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U N I T E D N A T I O N S **N A T I O N S U N I E S**

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TO THE INTERNATIONAL MONETARY FUND AND FINANCIAL COMMITTEE

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Global economic recovery fragile and uneven

The world economy started 2010 with clear signs of continued recovery. Both international trade and industrial production stayed on their upward trends and most economies showed positive GDP growth in the last quarter of 2009. The recovery remains, however, fragile and uneven across countries.

In most developed countries, the recovery has so far been mainly driven by policy stimuli and an erratic inventory cycle, while the recovery in demand from the private sector is far from robust. The impetus from the developed countries for the global recovery will remain limited in the outlook for 2010. While developing Asia, particularly China and India, is driving present global growth, the recovery is much more subdued in many economies of Africa and Latin America, and still very fragile in most economies in transition.

The risk of a double-dip recession has not yet fully receded, and it remains highly likely that a protracted period of weak world economic growth lies ahead of us. There is also the prospect of greater exchange rate instability, disrupting world trade and consequently, economic recovery. Premature and uncoordinated withdrawal of stimulus measures in major economies would seriously slow the ongoing recovery. Mounting public indebtedness in many developed countries is a reason for concern, but should not be a reason for withdrawal of stimulus at this stage of the recovery.

Developing countries are still suffering from the fallout of the crisis, which has led to a decrease in capital inflows, lower remittances, lower trade revenues, commodity price fluctuations and shortfalls in tourism revenue. 107 out of 160 countries for which data are available, registered a decline in per capita income during 2009. The reduction in employment and income opportunities has led to a considerable slowdown in progress towards poverty reduction and the fight against hunger. Estimates by the United Nations Department of Economic and Social Affairs suggest that, in 2009, between 47 and 84 million more people remained poor or fell into poverty in developing countries and economies in transition than would have been the case had pre-crisis growth continued. The World Bank's *Global Economic Prospects, 2010*, has warned of the prospect of higher food prices due to higher costs of production and demand for bio-fuel. Additional causes of concern acknowledged by the report include the influence of financial speculation in commodity markets and further declines in agricultural productivity in poor countries, especially in Sub-Saharan Africa.

The outlook for employment growth is mixed at best. Jobs recovery remains weak overall, but trends diverge. Unemployment rates are still on the rise in most transition economies, but they seem to have stabilized in several developed countries and come down in a number of developing countries. Yet, the employment situation in developing countries is expected to remain difficult. Jobs that were shed in export-oriented manufacturing sectors are expected to only come back very slowly, and workers pushed into vulnerable employment in the informal sector because of the crisis are likely to encounter difficulties in finding more secure and better paid jobs for some time to come. Since social protection coverage is limited, the number of working poor is likely to continue to increase in many developing countries, even during the recovery.

Strengthening recovery through counter-cyclical policies and development financing
There is a need for more resources and greater efforts to make up for the significant setbacks in progress towards the Millennium Development Goals (MDGs). Low-income countries with limited fiscal space are in need of additional official development assistance (ODA) to finance the expansion of social services and programs needed to meet the MDGs and engage in counter-cyclical policies. These increased needs contrast with the still significant shortfall in aid delivery against commitments. Although OECD's Development Assistance Committee (DAC) expects continued modest growth in total net ODA for 2009 and 2010, the estimated shortfall against the Gleneagles commitments will be $17 billion in 2010. Apart from fulfilling commitments, donor countries should consider mechanisms to de-link aid flows from their business cycles to prevent delivery shortfalls in times of crisis when the need for development aid is most urgent.

The crisis highlighted the need for very large liquidity buffers to deal with sudden and large capital market shocks. A more representative IMF could become a more effective provider of reliable emergency financing, taking over the role of international lender of last resort. The IMF should expand the use of its resources to help support counter-cyclical measures in those developing countries that have sustainable public finances in the medium term, but are impeded in this effort by adverse market conditions. Accordingly, there may be a need to further modify IMF conditionalities in such a way that pro-cyclical monetary and fiscal policy stances are avoided. There is also a consensus that lending by the Fund to low-income countries should be more flexible in light of long-recognized country needs and greater exposure to global volatility.

