Overseas Development Institute

The G-20 framework for strong, sustainable and balanced growth: what role for low-income, small and vulnerable countries?

Edited by Dirk Willem te Velde

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Acknowledgements and contributors

This collection of essays aims to inform the G-20 summits in Toronto (June) and Seoul (November) this year, particularly in relation to the development dimension of the G-20 framework for strong, sustainable and balanced growth.

The Overseas Development Institute (ODI) has published a number of influential studies on the G-20 involving collaborative research:

- In March 2009, it published ODI's G-20 Development Charter, containing a set of policies the G-20 could adopt to promote development.[i]
- In July 2009, it contributed to the G-20 Chair's Review of the Adaptability and Responsiveness of the International Financial Institutions (IFIs) by providing background briefings and co-hosting a consultation for low-income country finance ministers.[ii]
- In September 2009, it published a Briefing Paper 'The Global Financial Crisis and Developing Countries: Taking Stock and Taking Action', arguing for a global compact for crisis-resilient growth.[iii]
- In March 2010, it produced ODI's monitoring study of the global financial crisis, involving 50 researchers in 11 countries.[iv]

This volume, published by ODI, is the product of collaborative research bringing together a large number of ODI researchers, developing country think-tanks, a former minister of finance, permanent secretaries, officials from governments and representatives of international organisations, all writing in their personal capacities:

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I would like to express my gratitude to all authors for their excellent and timely contributions to this volume. I would also like to thank Roo Griffiths for editing and proofreading, and Joanna Fottrell for lay-out.

Dr. Dirk Willem te Velde

London, June 2010

i www.odi.org.uk/resources/details.asp?id=3169&title=development-charter-g-20
ii http://blogs.odi.org.uk/blogs/G-20_consultation/
iii www.odi.org.uk/resources/details.asp?id=2822&title=global-financial-crisis-developing-countries-crisis-resilient-growth
iv http://blogs.odi.org.uk/blogs/main/archive/2010/03/19/52457.aspx

A G-20–LIC 20-point charter for crisis-resilient and transformative growth

- **The G-20 to recommit to the framework of strong, sustainable and balanced growth and follow core policies in order to achieve this, including:**
  - Deficit countries to increase savings (US);
  - Europe to consolidate its budgets and engage in structural reforms to boost growth;
  - Emerging economies to revalue the exchange rate (e.g. China);
  - Emerging economies to boost domestic demand by raising social safety nets ensuring that households save less; and
  - Germany and Japan to provide greater incentives for their companies to invest.

- **LICs to provide plans, and benchmark their efforts, to promote transformative growth by:**
  - Building productive capacities and fostering productivity change;
  - Promoting economic diversification and competitiveness;
  - Promoting private sector development;
  - Providing energy and road infrastructure, and responding to the challenges of development in a carbon-constrained world;
  - Investing in good quality and appropriate human capital to improve labour productivity;
  - Ensuring and improving technological capacity to adopt new and implement old technologies; and
  - Streamlining governance and bureaucracy.

- **The G-20 to consider the effects of its core economic policies on LICs and, where appropriate, make its policies more developmentally friendly in areas such as:**
  - Exiting fiscal and monetary stimuli in a developmentally friendly way;
  - Appropriate financial regulation taking into account the capital needs of poor countries; and
  - Rebalancing the global economy, using reserves for global growth and promoting flexible exchange rates.

- **The G-20 to consider the policy coherence and effects of its external policies on growth in LICs in areas such as:**
  - Aid to address global challenges and transformative growth (AfT, e.g. supporting technical change and infrastructure, or filling the skills capabilities gap);
  - Provision of global financial liquidity, stimulating financial inclusion and investing international reserves for global growth;
  - Providing incentives for outward FDI to LDCs and support for SEZs drawing on local capabilities;
  - Promoting open trading rules; and
  - Removal of fossil fuel subsidies.

Acronyms

3G	Global Governance Group
ADB	Asian Development Bank
ADF	African Development Fund
AfT	Aid for Trade
AGOA	African Growth and Opportunity Act
APTA	Asia-Pacific Trade Agreement
ASEAN	Association of Southeast Asian Nations
AU	African Union
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BIS	Bank for International Settlements
BPO	Business Process Outsourcing
BRIC	Brazil, Russia, India and China
BRICK	Brazil, Russia, India, China and Korea
CGD	Center for Global Development
CGE	Computable General Equilibrium
CIC	China Investment Corporation
CSME	Caribbean Single Market and Economy
DFI	Development Finance Institution
DFQF	Duty-Free Quota-Free
DRC	Democratic Republic of Congo
EAP	East Asia and the Pacific
EBA	Everything But Arms
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECA	Eastern Europe and Central Asia
ECB	European Central Bank
EME	Emerging Market Economy
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
ERPD	Economic Review and Policy Dialogue (ASEAN)
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
G-20	Group of 20
GDP	Gross Domestic Product
GNP	Gross National Product
HSBC	Hong Kong and Shanghai Banking Corporation
IBRD	International Bank for Reconstruction and Development
ICBC	Industrial and Commercial Bank of China
ICT	Information and Communication Technology
IDA	International Development Association
IEA	International Energy Agency
IFC	International Finance Corporation
IFI	International Financial Institution
IFs	International Futures
IIF	Institute of International Finance
IMF	International Monetary Fund
ISFL	International Financial Services London
ITC	International Trade Centre
LAC	Latin America and the Caribbean
LDC	Least-Developed Country
LIC	Low-Income Country
MDG	Millennium Development Goal
MFN	Most-Favoured Nation
MNA	Middle East and North Africa
NEPAD	New Partnership for Africa's Development
n.e.s.	Not Elsewhere Specified
NiGEM	National Institute of Economic and Social Research Global Econometric Model
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum-Exporting Countries
PPP	Purchasing Power Parity
R&D	Research and Development
REC	Regional Economic Community
RTA	Regional Trade Agreement
SAFTA	South Asian Free Trade Area
SAS	South Asia
SDR	Special Drawing Right
SEZ	Special Economic Zone
SME	Small and Medium-Sized Enterprise
SPS	Sanitary and Phytosanitary
SSA	Sub-Saharan Africa
SWF	Sovereign Wealth Fund
TBT	Technical Barriers to Trade
UAE	United Arab Emirates
UK	United Kingdom
UN	United Nations
UNCTAD	UN Conference on Trade and Development
US	United States
WTO	World Trade Organization

Contents

Introduction

By Dirk Willem te Velde

The aim of the G-20 framework for strong, sustainable and balanced growth is to encourage G-20 countries to implement coherent medium-term policy frameworks in order to attain a mutually beneficial growth path and avoid future crises. While the position of low-income countries (LICs), or indeed small and vulnerable economies, in the growth framework is not well defined, apart from the observation that LICs are by definition included in balanced growth and so could contribute to growth, LIC growth clearly depends on G-20 policy actions to promote strong and sustainable growth in varying ways.

This paper contains over 20 briefings considering the role of low-income, small and vulnerable countries in the G-20 growth framework ahead of the Toronto and Seoul G-20 summits this year. It aims to provide food for thought for those interested in the development dimension of the G-20, and aims to prepare countries, including Ethiopia, Malawi and Vietnam, that have been invited to the upcoming summit. It includes views from around the world, obtained through work with 16 experts and officials.

The key argument in the paper is that the G-20 growth framework affects LICs so they need to be involved. Even though the main discussions and policy decisions will take place among the G-20 countries, there may be opportunities to promote a development dimension. The G-20 policy measures could directly or indirectly affect 10% of African GDP. For example, measures under the direct control of the G-20 could affect African incomes for more than 4%. Isabella Massa and Dirk Willem te Velde examine the effects of G-20 banking regulation and consider global imbalances and the development implications of measures by the G-20 to deal with this, as well as the possible effects of exiting from fiscal stimulus packages. Dirk Willem te Velde and Ray Barrell discuss the effects of flexible exchange rates. In addition, the G-20 could provide new impetus to stalled global negotiations on climate change and trade which, when concluded, would add a further 6.1% to GDP. It now seems important to provide low-income, small and vulnerable countries with a permanent seat at the G-20 table, while of course not jeopardising the economic content of the discussions themselves (the G-20 is not an aid agency).

This volume of essays highlights a number of development issues that require urgent attention before the G-20 meeting in Seoul:

- How do LICs take part in G-20 preparations (sherpas, deputies, ministers of finance, leaders)? What support do they need? How can they contribute?
- What are the most development-friendly ways of regulating financial systems while ensuring sufficient capital flows to LICs?
- How can the G-20 rebalancing best benefit LICs (e.g. using international reserves to promote global growth, appropriate use of development finance institutions)?
- What are the most development-friendly ways of withdrawing fiscal stimuli?
- How could the G-20 promote foreign direct investment (FDI) and special economic zones (SEZs) in LICs?

A number of essays in this paper discuss how economic power is shifting towards emerging markets, especially in Asia, arguing that the implications for LICs are still poorly understood. For example:

- Jane Kennan suggests that emerging markets have maintained imports from LICs more than developed countries have: what is the structure of trade patterns and how can this best facilitate diversification and technological change in LICs?
- Isabella Massa finds that emerging markets have increased FDI and bank lending to LICs, whereas developed countries have withdrawn investment and lending; how can emerging market funds best promote LIC growth and technological change?
- Massimiliano Calì discusses the fact that remittances from emerging markets to LICs have also held up better; are they a significant force in LIC growth?
- A general observation is that South–South development cooperation is increasing; what are the implications for the development policies of the other G-20 countries to contribute to LIC growth?

This paper also combines a number of country perspectives by country experts reporting on:

- Medium-term growth prospects after the global financial crisis;
- Growth constraints and the role of national government in overcoming these;
- The role of the G-20 in overcoming these.

Luis Jemio, Isaac Anthony, Mustafizur Rahman, Hem Socheth and Ali Mansoor consider the implications of the G-20 growth framework from their country perspective, and cover how LIC national governments can address the growth constraints. They suggest that governments can help best by:

- Building productive capacities;
- Promoting economic diversification and competitiveness;
- Promoting private sector development;
- Providing energy and road infrastructure;
- Investing in human capital to improve labour productivity;
- Ensuring and improving technological capacity;
- Streamlining governance, bureaucracy and corruption mechanisms.

