VOICES OF THE SOUTH ON GLOBALIZATION

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FINANCING FOR DEVELOPMENT

In this issue

The Monterrey Consensus 1

Will EU Bell the Cat? 2

Eurodad Pleads for Reinforcing UN Tax Committee 3

Capital Flight – A Bane to Development 4

Call for Revamping the Global Financial Architecture 5

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Voices of the South on Globalization is a monthly newsletter intended to inspire a meaningful North-South Dialogue by raising awareness for global interdependences and by offering a forum for voices from the South in the globalization debate. Each edition will present short analyses or commentaries from a Southern perspective on one particular issue of the globalization process.
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THE MONTERREY CONSENSUS

The United Nations International Conference on Financing for Development at Monterrey in March 2002 marked an important landmark in the partnership on global development. The Monterrey Consensus, adopted by more than 50 Heads of State and 200 hundred ministers of finance, foreign affairs, development and trade embraces six areas of financing for development:

- Mobilising domestic financial resources for development.
- Mobilising international resources for development: foreign direct investment and other private flows.
- International Trade as an engine for development.
- Increasing international financial and technical cooperation for development.
- External Debt.
- Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development.

In Monterrey, governments were joined by the Heads of the United Nations, the International Monetary Fund (IMF), the World Bank and the World Trade Organisation (WTO), prominent business and civil society leaders and other stakeholders.

The U.S., the European Union and other countries made new development aid commitments. Some critics suggest that Washington has ignored the consensus because the total amount of U.S. official development assistance, though by far the largest, is only 0.2 percent of the country's gross national income (GNI), whereas Sweden's oversteps the 0.7 percent UN target and amounts to 1 percent.

As the United Nations member states prepare to review progress on the Monterrey Consensus in Qatar's capital Doha from November 29 to December 2, the U.S. administration is keen that donor countries use the opportunity to re-commit to the principles agreed upon in 2002. In the view of the U.S. administration, there have been notable development successes since the adoption of the Monterrey Consensus:

- High and sustained levels of economic growth in most developing countries have led to a substantial reduction in global poverty rates;

- Foreign Direct Investment (FDI) support for infrastructure projects in developing countries has rebounded rapidly, increasing more than 80 percent since 2003, reaching nearly 380 billion dollar in 2006;

- Strong growth in exports from most developing countries since 2002 have contributed to the high levels of GDP growth in those countries;

- There have been substantial increases in levels of Official Development Assistance (ODA) and a significant rise in combined ODA for Sub-Saharan Africa from G8 countries;

- Improvement in debt sustainability has occurred in both low and middle-income countries. Debt servicing levels are substantially lower, and some countries repaid or prepaid debt while borrowing at more competitive rates in the international capital markets;

- Developing countries have increased their participation in international decision-making and norm-setting processes.

But time has left its deep imprint. ☑

WILL EU BELL THE CAT?

In her function as the UN Secretary-General's Special Envoy for the Financing for Development Conference, Economic Cooperation Minister Heidemarie Wieczorek-Zeul has underlined the special role played by the EU to ensure that industrialised countries deliver on the financial commitments they made in Monterrey. With its plan to gradually increase ODA, the EU has indeed sent a clear signal. The EU is also playing a significant role in drafting the Doha outcome document.

"We recognize that while new opportunities have been created, multiple challenges have emerged that impact the achievement of equitable and sustainable development, including eradicating poverty, achieving sustained economic growth and environment sustainability," says an amendment proposed by the European Union to the draft outcome document of the Follow-up International Conference on Financing for Development.

Some of the key challenges the world community faces today include: financial instability, substantial and persistent global imbalances, volatile capital flows and unstable exchange rate markets, large and abrupt price fluctuations in international markets of key commodities, slowing global economic growth, increased damage to the earth's environment and climate change, loss of biodiversity, deforestation, desertification and scarcity of water resources. In the amendment submitted Oct. 24, the EU members reaffirm their "resolve towards concerted global action to address all these areas, while consistently furthering economic and human development for all."