Better macroeconomic policy coordination to ensure a sustainable recovery
Governments worldwide have made the equivalent of 30 per cent of world gross product (WGP) available to address the crisis through the recapitalization of banks, partial or full government ownership of ailing institutions and providing deposit and financial asset guarantees. Furthermore, counter-cyclical policies in most major economies generated massive liquidity injections and fiscal stimulus packages totaling about $2.6 trillion (or 4.3 per cent of WGP) to be expended during 2008-2010 accompanied by drastic cuts in policy interest rates. These measures have been successful in reversing the free fall the world economy. But at the same time, insufficient coordination of the stimulus has also contributed to the new surge in the global financial imbalances.

Governments of the major economies will need to improve coordination of continued stimulus as well as subsequent 'exit strategies' while retaining a counter-cyclical policy framework. In most contexts, stimulus measures will need to stay in place until unemployment rates have decreased significantly. Coordinated macroeconomic policies should address global imbalances, income convergence between developed and developing countries, and greater environmental sustainability. Addressing the climate change challenge while allowing for rapid growth and poverty reduction in developing countries will require higher public investments directed at promoting transformative investments in infrastructure, financial transfers to developing countries to invest in renewable energy, as well as climate change adaptation and economic diversification.

As emphasized in the United Nations report, *World Economic Situation and Prospects 2010*, a successful framework for international macroeconomic policy coordination should comprise at least four components: developing a consensus on goals through international consultations; issuing multi-year schedules for policy adjustments; enhancing the context for mediation and the perceived legitimacy of the mediator; and initiating systemic reforms in the field of international monetary and financial affairs.

Given the magnitude of global challenges and their interconnectedness, the proposal by the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System to establish a "Global Economic Coordination Council", at the level of government leaders is worth considering. The Council would assess developments and provide global leadership on economic issues taking into account social and environmental factors. It would also give guidance to other agencies of global economic governance to ensure coherence among the competencies of each. However, while ensuring that all regions and all major economies are represented, its size should be guided by the fact that the Council must remain small enough for effective discussion and decision-making.

Strengthened cooperation for more effective international financial regulation

The crisis has demonstrated the urgent need to introduce international regulatory oversight of a globalized financial system, which would create less volatile financial flows for innovation, risk-taking and investing in employment, production and development. Reforms to reshape regulatory systems have to be geared towards enhanced international frameworks for macro-prudential regulation, increased oversight of systemically important financial institutions, markets and instruments, new principles of executive remuneration, enhanced international tax cooperation and more effective oversight of the activities of credit rating agencies.

In a financially integrated world, such reforms will only be successful if coordinated at the international level. However, current institutional arrangements to ensure that national decisions regarding regulation appropriately take into account both external and domestic consequences, are not adequate. Important inconsistencies among national regulatory systems exist, as well as a clear tendency for country authorities to favour domestic interests and to ignore the adverse international consequences of their actions.

Enhancing voice and participation of developing countries in the Bretton Woods institutions

The outcome of the 2009 United Nations Conference on the World Financial and Economic Crisis and Its Impact on Development emphasized the need for continued reform to better enable the international financial institutions to respond to current challenges and to better prevent similar crises in the future, in accordance with their respective mandates.

Last year, both the IMFC and the Development Committee agreed to shift at least 5 per cent of aggregate quota shares in the IMF and 3 per cent in the World Bank from developed to developing and transition countries. Many developing countries, however, had maintained that the shift should be of at least 7 per cent and 6 per cent respectively. To further democratize the voting procedure and ensure that decisions affecting key aspects of IMF governance have the support of the majority of its members, the Trevor Manuel Committee proposed amending the Articles of Agreement to lower the voting threshold from critical decisions from 85 per cent to between 70 and 75 per cent. To better balance the interests of large and small countries, consideration should also be given to significantly increasing the weight of the basic votes of all member countries and double majority voting to a wider range of decisions.

Global reserve system for stability, accountability and equity

The most feasible reform in this regard may be to broaden existing SDR arrangements which, over time, could gradually evolve into a new and widely accepted international reserve currency. Such a gradual transition would be more broadly acceptable politically besides being less disruptive. Monetary authorities could deposit part of their official reserves in a special account at the IMF denominated in SDR. This would help promote a greater role for SDR as a reserve currency and more effective reserve management at the global level, as it would allow central banks to diversify out of dollars without causing sharp exchange-rate swings.

International policy coordination among the IMF, governments, banks and non-financial firms is necessary to reach a certain critical mass for the development of a deep and liquid SDR market attractive for central bank reserves. Moreover, the feasibility of the SDR as a reserve currency would require a settlement system between the SDR and national currencies to make the unit an acceptable means of payment that facilitates the direct exchange of SDR claims, not only into dollars, but into all participating currencies.

