resolution of the problem of external sovereign debt, which many developing countries face, is closely linked to the issue of capital flows. The debt service burden in some of the poorest countries has become highly onerous and is causing economic retrogression, with declining health and nutrition standards. The HIPC debt initiative is not inconsequential – as some critics believe – but its goals remain modest and conditions to qualify for it stringent. The debt overhang remains a serious problem for a large number of other developing countries, constraining their development efforts.

The existing debt indicators can be misleading, for they measure only what is actually paid but not the debtor’s contractual obligations, thus not reflecting arrears. What seems to happen is that the arrears on debt service continue to accumulate as “phantom” debt. This simply implies that, in the absence of a comprehensive debt workout, the debt problem continues to worsen over time. The recognition of a situation of insolvency at an early stage is fundamental to minimizing the damage, as protracted negotiations year after year with unchanging cut-off dates – as happens under the current Paris/London Club arrangements – feed uncertainty and damage the prospects for economic recovery of the indebted countries. This situation benefits neither creditors nor debtors. Speedy resolution of the debt problem is not an act of generosity, but efficiency.

There are past examples when debtors were treated differently (notably, Germany during the post-war reconstruction period and Indonesia during the late 1960s, after the fall of President Sukarno) and were given a chance for a “fresh start”. Learning from these experiences, what seems to be required is recognition of the rights of sovereign debtors and introduction of a “fair and transparent procedure” (or FTAP), which involves applying industrial country bankruptcy rules.

The best model for dealing with sovereign bankruptcy is provided by the laws governing debts of municipalities and states in the United States, the so-called Chapter 9. The bankruptcy courts are founded on three basic principles of the rule of law, i.e., judgments are made by neutral and independent arbiters, creditors are not allowed to

decide on their own claims, and the debtors' income earning capacity is not compromised. The Paris Club arrangements do not respect any of these principles.

A suggestion was made on making debt restructuring as part of the development compact. The involvement of private sector creditors was seen as one problem, even if the principle of arbitration was accepted. There was also the question of what would come after arbitration: countries needed fresh money. Would it be available? Some developing countries were worried that this might turn off foreign private lenders.

However, all these problems were likely to be aggravated in a situation where external debt problems remained unresolved. There could be no new money without a "fresh start" and private creditors had not shown as much aversion to arbitration as earlier apprehended. In any case, FTAP was not intended to bind every debtor country to those arrangements, but rather each country must decide for itself how it wished to deal with its problems. While these ideas might appear ambitious, past experience had demonstrated that ideas that appear unfeasible today, becomes feasible under changed circumstances.

(iv) Private Creditors and Moral Hazard

Issues considered:

- The problems of "socializing" the private debt and moral hazard.
- The role of standards and codes as well as better regulation in avoiding financial crises.
- The issue of the "lender of last resort".

Emerging market economies, with open capital accounts, have proven to be susceptible to financial crises, which have dire consequences at home and abroad: they stunt domestic growth and tend to spill outside borders and hurt healthy economies. Domestically, financial instability can be managed through intervention by the central bank playing the role of a lender of last resort. When emerging market economies suffer financial crises, it is in the interest of all to contain contagion and prevent default, and to restructure private and public debt of the crisis-engulfed economies. But this creates a "collective action" problem: a situation where no individual lender or national central bank has the incentive to make the needed loans, even though, collectively, each country would benefit if every party played its part.

At present, the IMF acts as a supranational lender of last resort and attempts to handle this global coordination problem. But its intervention gives rise to moral hazard: by promising to act as a lender of last resort, it may encourage excessive risk-taking and thereby induce, rather than prevent, financial crises. The obverse of this proposition is that the private sector must be held accountable for the risks it takes. The interest premium charged – i.e., the "spread" over U.S. Treasury paper – already includes an allowance for the risk of default; hence there is no justification for "bailing out" the

lenders. The question then turns on whether risk is being properly priced and factored into the cost of lending.

A related issue is to what extent should the concern with moral hazard be allowed to determine the policy and conduct of the IMF? It was noted that the likelihood of being “bailed out” would not generally be sufficient to induce foreign investors to jump into risky ventures or for domestic enterprises to undertake them, especially in light of the losses experienced in the aftermath of the Asian, Russian and Latin American financial crises. A different concern was that, in playing the role of the lender of last resort, the IMF was being selective, in that, while the claim holders on “systemically significant” economies were bailed out, other countries (e.g., Ecuador, Pakistan) had been left alone to work out settlements with private foreign lenders, with no assurance of new money.