The concern of the international community with climate change has indeed increased markedly since the adoption of the Monterrey Consensus. Ongoing and potential responses to tackle this phenomenon therefore have major development implications and will incur a substantial additional cost to developing countries, says the EU draft, adding: "We agree to address such implications in a timely and decisive way, paying special attention to the needs of most vulnerable countries, especially LDCs and SIDS. We *inter alia* resolve to address the financing needs for the mitigation and adaptation to climate change in developing countries in the context of sustainable development."

The EU welcomes in this respect the adoption of the Bali Action plan of December 2007 and the objective to complete negotiations on a new comprehensive global agreement on climate change in Copenhagen in December 2009. The EU also welcomes the launching of the Adaptation Fund within the UNFCCC structure and recognises the need to develop in conformity with Bali Action plan an architecture to optimise and mobilise predictable, sustainable and new, additional and adequate investment and financial flows form various sources (including the private sector, the carbon market, public sector and innovative instruments) and to deliver financing efficiently, effectively and equitably.

They stress that financing to support nationally appropriate mitigation actions by developing countries as well as these mitigating actions should also be measurable, reportable and verifiable. "We call for international climate change finance to be inclusive, equitable and delivered in line with established principles and mechanisms of development assistance such as country ownership and alignment with national priorities and systems," says the EU draft.

It adds: Concerted efforts to address climate change should promote increased trade in environmental goods and not result in trade distortions that would be incompatible with WTO rules.

The EU draft underlines the need to facilitate the transfer of safe and sustainable low carbon technologies to support economic development efforts.

It also underscores the special challenges emerging from international commodity markets, particularly the volatility in food and energy prices. The draft amendment says: "We will make efforts to increase multilateral and bilateral resources to assist developing countries, particularly the least developed and those that are most affected by high food and energy prices, in coping with the consequences of these higher prices, while at the same time recognizing the necessity of a substantial expansion in food production. We reiterate that the global food crisis has multiple and complex causes and that its consequences require a comprehensive and coordinated response in the short, medium and long term by national governments and the international community."

The EU encourages thus the development of a global partnership for agriculture and food. In this regard, it welcomes the establishment by the UN Secretary General of the High-Level Task Force on the Global Food Crisis and encourages its continued engagement with member states, relevant organisations and all stakeholders, including private sector and especially farmers .

"We will encourage all countries to develop energy systems that meet development needs and are consistent with the necessity to stabilize the global climate," says the draft amendment. This goal will not be met without major changes in energy supply and use worldwide. IN view of this, it calls for substantially increasing the share of renewable energies and promoting energy efficiency, energy conservation and behavioural change. "We reaffirm that access to basic energy services and to clean and sustainable energy is indispensable to eradicate extreme poverty and to achieve IADGs, including the MDGs," the EU document says.

The EU points out that gender equality is a fundamental human right, a fundamental value and an issue of social justice; it is essential for economic growth, poverty reduction, environmental sustainability and aid effectiveness. In view of this, it reiterates the need for gender mainstreaming into the formulation and implementation of development policies, including financing for development policies, by all stakeholders of the Monterrey Consensus. ☑

EURODAD PLEADS FOR REINFORCING UN TAX COMMITTEE

Developing countries face the problem of tax evasion alone, say the European Network on Debt and Development (EURODAD)* in a preparatory note for the Doha conference, and calls for reinforcing the UN Tax Committee. The note points out that developing countries face many problems. These include weak tax administration and control mechanisms, the weakness of international tax cooperation, massive tax evasion, the collapse of customs revenues and tax competition between states, exacerbated by the effective blackmail exercised by some international investors, and zero rate taxes charged by tax havens. The shortfall is huge: alone, tax evasion cost over 400 billion dollar per year in the developing world. That money would be sufficient to finance the Millennium Development Goals (MDGs). Some excerpts:

No state alone can address these challenges. Their magnitude requires a coordinated response at the international level. The European Union and OECD have developed tools to combat tax evasion and harmful tax practices. These have not put an end to the problems, but they do represent a significant expertise and experience in this field. Yet, these organizations work primarily for their members, mostly rich countries.

Despite laudable efforts to strengthen tax administrations, particularly in Africa, developing countries remain the poor cousins in the fight against tax evasion and harmful tax competition.