This volume of essays also contains regional and group perspectives on the G-20. Ali Mansoor provides an example of how Africa could set investment and growth targets and implement these with support from the G-20; Derek Brien and Nikunj Soni discuss the importance of not overlooking the Pacific, and Debapriya Bhattacharya argues for a link between the least-developed country group (represented by Nepal in the United Nations (UN)) and the G-20. Pradumna Rana considers three ways through which Asia can be more effective in the G-20.

Dirk Willem te Velde concludes this volume of essays on the role of LICs in the G-20 growth framework and suggests that it is appropriate to chart a way forward on the development dimension by concluding a new global compact for crisis-resilient and transformative growth, whereby the LICs commit to a transformative growth charter and the G-20 commits to considering and promoting the development effects of their core economic policies. This could be a light-touch framework, focusing on core economic policies for transformative growth.

Part 1: Global growth and the G-20 framework for strong, sustainable and balanced growth

1. Global growth and low-income countries

By Dirk Willem te Velde

The global economy has recovered faster than expected from the deepest global recession since the 1930s. Asia is leading the global recovery for the first time, contributing more than half of global growth in 2009 (International Monetary Fund (IMF) Asian Economic Outlook). Since the turn of the century, growth rates in developing Asia and sub-Saharan Africa have substantially out-performed growth rates in advanced countries. Many emerging markets[5] have escaped relatively unscathed from the global financial crisis and are continuing to grow fast (at close to double-digit rates in China and India, with remarkable turnarounds in Brazil and Korea). The share of India and China alone in global gross domestic product (GDP) on a purchasing power parity (PPP) basis is expected to increase from 15% in 2007 to 21% in 2013 (on the basis of current IMF data and forecasts). Wealth and international reserves are shifting towards (developing) Asia, which has begun to increase its foreign investment, mergers, etc.

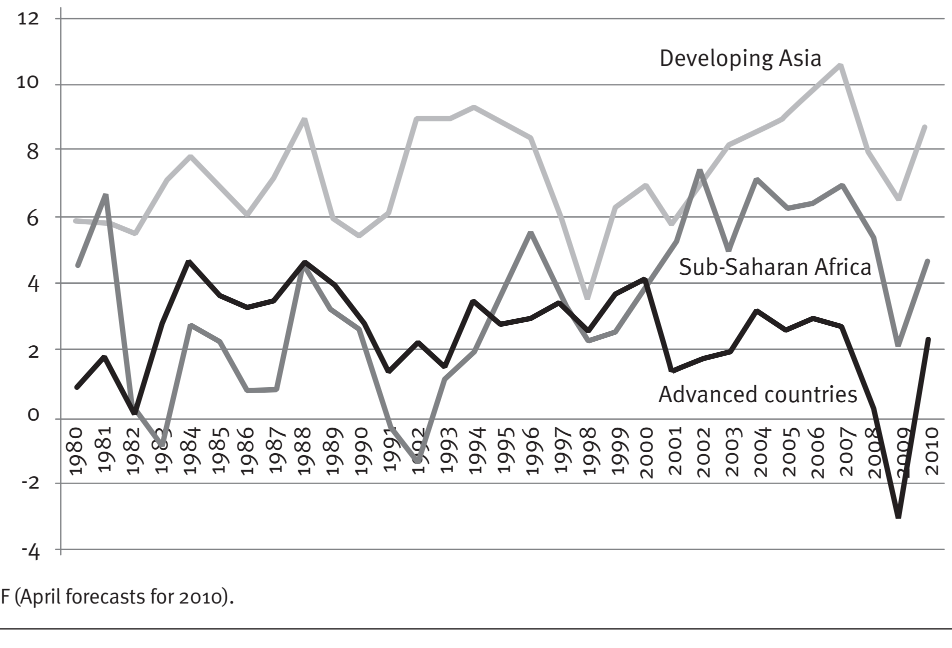
However, despite strong growth rates, there is still a large, albeit narrowing, productivity and welfare gap between developing and developed countries. Developing Asia has income levels worth one-eighth of those in advanced countries; sub-Saharan Africa's GDP per capita is only one-twentieth of developed country GDP per capita. Although growth has been sufficiently stronger than population growth in these regions, GDP per capita levels are converging only slowly with those of advanced countries. Productivity catch-up often occurs only slowly.

'despite strong growth rates, there is still a large, albeit narrowing, productivity and welfare gap between developing and developed countries'

Moreover, the global economy faces a number of immediate challenges. On the one hand, the eurozone crisis has led to an increased need for fiscal consolidation in a number of peripheral countries. This will put pressure on the contribution of the public sector to growth in Europe, with the consequences that Asia will emerge even faster but global growth will remain subdued. On the other hand, there is a risk of overheating in emerging markets, as speculative capital increases the possibility of an asset price bubble.

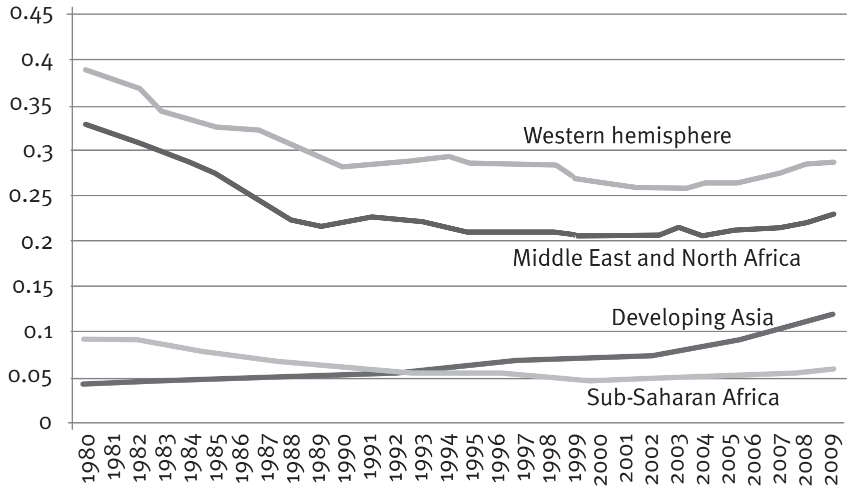
The G-20 (19 countries and the European Union (EU)) is key to handling both issues. It represents

Figure 1: Real GDP growth – coupling or decoupling? 1980-2010 (%)



Source: IMF (April forecasts for 2010).

Figure 2: Per capita Income gaps with developed countries, 1980-2009 (US$ PPP)



Source: IMF (compared with GDP/per capita in developed countries).

Table 1: GDP per capita (constant US$) correlation matrix, 1985-1999 and 2000-2008, pairwise correlations

	LICs	Sub-Saharan Africa	High-income	East Asia and Pacific
1985-1999				
LICs	1.00	0.91	0.38	-0.31
Sub-Saharan Africa	0.91	1.00	0.52	-0.12
High-income	0.38	0.52	1.00	-0.16
East Asia and Pacific	-0.31	-0.12	-0.16	1.00
2000-2008				
LICs	1.00	0.93	0.05	0.69
Sub-Saharan Africa	0.93	1.00	0.30	0.84
High-income	0.05	0.30	1.00	0.36
East Asia and Pacific	0.69	0.84	0.36	1.00

Source: World Development Indicators and own calculations.

84% of world GDP (IMF measured at PPP in 2008). Not included in the G-20 are: developed countries such as Israel, New Zealand, Norway and Switzerland (with around 1.3% of world GDP, combined); emerging countries such as Malaysia, Pakistan, the Philippines, Singapore, Taiwan and Thailand (around 4%); North Africa, including Algeria, Egypt, Morocco and Tunisia (around 1.3%); oil exporters such as Kuwait, Iran, the United Arab Emirates (UAE) and Venezuela (around 2.2%); Asian/Eastern European countries such as the Pacific and Ukraine; South American countries such as Chile and Peru; and the 48 countries of sub-Saharan Africa (2.5% of GDP, excluding South Africa).

Growth prospects in LICs depend on global growth including growth in the G-20, while the G-20 depends to a smaller extent on LIC growth. But growth engines have varied. LIC per capita growth was correlated strongly with high-income growth in 1985-1999, but since then has been correlated more strongly with that in East Asia (Table 1). The rest of this paper discusses the relationships between the G-20 and LICs.

Endnotes

5 We refer to emerging market members of the G-20, which include the BRICs (Brazil, Russia, India and China) and others such as Indonesia, Korea, Saudi Arabia and South Africa.

2. The G-20 framework for strong, sustainable and balanced growth

By Dirk Willem te Velde

The aim of the growth framework is to encourage G-20 countries to implement coherent medium-term policy frameworks to attain a mutually beneficial growth path and avoid future crises (Communiqué of the G-20 Ministers of Finance in April 2010). While G-20 countries will follow policies that are appropriate to their individual circumstances, they may also decide on collective action with clear mutual benefits as well as positive spillovers for other countries.

The G-20 growth framework, as discussed in St Andrews in 2009, contains five stages. First, G-20 countries fill out country templates on medium-term growth prospects and assumptions for the IMF. Second, the IMF works out a central case on global growth based on these assumptions. Third, the G-20 decides on a number of policy scenarios to be run by the IMF. Fourth, the G-20 decides on appropriate policy actions. Finally, the G-20 monitors actions.

The April meeting of the G-20 Ministers of Finance defined strong, sustainable and balanced growth as follows.

Strong growth should:

- Close current output and employment gaps in G-20 countries as soon as possible;
- Converge with the growth rate of potential output over the medium term;
- Be enhanced over the long term by increasing potential output growth, primarily by efficiently utilising available resources through the implementation of more effective structural policies.

Sustainable growth should be:

- In line with underlying potential growth over the medium term, thereby providing a firm basis for long-term growth;
- Based on sustainable public finances and price and financial stability;
- Resilient to economic and financial shocks;
- Determined primarily by competitive market forces;
- Consistent with social and environmental policy goals.

Balanced growth should:

- Be broadly based across all G-20 countries and regions of the world;
- Not generate persistent and destabilising internal or external imbalances;
- Be consistent with broad development goals, in particular convergence with high standards of living across countries in the long run.

Much of the discussion is about policy and growth within the G-20, with each country taking an active part (e.g. all have submitted a growth template to the IMF). However, there is some recognition of the development dimension, especially in the component on balanced growth. Unfortunately, the position of LICs in the framework is not well defined, even though they can contribute to balanced growth and their growth depends on G-20 policy actions to promote strong and sustainable growth.