The ways to “bail-in” the private sector have been discussed at length in recent years, but no clear consensus had emerged to date. It was suggested that the official sector needed to maintain a “constructive engagement” with the private sector while letting it do the necessary monitoring and supervision of credit markets. However, the validity of this proposition was questioned: the markets were not regarded as having done the monitoring well. Greater efforts to enhance the quality, timeliness and reliability of the flow of information to markets could be combined with the development of “insurance products” to cover credit risk and restructuring risk to produce better outcomes.

It was also pointed out that industrial country financial crises were managed quite differently from the way developing country crises were handled. In the first case, the immediate response tended to be to loosen liquidity along with the relaxation of regulatory requirements (as, notably, happened in the case of Long Term Capital Management crisis in 1998), while in developing countries, the approach had been exactly the opposite, i.e., tightening up of liquidity with interest rates allowed to skyrocket. This approach, during the Asian crisis, caused serious and avoidable, economic distress and resulted in massive insolvency in the private sector. It was noted that one reason for the asymmetry in approach was that strong economies with weak banks could more easily cope with financial crises than weak economies with weak banks. Nevertheless, the issue remains that a policy package that worsens the economic and financial situation by its very design could hardly be expected to contain the crisis and its spread to other countries.

The feasibility of “standstill” arrangements was discussed. These might be necessary to prevent a period of financial turmoil from turning into a full-blown crisis or to avoid outright default once the crisis had begun. They might serve to stop a creditors’ race to grab assets, which hurts not only the debtor but also creditors as a group. Standstills need, however, to be accompanied by policies to fix the economic situation as well as mandatory (if temporary) controls on capital outflows. Not every country would find this option appealing, but it should be a permissible route to adopt within a rule-based framework.

(v) Global Economic Governance: Enhancing the UN Role

Issues considered:

- The current division of labor between the Bretton Woods institutions (BWI) and the UN system.
- The practicality of bringing the discussion of international financial issues within the UN General Assembly or ECOSOC.

Over the past two decades, developing countries have frequently had to turn to the multilateral financial institutions – notably, the IMF and the World Bank – for help in crisis situations notwithstanding the disproportionate weight of major industrial countries in their voting and decision-making structures. Countries facing economic and financial collapse had few alternatives and no policy options other than those prescribed by these institutions. This experience gave rise to two interrelated concerns: (a) the need for outside, independent monitoring and evaluation of the performance of the BWI and regional financial institutions; and (b) the need for greater voice and representation of the developing countries, as directly affected parties, in the formulation and design of economic policy.

The United Nations – with its one nation, one vote – could offer its services as a solution to both these issues, but has been virtually excluded from global economic governance in recent years precisely because of the perceived threat to the international financial system if the developing countries were to wield greater influence. It is argued that the UN suffered from inefficiencies and had not been set up to carry out operational activities – an argument that lacks force in the face of the serious reform efforts and its carrying out of peacekeeping and humanitarian operations in recent years.

But the situation has begun to change. The agreement to hold the FfD conference itself is a manifestation of that. The reasons are complex and intertwined, but three stand out. During the 1970s and early 1980s, when the developing world asked for a “new international economic order”, the UN had come to be seen as hamstrung by ideological differences. However, with the end of the bipolar world of the Cold War period, an increased convergence of views on economic policy has emerged, even though the “Washington Consensus” continues to be questioned. A second factor that has attracted attention to the UN as a more responsive body has been the increasing popular protest against globalization, as evidenced during recent WTO and BWI meetings. The UN is also seen the appropriate forum for addressing the increased concern over the provision of global public goods.

These conditions favored a more comprehensive, assertive role for the UN. However, the “comparative advantage” of the UN remains in norm or agenda setting, rather than in operations. Some described the UN’s role as a sort of “parliament”, serving as the apex body to which all other international institutions and agencies were accountable. It was also pointed out that the FfD process itself was a good example of the UN involving all stakeholders and overcoming the sensitivities of the BWI and WTO

about their mandates. In order to carry out an expanded role, the UN, however, needed to improve its “self-image” and enhance its moral authority, which had been tarnished by the emphasis in recent years on managerial deficiencies that needed to be reformed.