The UN Tax Committee: History

Forty years ago, the Economic and Social Council (ECOSOC) of the United Nations established an ad hoc group of experts, composed of 25 members, to develop international cooperation tax. Rather than adopt the proposal to establish an international tax organization, as recommended by the Zedillo report, the international conference in Monterrey (2002) on financing for development merely stated the need to "strengthen international tax cooperation." On the recommendation of Kofi Annan, the UN General Assembly decided in 2003 to convert this group to an ad hoc Committee of Experts on tax issues, which meets annually in Geneva.

Composition

The committee comprises 25 experts, whose members are appointed by the Secretary General of the United Nations. It reports on its work to ECOSOC. Some believe that tax havens are overrepresented (see table). The main weakness of the committee is that its members have no political mandate of their country of origin.

Mandate

Its mandate is quite broad: to monitor and adapt the model United Nations Treaty on Double Taxation and guidelines for negotiation of tax treaties; provide a forum for international cooperation between national tax authorities; address emerging issues and their tax implications and make recommendations; make recommendations on capacity building and technical assistance to tax authorities; pay special attention to developing countries. In reality, the committee's work is highly technocratic, focusing on the issue of tax cooperation treaties.

It does not have the means to fulfil its full mandate: the committee's work is supported by only two persons from the Financing for Development office, attached to the Secretary General of the United Nations, one part-time.

Doha must send a strong signal

The Doha Conference on Financing for Development must mark, through a broad set of measures, the determined commitment of the international community to combat tax evasion, tax havens, and their impact on developing countries. One of the key measures must be the upgrading of the Expert Committee into an intergovernmental body, with the following characteristics:

- The committee members must be given **a political mandate by UN member states**. The mandate must be of limited duration to ensure a rotation of the countries represented. Relevant international organizations, the private sector and civil society must participate.
- Without being radically altered, the **mandate** of the committee should give priority to:

- producing reports, particularly on emerging issues and with special attention to developing countries;
- further work on the UN Model Tax Convention;
- the development, promotion and monitoring of a code of conduct against tax evasion and illegal capital flight. Monitoring should take the form of a review by both peers and experts, closely coordinating with the OECD, and focusing in particular on the application of international standards concerning information exchange and transparency;
- the production of recommendations concerning demand-driven technical assistance and capacity building for tax administrations in the South.

The committee must have **adequate financial and human resources** to enable it to fulfill its mandate. The "Financing for development" team of the United Nations should be expanded to take this into account. The European Union must commit itself to providing the necessary means. The committee should also build on existing expertise, particularly that developed by the OECD.

*Eurodad is a network of 54 non-governmental organisations (NGOs) from 17 European countries working on issues related to debt, development finance and poverty reduction. The Eurodad network offers a great platform for exploring issues, collecting intelligence and ideas, and undertaking collective advocacy. Its aim are to push for development policies that support pro-poor and democratically-defined sustainable development strategies, support the empowerment of Southern people to chart their own path towards development and ending poverty, and seek a lasting and sustainable solution tohe debt crisis, appropriate development financing, and a stable international financial system conducive to development. ☑

CAPITAL FLIGHT - A BANE TO DEVELOPMENT

At the 2002 UN Financing for Development summit governments agreed to work towards: "an enabling domestic environment" for "mobilising domestic resources, increasing productivity" and "reducing capital flight". At the 2005 World Summit they agreed the UN should "support efforts to reduce capital flight and measures to curb the illicit transfer of funds". Too little is being done to implement these and other commitments.

Illicit capital outflows are a major challenge for states in all regions of the world. Enormous flows of money pass from the South to the North, much of it secretly through tax havens. Developing countries loose roughly eight times in capital flight what they receive in aid each year. Experts estimate that global money laundering accounts for around 1-1.6 trillion dollar a year and half (500 billion to 800 billion dollar) comes from developing countries.

While the general opinion channelled through international institutions is that capital flight is mostly linked to corrupted elites and crime, those two aspects only represent less than half of the total estimated illicit cross border flows. Corruption related illicit flows account for only 5 percent and criminal related account for around 30 percent while commercial illicit flows, driven by tax avoidance schemes account for more than 60 percent of the problem.