This volume of essays aims to understand the linkages between the G-20 and LICs, how G-20 core economic policies affect poor countries and what LICs themselves could do to promote strong, sustainable and balanced growth, in order to provide suggestions on the role of LICs in the G-20 growth framework between the 2010 Toronto and Seoul leaders meetings.

The IMF suggests that global growth will be 2.5 percentage points higher over the next five years – compared with a baseline of 4% global growth – if countries cooperate within the G-20 growth framework. Policies needed for this include:[6]

- The US to increase its saving;
- Europe to consolidate its budgets and engage in structural reforms to boost potential growth;
- China to revalue its exchange rate;
- Emerging economies to boost domestic demand by raising social safety nets ensuring that households save less; and
- Germany and Japan to provide greater incentives for their companies to invest at home.

All of these issues are not neutral for non-G-20 countries and this volume brings that to the attention. So far, LICs have played a minor role, but three (Ethiopia as Chair of the New Partnership for Africa's Development (NEPAD), Malawi as President of the African Union (AU) and Vietnam as President of the Association of Southeast Asian Nations (ASEAN)) have been invited to the Toronto G-20 meeting. Singapore has tabled a proposal (11 March 2010) to strengthen the link between G-20 and non-G-20 countries with the UN taking a central and formal role. But this volume also suggests some lighter partnership alternatives in the specific context of the G-20 growth framework, and which could be taken forward by the G-20 development working group.

Endnotes

6 www.ft.com/cms/s/0/ddb42986-71ca-11df-8eec-00144feabdc0.html

Part 2: The G-20 growth framework and low-income countries – the growing importance of G-20 emerging market economies

3. The emerging markets in the G-20 and trade with low-income countries

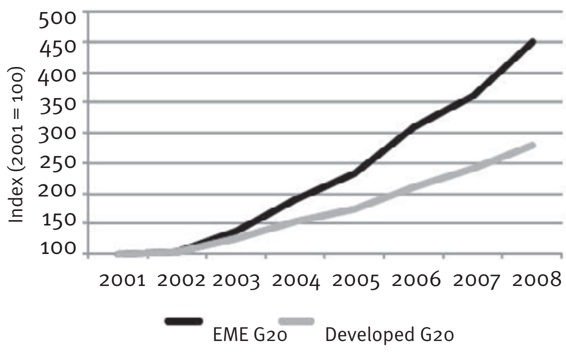
By Jane Kennan

The emerging market economy members of the G-20 (G-20 EMEs) are increasingly important destinations for exports from LICs, and this has helped LICs weather the global financial crisis better than would otherwise have been the case. LICs export relatively more raw materials and relatively fewer manufactures to the G-20 EMEs than to the world as a whole, and import especially manufactures from G-20 EMEs. The rise of the EMEs may therefore pose challenges for medium-term growth prospects.

Trends

The value of G-20 EMEs'[7] imports from LICs[8] has increased rapidly during the past decade (Figure 3). Between 2001 and 2008, the aggregate value of EME imports from LICs grew by an annual average of 24.0%[9] (with individual country annual increases ranging from 12.8% for Indonesia to 39.1% for Turkey). This compares with an aggregate increase for developed G-20 markets of 15.8% (with a range of 10.6% for France to 24.2% for Canada). In half of the EMEs, imports from LICs grew faster in value terms than those from the rest of the world (Table 2).

Figure 3: Value of G-20 imports from low-income countries, 2001-2008 (index, 2001=100)



Source: Calculated from data obtained from the International Trade Centre (ITC) Trade Map.

The value of imports fell in 2009. This was the case for all G-20 EME countries for which data are available[10] except Korea (which recorded a 3.6% rise in imports from LICs between 2008 and 2009), and for all developed G-20 markets other than Canada and Germany (which recorded increases of 7.5% and 1.2%, respectively). In all EME G-20 countries, the decline in imports from LICs was significantly lower than that in imports from the rest of the world. The fall in the value of imports from LICs was lower in the EMEs than in the developed G-20 markets: 9.1% as against 13.9% (Table 3). The growing importance of EMEs as a destination for their exports has helped LICs weather the global financial crisis better than some other groups of countries.

Structure of trade

The main LIC exports to G-20 EMEs are shown in Table 4 (which lists all product groups accounting for 1% or

Table 2: G-20 emerging market member imports from low-income countries, 2001, 2008

G-20 EME	Value of imports from LICs (US$m)		Average annual growth 2001-2008 (%)	
	2001	2008	From LICs	From rest of world
Argentina	18	132	32.5	16.0
Brazil	184	553	17.1	17.6
China	2153	14,010	30.7	24.5
India	1394	5662	22.2	29.6
Indonesia	434	1010	12.8	22.8
Mexico	275	889	18.2	9.0
Russia	1066	3673	19.3	30.5
Saudi Arabia*	275	897	21.8	19.3
South Korea	1200	3188	15.0	17.5
Turkey	202	2035	39.1	25.3

Note: * Data are for 2001 and 2007.
Source: Calculated from data obtained from ITC Trade Map.

Table 3: Change in value of G-20 imports from low-income countries, 2008-2009

Country	Value of imports from LICs (US$m)		Change 2008-2009 (%)
	2008	2009	
Brazil	553	448	-19.0
China	14,010	12,828	-8.4
Indonesia	1010	890	-11.9
Korea	3188	3303	3.6
Mexico	889	856	-3.7
Russia	3673	2827	-23.1
Turkey	2035	1891	-7.1
Total G-20 EMEs	25,358	23,043	-9.1
Australia	4541	2657	-41.5
Canada	1994	2144	7.5
France	5321	5094	-4.3
Germany	8511	8614	1.2
Italy	3686	2728	-26.0
Japan	11,633	8852	-23.9
UK	5475	5035	-8.0
US	27,128	23,690	-12.7
Total developed G-20	68,289	58,814	-13.9

Source: Calculated from data obtained from ITC Trade Map.

Table 4: Main low-income country exports to G-20 emerging market members, 2008

Export product group	% share in total value of	
	LIC exports to G-20 EMEs	LIC exports to world
Mineral fuels, oils, distillation products, etc	20.5	20.1
Pearls, precious stones, metals, coins, etc	9.5	4.0
Ores, slag and ash	8.0	3.7
Rubber and articles thereof	4.0	1.6
Copper and articles thereof	3.9	3.2
Cotton	3.9	2.0
Edible fruit, nuts, peel of citrus fruit, melons	3.9	1.7
Wood and articles of wood, wood charcoal	3.4	1.7
Edible vegetables and certain roots and tubers	3.1	1.3
Fish, crustaceans, molluscs, aquatic invertebrates n.e.s.	2.8	3.9
Iron and steel	2.8	1.9
Articles of apparel, accessories, not knit or crochet	2.5	8.4
Inorganic chemicals, precious metal compound, isotopes	2.4	0.9
Electrical, electronic equipment	2.3	2.9
Vehicles other than railway, tramway	2.1	1.4
Articles of apparel, accessories, knit or crochet	1.8	9.5
Coffee, tea, mate and spices	1.7	3.4
Nuclear reactors, boilers, machinery, etc	1.7	2.3
Footwear, gaiters and the like, parts thereof	1.6	3.4
Raw hides and skins (other than furskins) and leather	1.1	0.5
Salt, sulphur, earth, stone, plaster, lime and cement	1.0	0.8
Total	84.0	78.6

Note: n.e.s = not elsewhere specified.
Source: Calculated from data obtained from the ITC Trade Map (includes mirror data).

‘LICs export relatively more raw materials and relatively fewer manufactures to the G-20 EMEs than to the world as a whole, and import especially manufactures from G-20 EMEs. The rise of the EMEs may therefore pose challenges for medium-term growth prospects’

more of the total value of exports to G-20 EMEs in 2008). As is evident from the table, LICs export relatively more raw materials and relatively fewer manufactures to the G-20 EMEs than to the world as a whole. The rise of the emerging markets may therefore pose challenges for medium-term growth prospects unless action to promote capabilities and technological change is taken.

The main G-20 EME exports to LICs are shown in Table 5 (which again shows all product groups accounting for 1% or more of the value of total exports). Of the 25 product groups shown, 19, accounting for some 53% of the total value of exports to LICs, are manufactures; by contrast, only eight of the 21 main LIC export groups shown in Table 4 are manufactures, representing only some 14% of the total value of their exports to the EMEs.

Low-income country dependence on G-20 emerging market economies

The status of trade data reporting by the LICs is variable. Of the 43 countries, 11 have not reported to the United Nations (UN) Comtrade database in any of the years 2001-2008, and for many others reporting has been sporadic. Of the 19 LICs that have reported their exports for 2008, those most dependent on the G-20 EME markets were Ghana, Mali, Yemen and Zimbabwe – for all of which the EMEs accounted for 45% or more of total export value (Table 6). The countries least

Table 5: Main G-20 emerging market members’ exports to LICs, 2008

Export product group	% share in total value of
Mineral fuels, oils, distillation products, etc	11.8
Nuclear reactors, boilers, machinery, etc	8.7
Electrical, electronic equipment	7.2
Iron and steel	6.2
Vehicles other than railway, tramway	5.6
Articles of apparel, accessories, knit or crochet	4.4
Cotton	4.3
Ships, boats and other floating structures	3.4
Articles of iron or steel	3.2
Plastics and articles thereof	3.2
Articles of apparel, accessories, not knit or crochet	2.3
Cereals	2.2
Footwear, gaiters and the like, parts thereof	2.2
Manmade staple fibres	1.8
Knitted or crocheted fabric	1.8
Manmade filaments	1.6
Animal, vegetable fats and oils, cleavage products, etc	1.6
Pharmaceutical products	1.4
Fertilisers	1.4
Sugars and sugar confectionery	1.3
Paper and paperboard, articles of pulp, paper and board	1.3
Special woven or tufted fabric, lace, tapestry, etc	1.2
Rubber and articles thereof	1.1
Residues, wastes of food industry, animal fodder	1.1
Organic chemicals	1.0
Total	81.3

Note: n.e.s = not elsewhere specified.

Source: Calculated from data obtained from the ITC Trade Map (includes mirror data).