There was little support at the workshop for the establishment of new institutions or structures in the context of the FfD conference. The proposals for a global economic summit or Economic Security Council in the Zedillo Report were not held to have much chance of being adopted. In any case, there remained serious questions on the specification of such proposals. For example, what would be the structure and membership of the proposed Economic Security Council? Would some members have a veto power? Similarly, the proposal for an International Tax Organization was considered premature, since it raised complex issues of its links with the UN and other specialized agencies, including the BWI.

On the other hand, a greater role for the ECOSOC in global economic governance – as proposed by the Secretary General’s Report – could be more practical, though even here there was the sensitive issue of the size of its membership. However, the basic attraction of the ECOSOC was that it had a clear mandate and a solution could be found to ensure satisfactory country representation. The ECOSOC would play a central role in economic matters and would aim to bring about greater coherence and consistency in global economic policy, while leaving BWI to work within their own charters. All the same, this would call for formal arrangements on the reporting and accountability of BWI to this forum. It was, however, pointed out that ECOSOC would remain handicapped, even if such arrangements were feasible, if the WTO remained outside the UN family. Surveillance/review of the functioning of other institutions within ECOSOC could be a sensitive matter, and would be resisted by the institutions themselves and by the industrial countries.

(vi) Global Economic Governance: Reforming the BWI

Issues considered:

- The current structure of accountability in BWI.
- The increased role of G-7 and the US and the rise of new forums (e.g.G-20)
- The issue of “voice” versus “vote”.
- Application of corporate governance principles to BWI.

BWI governance is a critical issue for global economic governance, and has become a subject of debate in recent years. This is at least partly due to the increased importance and influence of these institutions in the conduct of economic policy in developing countries and the extension of their sphere of concerns to domestic political and government institutions. This has give rise to a general sense that the broadening of conditionality tended to reflect and serve the leading industrial countries’ own agenda. It

was, therefore, inevitable that the performance of BWI would come to be evaluated by the standards of governance they hold important for developing countries. There is a perceived need for independent audit or accounting of the performance of the two institutions in terms of the quality and effectiveness of their diagnosis, prescriptions, and remedies.

The key areas of concern, from the perspective of the developing countries, relates to the preponderant voting power of the industrial countries in the two institutions, which is in contrast to many other international organizations under the UN umbrella where the rule of one-nation, one vote applies, or – as in the case of the Global Environment Facility and regional development banks – where developing countries have much greater voting power. The formulas determining the vote (quotas in the Fund and shares in the Bank) have changed little since inception and, over time, they have become less and less linked to the importance of a country in the world economy. Thus some of the largest developing countries that fall among the world’s ten largest economies (e.g., Brazil and Mexico) have voting power that is less than that of relatively small industrial economies, such as Netherlands, Belgium, or Switzerland.

The governance problems at the BWI are reflected in the non-transparent procedure of selecting the heads of the two institutions, the use of qualified majorities in certain key areas of policy in addition to weighted voting, and the peculiar position of the Executive Directors, who are at the same time part of the managements and representatives of their constituencies in the two institutions. Thus, there have arisen concerns over representativeness, even legitimacy, of the existing structure of global economic governance. That these concerns are at least partially recognized is reflected in the rise of new groupings of countries – notably, G-20 – where developing countries (those considered to be “systemically significant”) are better represented in discussions on global economic policy and the reform of the international financial system.

While recognizing the difficulties in making changes to the constitutions of the two institutions, several suggestions were made to improve the vote and voice of the developing countries in their governance. For one thing, the “basic votes” which had been left unchanged at their original levels, (250 votes for each member regardless of the size of its quota) could be revised upwards to restore the proportion of “basic” to total votes that had been established at the inception of the IMF. The use of purchasing-power-parity (PPP) exchange rates, rather than actual (or market) exchange rates, in evaluating the size of the economies for the purpose of calculating quotas would also make a difference, since the former tended to be much higher for the developing countries. In addition, the boards themselves could be restructured to have a better balance between industrial and developing countries and between large and small countries. Applying some of the established principles of corporate governance with respect to protecting the rights of minority shareholders could also be helpful.