Transnational companies use tax havens to avoid paying taxes. This happens first by creating subsidiary companies in tax havens and then by transfer mispricing practices within them. Transfer mispricing is a common practice by which TNCs sell goods or services to subsidiary companies registered in other jurisdictions at artificially high or low prices in order to minimise taxes paid. As a result, transnational companies escape to their duty of paying taxes, not only preventing developing countries from national resources but also provoking an unfair competition with smaller domestic companies which are unable to compete with big transnational corporations.

This represents a huge leak of money since it is estimated that 60 percent of global exchanges happen within subsidiary companies of the same transnational corporation. As a result, Southern states become more dependent on donors-creditors and domestic markets are seriously damaged.

At the European level some important steps have been taken to avoid this by obliging Transnational companies to report their accounts in each country where they operate (country by country reporting). This measure only applies to the extractive industry sector and should be extended to all economic activities.

But Transnational corporations are not the only players. Tax avoidance schemes through tax havens are also highly used by big international banks, insurance companies and institutional investors such as hedge funds and other predatory actors such as vulture funds. The only way to track and pursuit this kind of illicit practices is thus transparency and traceability which demand a strong international cooperation. These practices also highlight once more the urgent need for a responsible financing framework that prevents these kinds of predatory actions.

Civil society organisations (CSO) have been campaigning for years against odious and illegitimate debts and for the restitutions of funds that have been embezzled by corrupted elites from the South and lodged in Northern bank accounts with the consent of Northern governments. According to the World Bank, "25 percent of the GDP of African states are lost to corruption every year, amounting to 148 billion dollar, but the problem is seen in all continents. Corrupt money associated with bribes received by public officials from developing and transition countries is conservatively estimated at 20 billion dollar to 40 billion dollar per year -- a figure equivalent to 20 to 40 percent of flows of official development assistance (ODA)".

But very little attention has been given to this issue by the international community. In September 2007, the World Bank launched the Stolen Asset Recovery (StAR) Initiative jointly with the United Nations Office on Drugs and Crime (UNDOC). Through research and knowledge management, the Bank intends to become a centre of expertise on the stolen assets issue, including establishing good practices from countries with experience.

The key elements of the Bank's work in this area are outlined in a report entitled Stolen Asset Recovery (StAR) Initiative: Challenges, Opportunities, and Action Plan. This is a major step and as such has been welcomed by CSO that see an important opportunity to strengthen their campaigns against odious debts and creditor co-responsibility. Nevertheless, the StAR initiative is mostly focusing on the corrupted side of the problem while not paying enough attention to the supply side, being the northern banks and tax havens through which these stolen assets have been chandelled. Eurodad plans to follow the developments out of this initiative.

Over the past thirty years the number of offshore centres and secrecy jurisdictions commonly known as tax havens has increased rapidly to more than 70. This rise has been facilitated by technological development that has helped a high and extremely fast mobility of capital flows. Today more than half of global trade occurs via tax havens even if these account just for 3 percent of global GDP. Nevertheless, official sources tend to give a more and more restricted definition. Today the OECD counts only three non-cooperative tax havens: Andorra, Monaco and Liechtenstein. The Financial Action Task Force, created by the G7 to fight money laundering has also set up a list of non-cooperative countries and territories but since its last update in October 2006 the list is just empty. There is a need for a clear definition of tax havens that includes their major features, namely a strong bank secrecy and/or low-zero taxation. Tax Justice Network has identified at least 80 tax havens and many of them are based in Europe. ☑

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CALL FOR REVAMPING THE GLOBAL FINANCIAL ARCHITECTURE - I

The global economic system is at a turning point, and the need to rethink the Financing for Development (FfD) concepts proposed by the World Bank and International Monetary Fund (IMF) is becoming increasingly apparent. It is unlikely that leaders from the North and South will rise to this challenge when they meet for the UN conference on development finance in Doha, says Yash Tandon, executive director of the South Centre, an intergovernmental policy think-tank of the developing countries based in Geneva. This view is supported by the ten-member board of the South Centre that is calling for revamping the global financial architecture, based on six lines of action.

The board headed by Benjamin William Mkapa, former President of Tanzania -- and comprising representatives of China, Colombia, India, Iran, Jamaica, Kuwait, Nigeria, the Philippines and South Africa -- says in a joint statement Oct. 29 that the financial crisis that originated in the United States a year ago has become a global financial crisis unprecedented since the Great Depression. Since mid-September financial markets have collapsed and the world is entering into possibly the worst recession of the post-Second World War period.