Table 6: Share of total export value accounted for by G-20 markets (%)

Country	2001		2007		2008	
	G-20 EMEs	Developed G-20	G-20 EMEs	Developed G-20	G-20 EMEs	Developed G-20
Mali	32.5	15.6	71.8	6.3	75.6	4.0
Ghana	n/a	n/a	41.3	36.3	53.2	30.0
Yemen	n/a	n/a	46.4	12.1	50.2	4.5
Zimbabwe	24.0	59.5	41.4	19.7	45.0	24.1
Malawi	12.5	51.8	27.0	43.9	22.5	52.3
Gambia	0.2	88.1	2.9	62.8	20.5	46.5
Zambia	25.5	56.6	23.9	6.9	19.8	7.8
Ethiopia	16.0	43.7	16.9	49.9	18.2	47.0
Vietnam	16.3	52.6	15.6	61.0	15.5	57.9
Mozambique	16.4	14.8	21.2	6.4	14.5	63.9
Afghanistan	n/a	n/a	n/a	n/a	13.8	0.1
Guinea	8.0	83.7	9.7	81.5	12.7	60.3
Senegal	13.7	42.7	7.5	27.1	12.4	18.0
Rwanda	14.3	16.9	3.1	41.0	7.8	24.8
Madagascar	5.0	79.4	4.5	82.0	5.7	84.2
Kenya	3.4	41.4	5.2	34.7	5.6	33.0
Uganda	5.6	34.1	2.9	26.5	3.1	28.3
Niger	0.4	59.3	4.2	62.7	2.8	66.8
Burundi	n/a	n/a	2.8	16.1	1.7	12.6

Source: Calculated from data obtained from ITC Trade Map.

dependent were Burundi, Niger and Uganda – for which less than 5% of exports were to G-20 EMEs. For 12 of the countries, the share destined for G-20 EMEs was greater in 2008 than it had been in 2007.

Rebalancing within the G-20 and imports from low-income countries

Table 7 shows that, if the US imports one unit less and China and Germany together import one unit more, this may have a non-neutral trade effect for LICs – the US imports proportionally more from LICs than does China. Germany and the US also import more manufacturing from LICs than does China.

Table 7: Share and value of G-20 markets' imports from low-income countries

	Value of imports (US$m)	Share of LIC imports in total imports (%)
US	23,690	1.48
'Other' EU	18,521	1.25
China	12,828	1.28
Japan	8852	1.61
Germany	8614	0.92
India	5662	0.79
UK	5035	1.05
France	5094	0.94
Australia	2657	1.67
Italy	2728	0.67
Russia	2827	1.76
South Africa	1803	2.83
Korea	3303	1.02
Turkey	1891	1.42
Canada	2144	0.67
Indonesia	890	0.92
Mexico	856	0.36
Brazil	448	0.35
Argentina	132	0.23
Saudi Arabia	275	0.88

Note: In the latest year for which data are available: 2007 for Saudi Arabia, 2008 for Argentina, India and 'other' EU (i.e. other than France, Germany, Italy and UK), 2009 for all others.

Source: Calculated from data obtained from ITC Trade Map.

Endnotes

7 Argentina, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, Korea and Turkey. South Africa has been excluded from the analysis in this section as some of its import data are considered suspect.

8 43 countries, as designated by the World Bank in April 2010 – see http://data.worldbank.org/about/country-classifications/country-and-lending-groups#Low_income.

9 This figure omits Saudi Arabia's imports (for which data are available only up to 2007).

10 2009 data are not yet available for Argentina, India and Saudi Arabia among the EMEs and the EU (other than France, Germany, Italy and the UK) among the developed G-20.

4. How emerging markets are changing the investor landscape in low-income countries

By Isabella Massa

Emerging markets and the BRICs in particular have come out as the relative winners of the global recession. While developed economies were the hardest hit and are heading to what it seems will be a double-dip recession, emerging markets, which experienced a milder slowdown, are recovering to pre-crisis high growth levels and are expected to lead in the global economic recovery.

The implications for global investment are significant. Figure 4 shows that the G7's investment abroad has decreased dramatically since 2007, whereas the BRICs' outward FDI has continued to increase steadily, notwithstanding the crisis. This implies that emerging economies now represent an important option for LICs to fill up the void in FDI left by the developed world. Indeed, in November 2009, during the African Economic Conference held in Addis Ababa, Ethiopian Prime Minister Meles Zenawi highlighted the importance for African countries of looking towards the East and South:

'Asia and in particular China but also [...] countries in the Arabian Gulf have accumulated trillions of dollars of surplus savings that they are unable to consume or invest in their countries. [...] It is possible to imagine that the Chinese will decide to redirect some of their surplus savings to infrastructural development in Africa. It is possible to do so because to some extent it is already happening [...] It is also possible to imagine that the Gulf states would shift part of their massive surplus savings to Africa and that the Indians will do what the Chinese are already doing [...]'

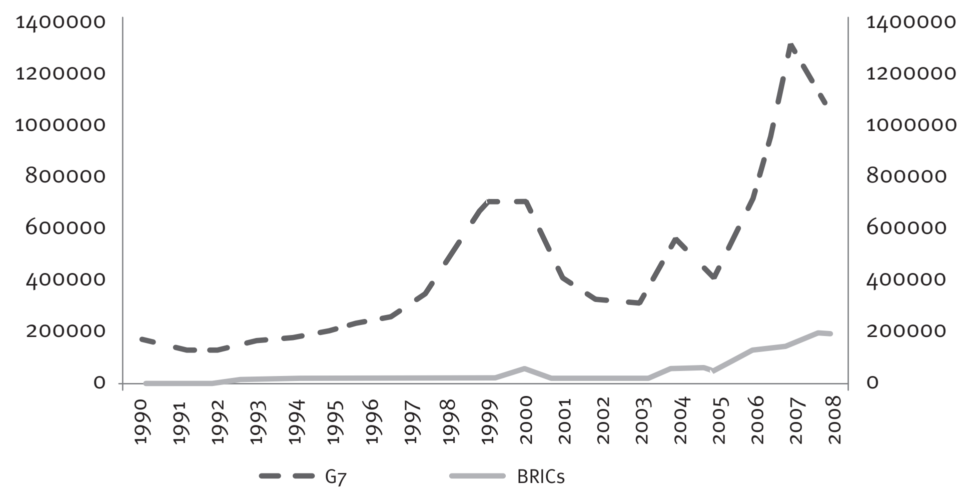
Anecdotal evidence shows that the investor landscape in LICs is changing. In Africa, for example, investment from the West weakened because of the crisis (see Table 8), whereas the BRICs and in particular China, in search of raw materials, are significantly increasing their investment deals within the continent (see Figure 5).

'emerging economies now represent an important option for LICs to fill up the void in FDI left by the developed world'

According to the Chinese Ministry of Commerce, China's African investments in the first nine months of 2009 rose an astonishing 80% compared with the same period in 2008, and Africa now represents 10% of China's total outward FDI. India is investing a great deal in Sudan and Mauritius (see Table 8), whereas Brazil is raising its stakes in the African oil and mining sectors, recently concluding mega FDI deals in Angola, Mozambique and Nigeria (see Table 9). Russia is increasing its interest not only in the resources sector but also in Africa's financial services and telecommunications (see Table 9).

The increase in FDI from emerging markets is good news for African countries and LICs generally. However, there are also challenges, as LICs need to develop adequate strategies to fully capitalise on the new opportunities offered by the increased investment, such as greater Chinese FDI in export processing zones (EPZs) in Africa.

Figure 4: FDI outflows, 1990-2008 (US$ m.)



Sources: UN Conference on Trade and Development (UNCTAD) (2009) World Investment Report and author's calculations.

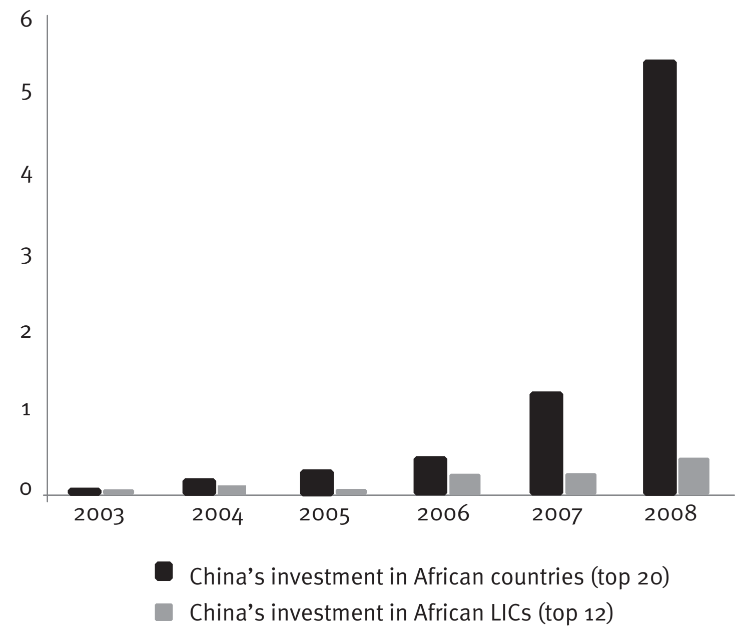
Table 8: FDI flows to Africa, 2005-2009 (US$ bn)

	2005	2006	2007	2008	2009
EU27 (1)	20.2	14.7	24.6	27.3	
Of which:					
UK (2)	10.6	-0.4	9.5	1.7	
Germany (3)	0.6	0.2	2.3	1.3	
France (4)	4.6	3.1	5.4	16.7	
US	2.6	5.2	4.4	3.3	6.2
Japan (5)	0	0.9	1.1	1.5	-0.3
China (6)	0.3	0.4	1.3	5.5	
Brazil (7) (excludes FDI via third countries)			0.08	0.13	
India (8) FY Apr-Mar, Mauritius only			1.5	2	
India Q1-Q3, Mauritius only				1.5	1.5
India, overseas acquisitions			0.1	0.2	
India, Mauritius FY + other acquisitions			1.6	2.2	
Russia (9), only for Libya, Egypt and South Africa			0.03	0.02	0.04
Total (10)	38.2	57.1	62.8	75	55.6

Notes: 1) euros converted to dollars using period average exchange rates; 2) UK pounds converted to dollars using period average exchange rates; 3) euros converted to dollars using period average exchange rates; 4) euros converted to dollars using period average exchange rates. 2008 data influenced by big investment in Egypt; 5) yen converted to dollars using period average exchange rates; 6) data for 2008 influenced by bank takeover in South Africa; 7) $82 million in 2007 and $126 million in 2008 – data exclude Brazilian investment in Africa via third countries, e.g. Petrobas invests via the Netherlands; 8) data refer to Indian investment in Mauritius (which, according to some sources, is around 70% of all Indian FDI to Africa) for the financial year April-March. Some suggest overseas acquisition of Indian companies in Africa increased from $188 million in January-June 2008 to $451 million over January-June 2009 (see Pradhan, 2009) but this did not seem to include Mauritius; 9) 2009 refers to Q1-Q3 only. $31 million in 2007, $24 million in 2008 and $38 million in 2009 Q1-Q3; 10) data for 2009 are partially an estimate, using data for Q1-Q3.