Questions were also raised regarding the quality of advice and competence of staff to handle financial crises. Here opinions differed in the workshop. Some felt that the competence of the staff in handling complex financial and economic issues was

questionable; while others felt that the weaknesses lay mainly in adapting policies and recommendations to different country situations. It was also pointed out that the BWI were responsive to criticism and making improvements to be more responsive, although the progress was slow. Some argued that there was a case for demanding compensation to the country where “grave negligence” on the part of the institution could be established. This would require independent assessment of the institutions’ performance.

The failure of developing countries to fully use their own power and influence in the international institutions was noted. It was pointed out that developing countries had not always wielded greater influence in the regional development banks where they had half or more than half of the voting power. Giving “voice to the voiceless” required more than seeking more votes.

There was agreement that greater transparency in the governance of BWI could only help the institutions’ credibility and effectiveness without raising the cost of their operations. The IMF has to continue to play its role in averting and managing financial crisis; the existence of moral hazard is not a reason for weakening its lender-of-last-resort functions. Bilateral creditors cannot be relied upon, for they demand fulfillment of conditions of special interest to them, as became evident during the handling of the East Asian crisis of 1997.

(vii) Trade

Issues considered:

- The trade-development link.
- Commodity price instability and terms of trade shocks.
- Asymmetric world trading rules.
- Trade liberalization and rising trade deficits; the need for additional external financing.
- The interests of the developing countries in the proposed “development round”.

Trade policy and the role of the WTO have been central to the discussion of trade issues in recent years. Developing countries have been told that free and open trading regimes result in efficient use of resources as countries exploit their comparative advantage. Thus, trade liberalization and opening up their economies have been key pillars of policy reform. However, the promised benefits have been elusive. While imports have risen sharply, expansion of exports has been constrained by problems of market access, on the one hand, and structural weaknesses of developing economies, on the other. This has resulted in a general increase in trade deficits, requiring increased foreign financing. At the same time, implementation of decisions reached during the Uruguay Round has been slow and selective. The industrial countries have backtracked

on their commitments on liberalizing trade in agriculture and textiles, while developing countries, faced with the imperative of introducing new laws and regulations, have found it difficult to meet the complex requirements of TRIPs, TRIMs, and new regimes for trade in services within the stipulated time periods.

Now, the industrial countries (especially, the European Union) propose a new round of trade negotiation, which in recognition of developing country reservations would be called the “development round”, addressing issues of market access and implementation of past commitments. In return, the industrial countries would like to bring into the multilateral framework new issues of competition policy and rules governing foreign investment and government procurement, and, quite likely, labor and environment standards. Developing countries are skeptical about the new round and the tradeoffs it implies. They do not believe that problems of implementation require new negotiations (which inevitably involve compromises) and are reluctant to allow further broadening of the WTO’s mandate to include the proposed new subjects.

Although individual country positions differ, developing countries’ agenda covers basically three points: (i) the WTO’s mandate needs to be examined carefully, and confined essentially to trade policy; (ii) even in WTO’s main area of concern (removing barriers to trade), the rules need to be recalibrated to promote development in developing economies; and (iii) the new issues that the industrial countries are striving to bring into the WTO (labor standards, environment, and the issues mentioned above) should be addressed by agencies already set up to address them.

At the same time, there are trade issues of direct concern to the developing countries which are not being addressed anywhere, notably, the deteriorating and unstable terms of trade, commodity trade, diversification, etc. If the industrial countries were serious about labor standards and not driven by domestic protectionist pressures, they would also focus on the plight of primary producers in the developing countries, experiencing dramatic fluctuations in income from year to year. Similarly, environmental concerns could be extended to assessing the consequences of the production of synthetic substitutes in the industrial countries, not just pollution from industry in the developing world. It was also observed that the sequencing and pace of trade liberalization had not been given adequate attention in reform programs and that serious losses of public revenue from import duties had added to the macroeconomic imbalances. A point was also made that abrupt terms of trade changes affected not only producers but also developing country consumers; the hardship from the recent oil price spike was noted.