The credit freeze has severely hit developing countries through increasing risk premia and a severe cut in financing, even of short-term commercial lending. Capital outflows from developing countries have generated a collapse of stock markets and exchange rates and a loss of reserves. Commodity prices have plunged and export orders are being cut worldwide. Even developing countries that were seen as relatively invulnerable to a recession in the industrial world are now feeling the strain.

The financial crisis has shown how dysfunctional the current international financial architecture is to manage the global economy of today, with its myriad of interconnections through which financial turmoil spreads across the world and with its revealed and significant regulatory deficit. In the 1980s, the debt crisis in Latin America, Africa and other parts of the developing world, and in the late 1990s the succession of the Asian, Russian and Latin American crises, had already revealed that something was deeply wrong with that architecture. The industrial world did not understand the need for serious rethinking of the governance of global finance.

"The fact that this time developed countries are at the centre of the storm may now lead them into action. The call by some of them to engage in a reform of the current governance and convene a Bretton Woods II Conference is, therefore, most welcome," the South Centre's board says. The six lines of action it favours are:

1. The process and institutional design that it develops must be inclusive. The South Centre welcomes the initiative of industrial countries but underscore that any discussion process must be inclusive, giving adequate voice to both industrial and developing countries, and to both large and small countries. The governance system that it designs must be based on representative institutions, not on any one ad-hoc grouping of countries, be it the G7, a G13 or a G20.

The board calls in particular for a deeper involvement of the United Nations in any reform process, as it is the most representative global institution. In its view, the follow-up to the Conference on Financing for Development is the best occasion to launch a participatory process leading to a reform of the global financial architecture, with the backing and close collaboration of the United Nations and the Bretton Woods institutions. This process should include a discussion of the voice and representation of developing countries in international economic decision making and norm setting, as mandated by the Monterrey Consensus. So far the only reforms in this area were undertaken by the International Monetary Fund (IMF) and were extremely modest.

2. The regulatory deficit of global finance must be corrected. The magnitude of the current crisis is clearly associated with inadequate regulation and supervision of financial activities. Since the Asian crisis, it became an established criterion that financial liberalisation must be accompanied by stronger prudential regulation and supervision. This principle has been applied in many parts of the developing world but was entirely disregarded in the United States, where further liberalization was accompanied by deregulation and weak supervision of financial intermediation.

The discussion on regulation must start by agreeing on basic regulatory principles, the South Centre board says. The first principle is that regulations must be comprehensive, to avoid the massive loopholes through non-banking intermediation that led to the current turmoil. This will also include regulating the types of transactions that led to the current crises, particularly securitization and derivatives, and force all the markets to be open and transparent and thus limit over-the-counter operations. They should also have a strong counter-cyclical focus, thus avoiding excessive indebtedness (leverage) and force the accumulation of increasing capital and provisions (reserves) during booms.

This should also imply that, when pricing assets according to their market value (mark-to-market pricing) to maintain transparency, the system must have mechanisms to avoid asset price bubbles from feeding into the credit expansion, and asset price busts from feeding into the credit squeeze (for instance, variable loan-to-value ratios through the business cycle). Reliance on the internal models of financial institutions, the major focus of Basel II, should be discarded. It has already shown how perilous it can be, and how the use of similar risk models by financial institutions can lead to greater instability.

"To these new principles we must add well established ones: restricting monopoly power, encouraging diversification and avoiding unsafe financial products. Suffice is it to say that even these well established principles were not followed in recent years." ***(Continued on page 6)***

CALL FOR REVAMPING THE GLOBAL FINANCIAL ARCHITECTURE - II

(Continued from page 5)

Any system that is designed in this area should be based on a well functioning network of national and regional authorities (which is still missing in the EU) and include truly international supervision of financial institutions with a global reach. The IMF should not be at the center of the regulatory system. The BIS and the Basle Committee are better placed, but this would require a fundamental reform to broaden their membership and avoid two major problems that the Basle Committee has faced in recent years: the lack of representation of developing countries, and the excessive influence over regulation by large multinational banks. Alternatively, building on these institutions, a new Global Financial Regulatory Authority could be created.