Sources: Eurostat, UK Office of National Statistics, Bundesbank, Bank of France, US Bureau of Economic Analysis, Japanese Ministry of Foreign Affairs, China's Ministry of Commerce as reported by Warrell and Romei (2010), Banco Central Do Brasil, RSI Bulletin various issues, Central Bank of Russia, UNCTAD's Global Investment Monitor and ODI calculations.

Figure 5: Chinese investment in African countries, 2003-2008 (US$ bn)



Notes: Top 20 African countries include Algeria, Benin, Botswana, Chad Congo, Democratic Republic of Congo (DRC), Egypt, Ethiopia, Gabon, Ghana, Kenya, Libya, Madagascar, Mauritius, Nigeria, Rwanda, Sierra Leone, South Africa, Tanzania, Zambia. Top 12 LICs include Benin, Chad, Congo, DRC, Ethiopia, Ghana, Kenya, Madagascar, Rwanda, Sierra Leone, Tanzania, Zambia.
Sources: Yoshida (2010) and author's calculations.

Table 9: BRICs deals in Africa since 2009 (US$ m.)

	Use	US$m	Type
Brazil			
Angola	Oil	800	FDI
Mozambique	Mining	1300	FDI
Nigeria	Oil	2000	FDI
China			
Angola	Oil	1300	FDI
Liberia	Mining	2600	FDI
Tanzania	Information and communication technology (ICT) etc.	180	Loan*
Zambia	Development	1000	Loan*
Zambia	Stadium	10	Grant
Zimbabwe	Development	2.9	Grant
India			
Chad	Textiles	25	Loan
Malawi	Development	50	Loan
Malawi	Earthquake relief etc	5	Grant
Mozambique	Electricity	30	Loan
São Tomé and Príncipe	Agriculture etc	5	Loan
São Tomé and Príncipe	Small and medium-sized enterprises (SMEs)	1	Grant
Zambia	Hydropower	50	Loan
Zambia	Social sector	75	Loan*
Zambia	Health and education	5	Grant
Russia			
Angola	Construction	500	FDI
Angola	Telecoms	328	FDI
Nigeria	Gas	2500	FDI

Note: * Concessionary.
Source: Author's elaborations on various sources.

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5. Cross-border bank lending to developing countries: the new role of emerging markets

By Isabella Massa

The Industrial and Commercial Bank of China (ICBC), Brazil's Itaú Unibanco, Russia's Sberbank, State Bank of India: these are just some of the latest emerging market banks that, despite the crisis, have earned a place among the top 25 banks worldwide, next to the traditional Western giants such as Hong Kong and Shanghai Banking Corporation (HSBC), Citigroup and UniCredit.

The global financial crisis has put severe pressure on global banking systems. However, while banks in the developed world have been severely hit and are still under continuous threat, their peers in emerging markets have proved to be stronger and more able to weather the storm. A number of factors have contributed to keeping emerging market banks afloat amidst the worst effects of the global credit crunch. First, unlike in Western economies, the banking sector in most emerging markets is dominated by state-controlled banks. China's biggest banks are all state controlled. In India, three-quarters of the banking sector belongs to the state. In Russia, more than half of the banking industry is in the state's hands. Even in Brazil, where private banks have increased in number in recent years, over 40% of the banking system's assets are still state controlled (see Figure 6).

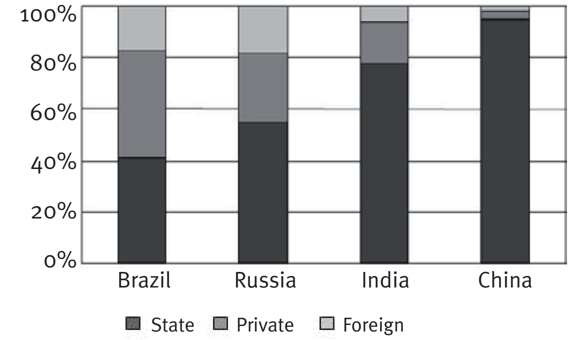
Second, emerging market banks rely on societies with high levels of savings and therefore can accumulate a significant surplus of deposits over loans. In 2008, this surplus amounted to about $1.6 trillion against a deficit of $1.9 trillion in developed world banks (The Economist, 2010). Third, thanks to the lessons learnt from previous crises originating in developing countries, emerging markets have ensured that their banks maintain adequate capital ratios, which in 2009 averaged 10%, and even 12% excluding China (ibid). Finally, emerging market banks are exposed to fewer risks than their Western peers, since they are not engaging actively in investment banking.

'emerging market banks have gained impressive strength and are determined to expand abroad in a time when rich countries' banks are on the retreat'

What does this mean for low-income countries?

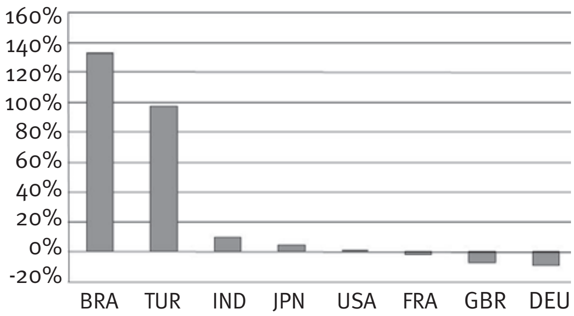
Because of the crisis, cross-border lending to low-income economies by several banks in developed countries fell rapidly, but emerging market banks were able to continue to increase credit outlays, not only within their economies but also abroad. Figure 7 shows that, between December 2008 and December 2009, international lending to sub-Saharan Africa by banks in the UK, Germany and France declined by on average 6%, whereas Brazil, Turkey and India increased cross-border bank lending to sub-Saharan Africa by 133%, 98% and 9%, respectively, over the same period. China has also increased its lending to African developing countries. Anecdotal evidence shows that Chinese banks have offered resource-backed loans to several African economies: in 2007, for example, China

Figure 6: Selected emerging markets' banking sector mix, 2009 (%)



Source: Adapted from The Economist (2010).

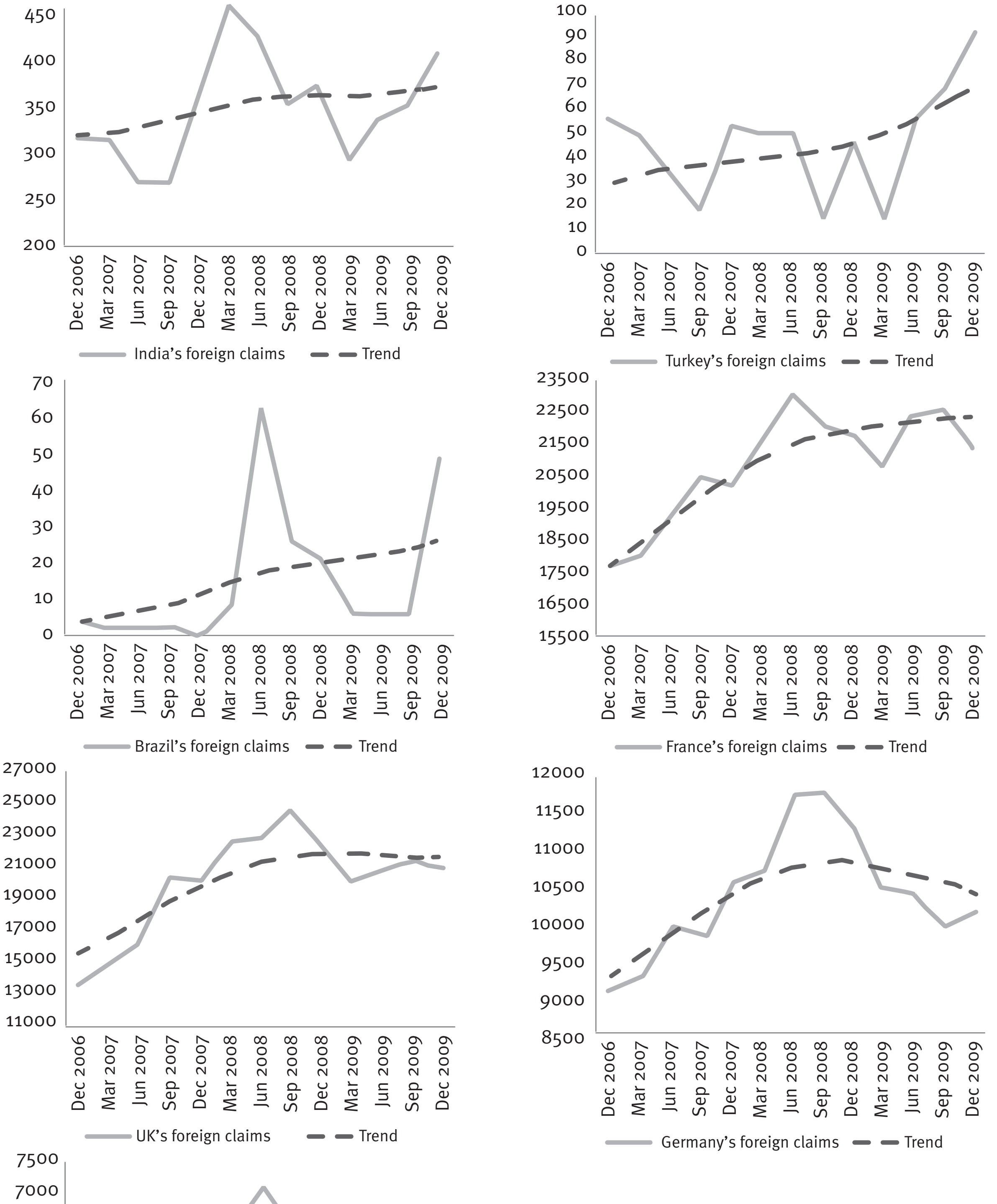
Figure 7: Selected countries' percent change in cross-border bank lending to sub-Saharan Africa (excluding South Africa) by bank nationality, Dec 2008-Dec 2009 (%)

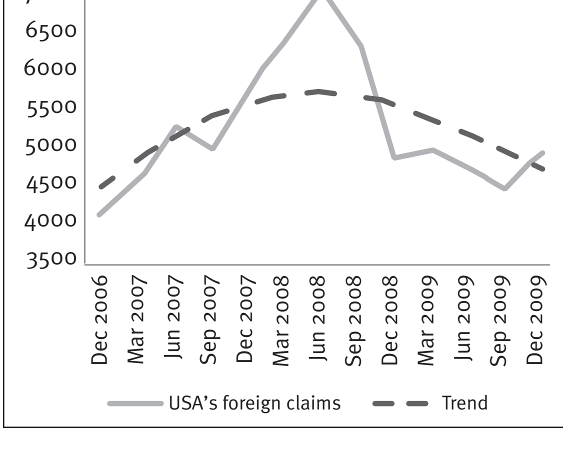


Note: Claims on an ultimate risk basis for India; claims on an immediate borrower basis for all others.