In addition to their potential role as the eventual centre of a new reserve currency arrangement, SDR could also become a source for development finance. By pooling their reserves, countries could reduce their own needs for holding reserves and free up resources for domestic investment. The reserve pool could also be used to leverage resources for development financing (e.g., by issuing SDR-denominated bonds).

Strengthening international cooperation in tax matters

In the face of pressure to manage the fallout from the crisis, fiscal reform to increase fiscal policy space, as well as to improve the quality of public expenditure, needs to be sustained by enhancing effective mobilization of tax revenues based on a modernized, effective and equitable tax system and a broadening of the tax base. There is an emerging consensus on the enormous cost to development created by illicit capital flows, including capital flight and transfer abroad of stolen assets, from developing countries. Tax evasion, including through mis-invoicing of intra-firm transactions, is a key concern.

This recognition presents a unique opportunity to bring the development and tax communities closer together to promote stability and growth for the benefit of both developing and developed countries, through tax cooperation for development at the bilateral, regional and international levels. Indeed, tax cooperation with a development focus has not received the attention that its importance requires. Regional and truly global tax cooperation has not garnered its fair share of commitment and support, despite its crucial role in domestic resource mobilization for development.

Bilateral capacity building in tax policy and administration can be an effective form of assistance, but its impact could be multiplied by international cooperation, as recognized in the Monterrey Consensus and Doha Declaration on Financing for Development and as advanced by the UN Committee of Experts on International Cooperation in Tax Matters. The Committee is working in key areas, such as a draft Practical Manual on Transfer Pricing for Developing Countries, tax incentives as an aspect of tax competition, the role of tax cooperation in enhancing domestic and regional climate change-related initiatives and a proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance.

Financing a clean energy investment strategy

Financing clean energy investment remains the key response to global warming. Large-scale investments in energy efficiency and renewable energy generation will be needed to lower the cost of green technologies and to effectively achieve low-emission growth paths. Such investments will also have to be made in developing countries, whose energy demands will increase starkly along with their efforts to reach higher levels of development. By leapfrogging to green technologies, they could contribute to emission reductions while sustaining high-growth development trajectories. Substantial investments will need to be made for climate change adaptation, especially in developing countries already affected or threatened by adverse effects of global warming.

To expedite progress in this regard, United Nations Secretary-General Ban Ki-moon has established a High-level Advisory Group on Climate Change Financing, co-chaired by Prime Minister Gordon Brown of the United Kingdom and Prime Minister Meles Zenawi of Ethiopia, to mobilize the financing promised for climate change during the United Nations Climate Change Conference in Copenhagen last December. The Group will study the potential sources of revenue for financing mitigation and adaptation activities in developing countries and present its report to the United Nations Secretary-General and to the current (Denmark) and next (Mexico) Presidents of the United Nations Framework Convention on Climate Change Conference (UNFCCC) of the Parties by November 2010. In Copenhagen, Governments committed to mobilize $100 billion annually for developing countries by 2020. Viable new programs and schemes for innovative finance need to be expeditiously explored to translate these commitments of the Copenhagen Accord into reliable resource flows that will complement traditional ODA as part of a legally binding framework within the UNFCCC.

Owing to overinvestment in most economic sectors with the easy availability of cheap credit before the crisis, it is very unlikely that further investments in such sectors will be forthcoming in the near future without some inducements. Instead, it will be necessary to promote investments in renewable energy as well as tropical food agriculture in order to address climate change mitigation without undermining developing countries' developmental aspirations as well as to ensure affordable food security, especially in low-income countries. Such an effort will not come about without cross subsidization of public incentives for such investments in developing countries.

The Global Green New Deal (GGND) thus offers the opportunity to accelerate economic recovery while addressing the development, climate change and food security challenges. The GGND should become a central plank of the broader counter-cyclical response to the crisis. The Deal must include national stimulus packages in developed and developing countries aiming at reviving and greening national economies. This would require financial support to developing countries to increase their fiscal space, as well as international policy coordination to ensure that developed countries' investments will have strong sustainable developmental impacts in developing countries. The GGND would help mobilize and re-focus the global economy towards investments in clean technologies, which should lead to the revival of growth that is both environmentally and socially sustainable.

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