3. The IMF should be revamped. Four essential reforms of the IMF should be part of the reform agenda. The first is the creation of a meaningful and truly global reserve currency, which could be based on the IMF Special Drawing Rights (SDRs). This would overcome both the inequities but also the instability that is inherent in a global reserve system based on a national currency. Experience has indicated that this system is plagued by cycles of confidence in the US dollar and by periodic shocks due to policies of the reserve currency country that are adopted without any consideration of their international impact. A system based on competing currencies would also be inadequate, as it does not eliminate the inequities of the system (the unfair distribution of seigniorage powers and the need to transfer resources from the developing to industrial countries through the accumulation of foreign exchange reserves) and may be even more unstable, due to the volatility of the exchange rate among competing reserve currencies.

The second issue is the need to place the IMF at the center of global macroeconomic policy coordination, not the G7 or in fact any Group. This is the only way to give developing countries a voice on the issue. The multilateral surveillance exercise on global imbalances launched by the Fund in 2006 was an interesting step in that direction, but it has lacked binding commitment by the parties and an accountability mechanism.

The third issue is the need for the IMF to lend during balance of payments crises rapidly and without overburdening conditionalities, particularly when the sources of the crises are a rapid reversal of capital flows and a sharp deterioration in the terms of trade. This means putting in place a preventive credit line for capital account crises (such as the defunct contingency credit line) and making active use of the compensatory financing facility (which has not been used in recent years due to overburdening conditionalities) and of the Poverty Reduction and Growth Facility to manage the adverse terms of trade shocks faced by low-income countries. This implies that the IMF would act more like a central bank, providing liquidity in an agile way, the way central banks have actually been providing funds in industrial countries on a massive scale in recent months. In the case of the IMF, the financing for such liquidity could be counter-cyclical issues of SDRs.

4. A coordinated global macroeconomic policy package must be urgently adopted. The global recession now under way calls for a strong policy response. This means a clear expansionary monetary and credit policies in all industrial countries (which is still missing in Europe) as well as expansionary fiscal policies. Developing countries should also be part of the solution, and should adopt equally expansionary policies. Those countries that have accumulated large amounts of foreign exchange reserves do have more room to maneuver to adopt these policies than they had during previous crises. For those who do not, this implies that it is essential to avoid the IMF conditionalities of the past, which forced developing countries to adopt contractionary macroeconomic policies.

This also means that a large increase in ODA to low income countries can play an important role to both combat poverty and contribute to the generation of aggregate demand at the global level. Additional ODA is particularly important to avoid contractionary policies in the poor countries in the face of a deterioration of their terms of trade due to the collapse of commodity prices.

5. An international debt court must be created. The lack of a regular institutional framework to manage debt overhangs at the international level –i.e., a court similar to those created to manage bankruptcies in national economies, the decisions of which are legally binding—is one of the major deficiencies of the current international financial architecture. The system has relied in the past on ad-hoc mechanisms, such as the Baker and Brady Plans of the 1980s and the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief (MDRI) Initiatives since the mid-1990s, or on traumatic individual debt renegotiations.

6. The system must rely more broadly on regional institutions, and developing countries should actively cooperate to create them. In all of the areas of reform, the IMF should make more active use of regional institutions, such as the Chiang Mai Initiative or the Latin American Reserve Fund, and support their creation in other parts of the developing world. Indeed, the IMF of the future should be seen as the apex of a network of regional reserve funds –that is, a system closer in design to the European Central Bank or the Federal Reserve System than to the unique global institution it currently is. This is also the system in place in the case of multilateral development banks. A similar institutional design could be adopted for prudential policies or for the international debt court. A denser network of institutions seems better adapted to a heterogeneous international community, and it is likely to provide better services and give stronger voice to smaller countries. "The developing countries are in an excellent position to contribute to this task, given their large foreign exchange reserves. Using those reserves more actively for swap arrangements among central banks, pooling them in reserve funds, or using them to support the development of regional bond markets are all mechanisms to multiply the room to manoeuvre that they provide," says the South Centre board. ☑