Source: Bank for International Settlements (BIS) International Consolidated Banking Statistics, April 2010, and author's calculations.

Figure 8: Selected countries' cross-border bank lending to sub-Saharan Africa (excluding South Africa) by bank nationality, Dec 2006-Dec 2009 (US$ millions)





Note: Claims on an ultimate risk basis for India; claims on an immediate borrower basis for all others.
Source: BIS International Consolidated Banking Statistics, April 2010, and author's calculations.

Exim Bank approved a cocoa-backed loan of $562 million to Ghana (Brautigam, 2009). Nevertheless, it should be noticed that emerging markets' cross-border bank lending to developing economies is still modest compared with that coming from the developed world.

This picture is confirmed by quarterly cross-border bank lending flows reported in Figure 8. After September 2008, when Lehman Brothers collapsed, international lending to African developing countries by European and American banks dropped or slowed significantly, while cross-border bank lending flows from emerging markets such as Brazil, Turkey and India regained momentum quickly after an initial slowdown, keeping above their historical trends.

So, will emerging market banks replace their Western peers in LICs?

There is still a large difference between the amount of international lending to developing countries by emerging economies and that by rich countries, but it is clear that emerging market banks have gained impressive strength and are determined to expand abroad in a time when rich countries' banks are on the retreat. The shift from developed countries to emerging markets is likely to be a gradual process rather than a sudden change, however. Indeed, emerging market banks need first to overcome the issue of state control, which represents a key constraint in taking full advantage of opportunities abroad, even though it has prevented the banking systems from collapsing during the financial crisis.

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6. Remittances flows to low-income countries and the role of G-20 emerging markets

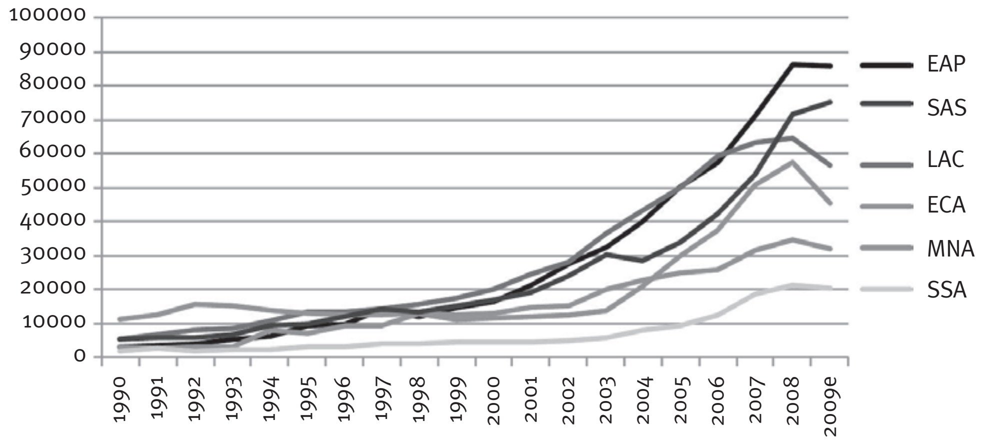
By Massimiliano Calì

Most migrants support their family members at home by sending money and goods to their country of origin. The importance of these flows has increased steadily over time across all developing regions, although with a small decline in most regions as a result of financial crisis (Figure 9).

Remittances to developing countries topped $335 billion in 2008, which represents almost three times the level of international aid. Adding remittances through informal channels (over 50% of the official estimate) makes remittances the largest source of external capital in many developing countries.

Remittance flows to LICs have also increased rapidly, especially in the past decade, and the increase has continued even during the financial crisis, albeit at a lower pace than before (Figure 10). The growth in remittances to LICs has been more rapid than that for the other developing countries since the mid-1990s, with their share in total remittance flows to developing countries increasing from 6-10% in 2009. Remittances contribute to household income and poverty reduction. The poverty-reducing effect of remittances is likely to be particularly relevant in the case of LICs, as their poverty incidence is higher and so is the likelihood of a poor household receiving

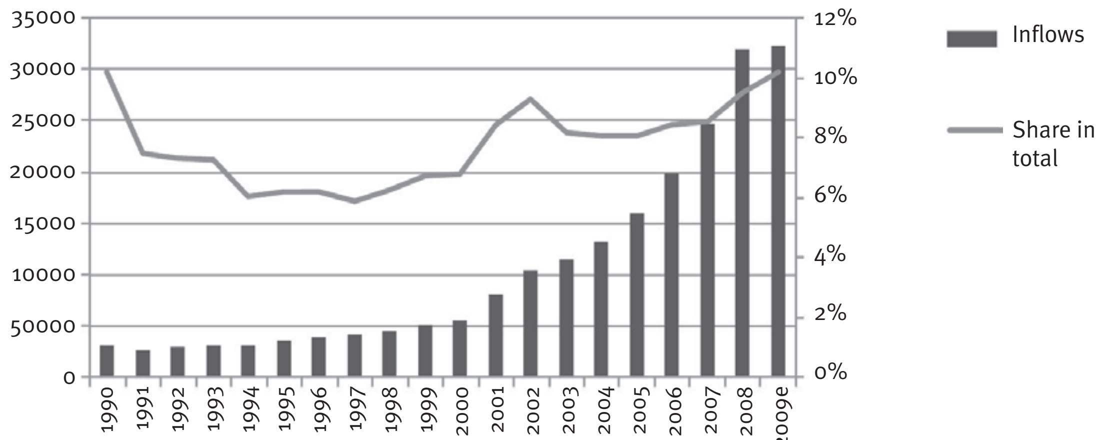
Figure 9: Remittances to developing regions, 1990-2009 (US$ m.)



Note: EAP East Asia and the Pacific; ECA Eastern Europe and Central Asia; LAC Latin America and the Caribbean; MNA Middle East and North Africa; SAS South Asia; SSA Sub-Saharan Africa.

Source: World Bank remittances data inflows, online database (April 2010 revision).

Figure 10: Remittances to low-income countries, 1990-2009 (US$ m. and % share in developing countries)



Source: World Bank remittances data inflows, online database (April 2010 revision).

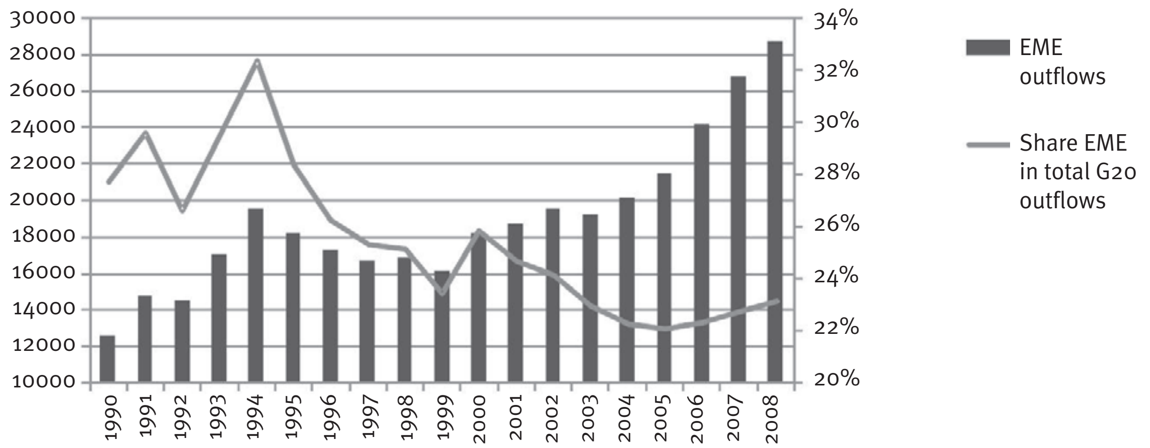
remittances. Estimates from the World Bank (2006) show that, in recent years, total remittances have led to reduced poverty levels in LICs, e.g. by about 11% in Lesotho, 5% in Ghana and 6% in Bangladesh.

The growth of remittances has been fairly stable as a result of their resilience to shocks, which makes these flows more 'virtuous' than the sudden increased inflow of foreign exchange typical of commodity booms, which may generate a sudden exchange rate appreciation. In fact, the recent global financial crisis has once again confirmed the relative stability of these flows vis-à-vis other external flows such as private capital flows and trade. The World Bank estimates that remittances to developing countries declined by 6.1% in 2009 (as a result of weak job markets in destination countries). This resilience is explained by a relatively small elasticity of remittances to GDP changes in the host economy (Calì and Dell'Erba, 2009).

Although systematic data on remittance outflows are not available for 2009, there is some evidence that G-20 EMEs have been particularly important in maintaining the resilience of remittances to LICs. This is because of the economic resilience of EMEs during the crisis, which has allowed the majority of them to maintain healthy growth rates, even in 2009. For example, Bangladesh, the largest remittances recipient among the LICs, has experienced a substantial growth in remittances during the crisis (estimated at 20% in 2009), mainly because of the unabated increase in the stock of migrants to the Gulf, and to Saudi Arabia in particular (Rahman et al., 2010). Although the rate of increase in the Bangladeshi net migrant stock in the Gulf has now slowed down, this has not translated into a reduction in remittances.