However, the really hard question posed at the workshop was: what trade issues should developing countries press for at the FfD conference? What bargain could be struck with the industrial countries in that forum? There was a general recognition that matters under discussion within WTO – i.e., the new round – should not be brought into the UN conference. On the other hand, the problem of financing the rising trade deficits and terms of trade effects had implications for resource transfers and should be addressed on that occasion. Although commodity agreements had faced many problems, there was

a case for revisiting them. It was also noted that there were divergent pressures within industrial countries, in that banks and other creditors would like to see developing country exports rise to keep them creditworthy, while labor unions saw those exports as a threat to jobs. Perhaps, in pursuit of a “grand bargain”, developing countries could benefit from such divisions.

REFLECTIONS ON THE WORKSHOP OUTCOME

It is impossible to do justice to the richness of the discussion during the two-day workshop in a brief report, and it is to be expected that the participants formed their own opinions and conclusions. It is, therefore, necessary to acknowledge that this section is in the nature of reflections on what appear to be key outcomes of the workshop, rather than providing firm recommendations that could be pursued in the forthcoming sessions of the PrepCom. These reflections are based on the views and impressions expressed by three experts on finance and development during the workshop’s concluding session.

In each of the four areas of concern – resource transfers, external debt, global economic governance, and trade – the workshop helped to delineate common ground, if not arrive at a convergence of views. With respect to resource transfers, developing economies will obviously require substantial foreign capital inflows (official as well as private) if they are ever to catch up with the richer economies. These transfers are needed to augment countries’ productive assets – human as well as physical capital. Humanitarian assistance, curbing civil strife, or refinancing of past debt are without question critically important in arresting the decline of living standards witnessed in a large number of developing countries. But clearly this is not enough – conditions for economic growth must be recreated.

Private capital flows rose sharply during the 1990s and now amount to a multiple of ODA, but the problem remains that they are not attracted to sectors where returns are slow to materialize (most infrastructure sectors) or where the returns are hard to appropriate (education and health), or into countries where risks are deemed to be high. There is also some doubt that private flows actually respond to needs, rather than flowing to countries in a herd-like fashion, as is evident from their very heavy concentration in only a handful of developing countries.

Various ideas were offered on guarantees and other instruments to insure against risk, and the World Bank and other regional development banks could play a more active role in this domain, though going beyond what is already being done would call for a change in their charters – by no means a simple task. Industrial countries could also do more to encourage capital flows to developing countries, but all the suggested means were not considered either to be particularly effective (e.g., tax incentives) or to be consistent with WTO rules. Still, search for other methods to encourage private foreign investment must continue.

In the end, it is the conditions in developing countries that would be decisive. Improving governance, reducing corruption, maintaining macroeconomic stability,

introducing effective banking supervision and regulation, etc., are all very worthy goals, which must be pursued by developing countries in any case. But the problem is that they are both the precondition and consequence of economic growth. How could countries that are caught in the poverty trap be helped to break into the virtuous circle of growth-savings-investment? It is in this context that the role of official resource flows should be seen: if the industrial countries were to meaningfully contribute to development, they must greatly improve upon their recent record on ODA in support of development and investment. Provision of financing for development must be viewed distinct from financing required to meet humanitarian challenges, supply of GPG, and refinancing of past external debts.

But this gives rise to the second crucial question: What have developing countries to offer in return? The participants wrestled with the notions of “a grand compact” and reciprocal responsibilities and obligations. Although the discussion lacked clarity on this, there could be little doubt that the industrial countries would directly benefit from a developing world where standards of living were rising, permitting expanding markets and helping to curb social and political tensions, whose consequences – as recent events have demonstrated most tragically – can no longer be confined to isolated localities.

It is recognized that globalization, far from “raising all boats”, has caused much economic distress and has been a major factor in the widening of the income-gap between and within countries. Thus, as countries become integrated into a global economy and economic interdependence deepens, the case for income transfers from richer to poorer regions becomes hard to counter. This is certainly the practice within federations and economic unions; the examples of the United States and European Union being particularly apposite. If this idea were to be accepted at the FfD conference even as a matter of principle, a significant step towards global harmony will have been taken.

There was general agreement at the workshop that the emphasis had to be placed on both enhancing the quantity and effectiveness of official transfers. Although it is difficult to be precise about the developing countries’ needs, it is essential to reach a consensus on a rough order of magnitude. It was also felt that a clearer picture on the resource flows was necessary, taking account of terms of trade changes and unrecorded capital flows. Because of budgetary stringency and other priorities obtaining in the industrial countries, the need for exploring innovative sources of financing becomes obvious. Various suggestions were discussed in this connection, but none seemed to have gained universal acceptance. It was pointed out, however, that there were steps that individual industrial countries could take to raise financing for development without waiting for others to come on board; a specific example being a small tax on pharmaceuticals to subsidize provision of drugs in developing countries.

The effectiveness of foreign assistance, on the other hand, required the recipients gaining greater control over the design of their development programs and independent monitoring of donor performance at the level of individual recipient countries as well as that of the recipients. Any reduction in the so-called “transaction costs” of foreign

assistance implies a commensurate increase in resource flows. This again did not depend on all donors accepting the principle.

The issue of external debt is closely tied to resource transfers. So long as the problem of debt overhang persists, developing countries could not have a “fresh start”. What is needed is a system that is efficient as well as fair, which the current ad hoc arrangements of Paris and London Clubs are clearly not. The idea that ways should be found to apply to sovereign debt principles on which domestic bankruptcy courts were founded received wide support at the workshop. Basically, what this involved was to devise arrangements that respected the rule of law in three respects: (i) an independent authority to preside over resolution of debt disputes; (ii) creditors must not be allowed to decide on their own claims; and (iii) every effort must be made that debtors’ capacity to maintain essential social services and pursue economic growth must not be compromised.

These ideas would obviously face strong resistance from the industrial countries as well as international financial institutions, but it was something that the developing countries could unite to pursue at the FfD conference. Even a simple recognition of the principle of “debtors’ rights” would be a big leap over the current state of affairs.

On the other hand, the workshop did not come to any clear conclusion on the actual handling of financial crises. The problem of moral hazard was discussed and the need for involving the private sector and relying on market instruments was stressed. But no specific suggestions were made with respect to the need for an international lender of last resort or the IMF’s role generally. Nevertheless, there was convergence of views that solutions that made economic and financial conditions worse – as was the experience during the management of the Asian crisis – had to be avoided in future. And, this conclusion is closely tied up with the issue of BWI governance.

The under-representation of the developing countries in the BWI is widely acknowledged. The workshop’s contribution lay in arriving at a common ground on specific recommendations that improve the situation. These related to raising basic votes, application of purchasing-power-parity exchange rates to determining the relative economic size of the member countries, redistribution of chairs within the executive boards in favor of developing countries and at the expense of European countries (which are over-represented), and incorporating principles of corporate governance with respect to protecting minority shareholders’ rights. A relative increase in the role of regional and sub-regional official development-oriented financial institutions also might help to increase the voice of the developing countries in global economic governance.

Again, all these changes would be vehemently resisted and probably dismissed as unrealistic, but the developing countries must come together in pursuit of them. However, this effort would amount to little if developing countries do not address the issue of their weak “voice” even in institutions where they do enjoy larger vote. For this only they could be held responsible.

The absence of accountability of the BWI to an outside body is central to the problem of global economic governance. Here, too, the workshop seemed to converge

on the view that the temptation to set up new institutions should be resisted and the UN should play a more active role in economic matters. The reform of the UN was noted, though cuts in staffing and other pressures had compromised the analytical capacities at the staff level. ECOSOC could serve as a sort of apex with a mandate to discuss the coherence and consistency of economic policy, with the BWI invited to report on their activities and performance. But this function could not be satisfactorily discharged without an enhancement in the intellectual capital and standing of the UN staff. Because of the one-country, one-vote in the UN, quality work of the UN staff could be the key to giving greater voice to the developing countries in global economic governance.

Finally, the workshop discussed a number of important ideas with respect to trade in the context of the FfD conference. There was a general sense that care must be taken not to undermine the delicate negotiations that are going on in the WTO with respect to the proposed next round of trade negotiations. But it was equally important that the WTO should come within the fold of the UN family of organizations. However, the problems of international trade facing developing countries transcended trade policy and the WTO's mandate. The missing "development dimension" related to unstable and deteriorating terms of trade, heavy dependence on primary products, the need for diversification, and judicious use of trade policy interventions in support of economic development, etc. In the past, these concerns were addressed at UNCTAD, but now there was no institution that kept them under review. It was, therefore, necessary that the developing countries speak with one voice on these issues at the FfD conference and seek mechanisms to deal with them within the UN.