This is consistent with the increasing importance of EMEs as a source of remittances for developing countries in the past few years. Albeit not very large, the elasticity of remittance outflows to GDP in the host country is significantly positive, even after controlling for the stock of migrants (Calì and Dell'Erba, 2009). This has allowed remittance outflows from the G-20 EMEs to grow substantially, especially in the past 10 years. Moreover, as EMEs have been growing at a faster pace than the rest of the G-20 economies, their

Figure 11: Remittances from G-20 EMEs, (US$ millions and share in total G-20)



Note: EME G-20 = Argentina, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa and Turkey.
Source: World Bank remittances data inflows, online database (April 2010 revision).

Figure 12: Remittances to Bangladesh, 1990-2004 (US$ millions and % share from EMEs in total)

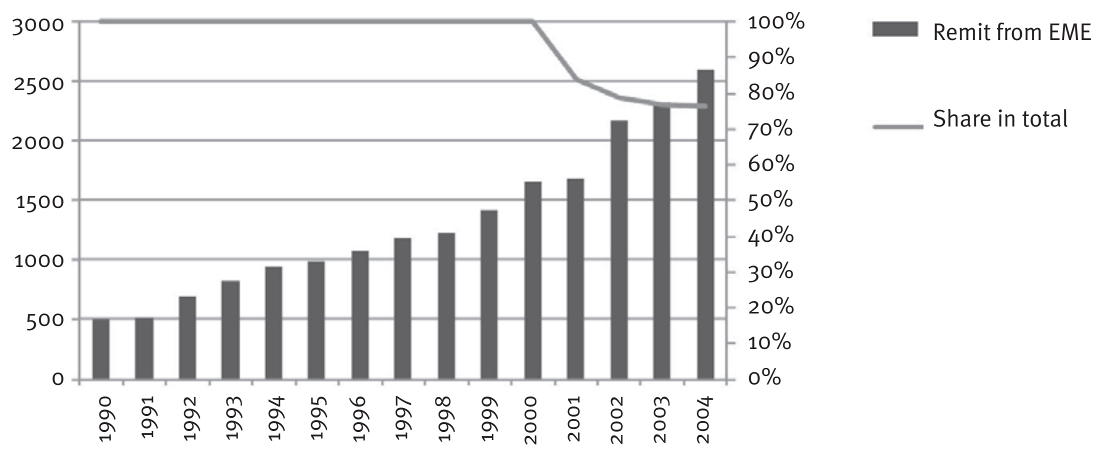
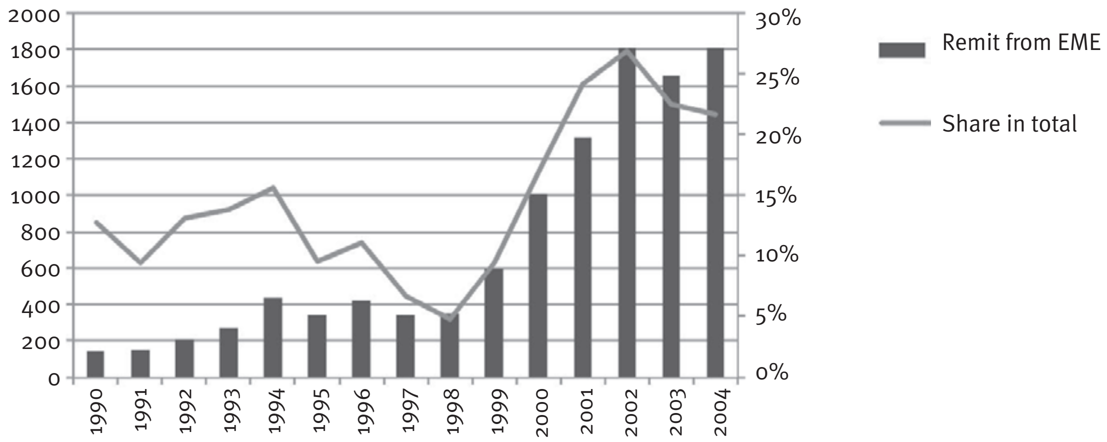


Figure 13: Remittances to Philippines, 1990-2004 (US$ millions and % share from EMEs in total)



Note: Only major remittance-sending countries are considered (thus the total flow from EMEs is underestimated).
Source: IMF.

share of remittance outflows in total G-20 outflows has also increased, although only since 2005.

The importance of EMEs as providers of remittances is also confirmed at the country level in those few countries for which bilateral data are available. The only LIC for which bilateral data is available is Bangladesh, whose remittance inflows have historically been dominated by countries from the Gulf region. Remittances from EMEs represented 100% of total remittances from major source countries recorded by Bangladesh Central Bank over the 1990s (Figure 12). That share eventually declined, probably also because of better recording of remittances from OECD countries (especially the UK and the US), but remained well above 75% (at least until 2004). The Philippines have also been receiving a sizeable share of remittances from EMEs (23% with around $1.8 billion received from EMEs in 2004), again especially from the Gulf. This share was increasing between the end of the 1990s and the beginning of this decade and eventually declined a bit between 2002 and 2004.

Already, substantial flows of migrants are moving towards G-20 EMEs such as Argentina, Brazil, China, India and South Africa from developing countries in the respective regions. These flows are likely to increase as EMEs continue to grow and lead the recovery of the world economy, thus becoming relatively more attractive destination for job seekers from poorer economies. It is thus reasonable to expect the importance of EMEs (especially those in the G-20) as a source of remittances for LICs and other developing countries to continue to increase. The challenges facing these economies in integrating new flows of migrants cannot be overestimated, as their labour markets are often highly segmented and their institutional capacity limited. These problems may be compounded by higher costs of remitting from these countries, as their level of financial development is usually lower than that of advanced economies and transfer costs are negatively related to the level of financial development (Freund and Spatafora, 2008).

Endnotes and references

11 Part of the reason why the increase in the share of EMEs in total G-20 outflows has occurred only since 2005 could be a result of measurement errors on the side of EMEs' reporting institutions, which may have become more efficient in later years.

12 These data have been assembled for 12 developing countries (from Europe and Asia) by the IMF on the basis of central banks' data. Only a few central banks in receiving countries collect remittance inflows data, including information on the source country.

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Part 3: The implications of G-20 economic policies and implications for low-income, small and vulnerable countries

7. G-20 financial regulation, international bank lending and low-income country growth

By Dirk Willem te Velde and Isabella Massa

The G-20, which emerged after the East Asian financial crisis, has a long history of discussing financial regulation. After the recent global financial crisis, this took on additional urgency and intense public scrutiny. Discussions have focused on bankers' pay (discussed at previous G-20 summits), global bank levies and bank capital and liquidity rules to force banks to hold more capital during boom times as part of the Basel III set of banking regulations (in practice, banks already hold more capital now than under Basel II). While these discussions are mainly among G-20 countries, they have clear implications for LICs.

Table 10 provides a summary of the two most important regulatory issues: a global bank levy and bank capital and liquidity rules. After much discussion and analysis by the IMF and other bodies, the idea of a G-20-supported and uniform global bank levy is firmly off the table. For example, Australia and Canada, whose banks did well during the financial crisis, do not see the point of punishing their banks now. However, some individual countries may still implement certain types of bank levies, particularly to raise domestic revenues. Depending on how the levy is implemented, this may take funds away from lending activities in developing countries. The impact of a currency transaction tax on poorer countries relates to the trade-off between reduced volatility (although this may never have been the main objective) and increased financial flows.

The G-20 is also discussing bank capital and liquidity rules to force banks to hold more capital during boom times. While the principle is sound, there are fears that imposing strict conditions too soon could jeopardise the global recovery, and lending to SMEs and poorer countries has been reduced (these are areas where cuts can be made most easily when being forced to hold more capital). Banks suggest tougher requirements will also soon force them to raise new capital at the expense of being able to lend to promote economic recovery. BNP Paribas suggests that the Basel III reforms would cost European banks €400bn ($540 billion) in extra capital and force them to issue €1500 billion in debt to finance lending (Daneshkhu, 2010).

A recent Institute of International Finance (IIF) study suggests that the new Basel proposals would cut growth by 0.9 percentage points per year, resulting in a cumulative reduction in GDP of $920 billion, or 4.3%, by 2015. The US would see a cumulative reduction of 2.6%. The IIF also estimates that banks will need to raise $700 billion of common equity and issue $5400 billion of new long-term wholesale debt over the period 2010-2015 to meet the new requirements.

'new capital adequacy ratios may reduce African incomes by some 1.5% through the negative GDP effects of a drop in bank lending of 9.6%'

In practice, many EU banks have already increased their capital ratios. For example, France's top five banks average Tier 1 ratio increased to 10.2% at the end of December 2009 from 8.7% a year earlier. Some suggest that capital ratios of UK banks have increased some 4% in recent years.

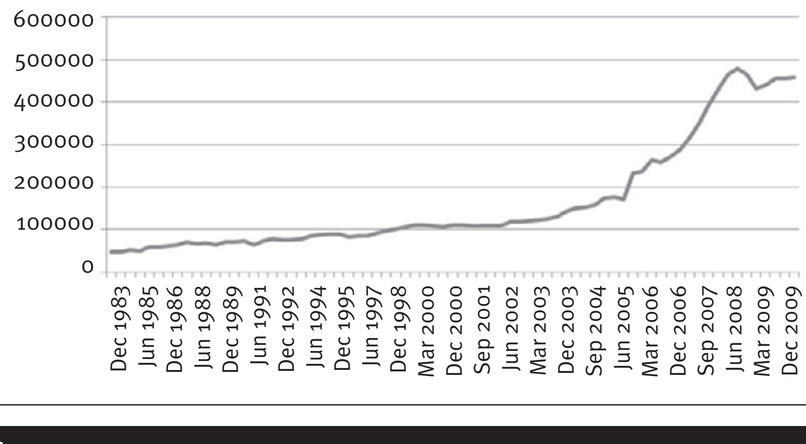
At the same time as capital ratios have increased, the growth in EU bank lending to poor countries (e.g. Africa, see Figure 14) has come to a standstill, and in December 2009 was still 5% below its peak (a two to four percentage point capital increase coinciding with a 5% decrease in bank lending). In line with this empirical observation, Francis and Osborne (2009) estimate that a one percentage point increase in capital adequacy requirements reduces risk weighted assets by 2.4%. This implies that a four percentage point increase in the new Tier 1 ratio under Basel III (this still needs to be confirmed) would reduce lending by some 9.6%. This information can be used to examine the possible growth effect of a drop of 9.6% in bank lending. Brambila-Macias and Massa (2010) suggest that a 10% decrease in international bank lending would decrease growth by 1.5% in a panel of sub-Saharan African countries. Hence, new capital adequacy ratios may reduce African incomes by some 1.5% through the negative GDP effects of a drop in bank lending of 9.6%. Such effects do not include possible relocation effects, and price effects, or other general equilibrium effects resulting from higher capital ratios.