In formulating their demands, the participants were mindful of the need to offer something in return. The search for a global compact has been noted already. Here, in conclusion, three very worthwhile ideas, suggested at the workshop, can be mentioned and which developing countries might consider as they define their negotiating positions: (i) developing countries might adopt and emphasize in their negotiations goals that the industrial countries themselves hold to be important (notably, human rights); (ii) the process might be cast in terms of a series of small bargains rather than aiming at one grand outcome; and (iii) the developing countries could build north-south alliances with NGOs on matters of common interest.

Final word. It is important that the FfD conference is accepted as the start of a process; an agenda for follow-up must be one of the outcomes that the developing countries must seek.

G-24 Liaison Office
Washington, DC

October 3, 2001

G-24 Workshop on Financing for Development
September 6-7, 2001
Nigeria House, 21st floor
828 2nd Avenue (corner of 44th St.), New York, NY 10017

Programme

September 6

9:00-9:30

Registration

9:30-10:30

Opening Session

- Welcoming statement

Chairman, Dr. RO Mowoe

- Briefing on the FfD process

Ambassador Bagher Asadi,
G-77 Chairman

Mr. Oscar de Rojas
Executive Coordinator, FfD

Coffee break

10:45-12:30

Resource Transfers:
Official Capital Flows

- Presentation of the paper

Mr. Arjun Sengupta

- Discussant's Comment

Mr. Gerry Helleiner

Chair: Dr. R.O. Mowoe

- General discussion

- Chairman's summing-up

Lunch

2:00-3:30

Resource Transfers:

- Presentation of the paper

Mr. Percy Mistry

Private Capital Flows

- Discussant's Comments

Mr. Aziz Ali Mohammed

- General discussion

- Chairman's summing-up

Chair: Ms. H. Sayed

Coffee break

3:45-6:00

External Debt

- Presentation of papers

Mr. Kunibert Raffer and
Ms. Ruth Krivoy

Chair: Mr. Ernest Ebi

- Discussants' Comments

Messrs. Yilmas Akyuz and
Percy Mistry

- General discussion

- Chairman's summing-up

September 7

9:00-10:30

Global Economic
Governance: The
Enhanced Role of the
UN

Chair: Ms. Sheelagh de
Osuna

- Presentation of the paper
- Discussant's Comments
- General discussion
- Chairman's summing-up

Mr. Leiv Lunde

Mr. Arjun Sengupta

Coffee break

10:45-12:30

Global Economic
Governance:
Transparency and
Accountability of BWI

Chair: Ms. Sheelagh de
Osuna

- Presentation of the paper
- Discussant's Comments
- General discussion
- Chairman's summing-up

Mr. Ariel Buirá

Mr. Kunibert Raffer

Lunch

2:00-3:30

Trade and Finance
Issues

Chair: Mr. Balmiki Singh

- Presentation of the paper
- Discussant's Comments
- General discussion
- Chairman's summing-up

Mr. Martin Khor

Mr. Irfan ul Haque

Coffee break

3:45-5:30

Reflections on the
discussions by experts

Chair: Amb. Milos
Alkalay

- Panelists Comments
- General discussion
- Closing remarks

- Mr. Gerry Helleiner
- Mr. Yilmaz Akyuz
- Mr. Aziz Ali
Mohammed

- Chairman G24
Deputies

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Mr. Mohammad Ali Zarie Zare
Permanent Mission of Iran to the UN

List of Papers Commissioned for and Discussed at the G-24 Workshop on Financing for Development

- Global Economic Governance: Reforming the Governance of the Bretton Woods Institutions
Author: Mr. Ariel Buira
- Financing for Development: Trade and Finance Issues
Author: Mr. Martin Khor
- Financial Crises and the Private Sector: Reducing Moral Hazard
Author: Ms. Ruth Krivoy
- *Global Economic Governance: Conditions and Opportunities for an enhanced role for the United Nations*
Author: Mr. Leiv Lunde
- Mobilizing Private Sources of Financing for Development
Author: Mr. Percy Mistry
- Schemes for Resolving the Sovereign External Debt Problem
Author: Professor Kunibert Raffer
- Official Development Assistance
Author: Arjun Sengupta