Other financial sector issues being discussed include: IMF quota reform where there has been an agreement for increasing the voting power of developing countries, however much of this is going to emerging markets; global financial safety nets to deal with capital volatility and prevent crisis contagion; and the SME Finance Challenge. These can also be in the interest of poor countries, so there is further work ahead on the road to Seoul.

Table 10: G-20 financial regulation and impact on development

	Busan G-20 communiqué (June 2010)	Discussions	Impact on development	Development issues on the road to Seoul
Global bank levies (financial sector to pay for future crises)	Agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the banking system or fund resolution taking into account individual country's circumstances and options.	Canada, Australia, Brazil, India and Indonesia opposed to introduction of global levy (in part because banks in their countries did well during crisis). US, UK and some European countries still want go ahead.	Probably negative as revenues are likely to be used for reducing national deficits, while banking activities were global. However, development effects depend on nature of bank levies and on how the proceeds are used.	Ensure any levy does not punish lending activities to poorer countries and that levy receipts benefit development.
Bank capital and liquidity rules (Basel III)	Committed to reach agreement expeditiously on stronger capital and liquidity standards. As we agreed, these rules will be phased in as financial conditions improve and economic recovery is assured, with the aim of implementation by end-2012.	Fears that imposing strict conditions could jeopardise recovery. Banks suggest tougher requirements too soon will force them to raise fresh capital at the expense of being able to lend to aid economic recovery. Lengthy phase-in (e.g. 10 years) seems inevitable Two percentage points of higher capital requirements would halve the probability of systemic risk.	Negative: a four percentage point increase in G-20 capital adequacy ratios may reduce African growth by 1.5% (while the benefits of avoided crises are mainly in developed countries) Fewer effects if required capital can include debt/ equity in a diversified poor country portfolio.	Ensure that new rules do not hit capital outlays in poor countries disproportionally; if they do, ensure compensatory financial inclusion or SME Finance Challenge mechanisms.
Other related issues	MF quota reform. Financial safety net (to be discussed at Seoul). SME Finance Challenge (Toronto).			Ensure more quotas for poorer countries. Ensure comprehensive financial safety net and SME Finance Challenge.

Figure 14: Foreign claims of European banks on Africa, 1983-2009 (US$ m.)



Source: BIS.

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8. G-20 fiscal stimulus exit strategies, interdependencies and low-income countries: towards a smart development friendly fiscal policy

By Dirk Willem te Velde

Over recent months, the mood at the G-20 meetings has shifted from one of using fiscal policy to ensure global recovery towards one of ensuring fiscal sustainability. The fiscal stimulus of 2009-2010 raised domestic demand in G-20 countries (by bringing forward spending, especially in China). However, recent events (such as the eurozone fiscal crisis in countries such as Greece, Portugal and Spain) have led countries to prioritise fiscal consolidation. There is a fine balance between stimulating the economy and ensuring global recovery in the short run on the one hand, and fiscal sustainability and reliance on the private sector on the other. A rapid withdrawal of fiscal stimuli could contribute to a double-dip recession. This could also have severe negative spillovers for LICs.

Barrell et al. (2009) simulated a series of fiscal packages from the G-20 economies, the bulk of which affected budgets in 2009 and 2010: a fiscal expansion worth $797 billion in US; $110 billion in Japan; in the eurozone worth $270 billion; in Canada worth $33 billion; a UK fiscal expansion worth $22 billion; a fiscal expansion in China amounting to $586 billion.

Together, these fiscal packages were simulated to raise growth in sub-Saharan Africa by 1-1.5% per annum in 2009-2010 using the National Institute of Economic and Social Research Global Econometric Model (NiGEM), and so would raise the level of GDP by around 2.5% (a temporary increase). This spillover stimulus is now at risk, at a time when the budgets for 2011 are being prepared and those for 2010 are being redrawn.

'Over recent months, the mood at the G-20 meetings has shifted from one of using fiscal policy to ensure global recovery towards one of ensuring fiscal sustainability'

Table 11 shows how large the government deficits and debt ratios have become. Large budget deficits have already led to panic selling and a €110 billion response from the European Central Bank (ECB) which, together with other sources, provided a €750 billion package to rescue the eurozone. Countries afraid of following financial market problems (spreads between Greek and German bonds have increased dramatically, indicating a higher probability of default) have begun to consolidate their finances. It was inevitable that the G-20 Communiqué in Busan

Table 11: Macroeconomic variables in selected G-20 countries, 2008-2010 (% of GDP)

	Current account			Government deficit			Government debt	Estimated output gap
	2008	2009	2010	2008	2009	2010	2009	2010
Australia	-4.4	-4.1	-3.2	0.3	-3.9	-3.2		-0.3
Brazil	-1.7	-1.5	-2.8	-1.9	-3.3	-0.8		
Canada	0.5	-2.7	-1.6	0.1	-5.1	-3.4	81.6	-3.6
China	9.4	6.1	2.8	1.0	-0.9	1.0		
Eurozone	-0.8	-0.3	0.3	-2.0	-6.3	-6.6		
France	-2.3	-2.2	-1.9	-3.3	-7.6	-7.8	77.4	-3.1
Germany	6.7	5.0	6.0	0.0	-3.3	-5.4	72.5	-3.5
India	-2.4	-3.0	-2.3	-8.8	-11.8	-10.3		
Indonesia	0.0	1.9	0.2	-0.1	-1.6	-1.7		
Italy	-3.5	-3.1	-3.6	-2.7	-5.2	-5.2	115.8	-3.3
Japan	3.3	2.8	3.3	-2.1	-7.2	-7.6	217.6	-5.7
Mexico	-1.5	-0.6	-0.7					
South Africa	-7.1	-4.0	-4.9	-1.0	-6.8	-6.3		
Turkey	-5.5	-2.2	-4.5	-5.3	-6.4	-6.5		
UK	-1.5	-1.3	-1.6	-4.9	-11.3	-11.5	68.2	-5.0
US	-4.9	-2.9	-3.8	-6.5	-11.0	-10.7	83.2	-2.0

Sources: Organisation for Economic Co-operation and Development (OECD) and IMF (debt and output gap), forecasts for 2010.

would suggest that countries needed 'to put in place credible, growth-friendly measures, to deliver fiscal sustainability, differentiated for and tailored to national circumstances'. Finding the right balance between growth and fiscal sustainability means finding the right fiscal policy targeted at alleviating the binding constraints. Fiscal projects with high-benefit costs ratios should still go ahead.

One such investment would be infrastructure in Africa. Table 12 tabulates the costs and benefits to the financing countries, and also to the world as a whole and China, of the $50 billion simulation of investment in infrastructure in sub-Saharan Africa, entailing productivity spillovers. Taking the UK as an example, we find that, while spending $1 billion on the sub-Saharan African fiscal stimulus, it receives $0.7 billion back in the form of exports in the first year. If the UK can persuade G-20 countries to contribute a fixed percentage to a stimulus in sub-Saharan Africa, there will be a 20% rate of return on its own investments (0.011% net GDP impact compared with 0.05% of GDP investment) in 2009. This number has to be treated with caution because it depends on a particular allocation in contributions to the fiscal stimulus.

To take another example, Germany can help promote global growth and help development in at least two ways. Table 12 shows that Germany can promote African incomes (through the infrastructure stimulus) and support German exports in the process. Table 11 also suggests that Germany has ample scope for supporting the economy, because it has a relatively low deficit (-5.4% expected for 2010) and the highest of G-20 current account surpluses (6% expected in 2010), so a targeted domestic consumption stimulus that benefits African exporters would help. Germany also still has a relatively large output gap (3.5%), further informing the right balance between promoting growth and ensuring fiscal sustainability.

Table 12: Impact of sub-Saharan African fiscal expansion on financing countries in 2009

	Direct costs (US$)	Additional exports (US$bn)	Net impact on real GDP (%)
US	28.5 billion (0.20% of GDP)	1.4	+0.003
Japan	6 billion (0.11% of GDP)	0.6	+0.005
Germany	6 billion (0.18% of GDP)	1.8	+0.007
France	4 billion (0.15% of GDP)	1.6	+0.025
Italy	3 billion (0.14% of GDP)	0.7	+0.007
Canada	1.5 billion (0.12% of GDP)	0.3	+0.006
UK	1 billion (0.05% of GDP)	0.7	+0.011
China		1.4	+0.016
World		20.4	+0.073

Source: Barrell et al. (2009).

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Barrell, R., Holland, D. and te Velde, D.W. (2009) 'A Fiscal Stimulus to Address the Effects of the Global Financial Crisis on Sub-Saharan Africa'. NIESR/ODI report for One.

9. The effects of a renminbi appreciation on Chinese inflation, global imbalances and low-income country growth

By Ray Barrell and Dirk Willem te Velde

Zhou Xiaochuan, Governor of the People's Bank of China, suggested earlier this year at China's National People's Congress that Beijing is preparing to abandon the peg to the US dollar it informally introduced in mid-2008 as a financial crisis measure (Dyer and Anderlini, 2010). The renminbi exchange rate is a sensitive topic, especially between China and the US: the latter claims that a weak rate is essentially an import barrier and an export subsidy.

With the Chinese economy in danger of overheating with double-digit growth rates and high inflation rates,[13] there are now domestic reasons for China to tighten its lending policy (some credit tightening has already occurred) and subsequently to appreciate the currency. What will the effects be in China and elsewhere, including on global imbalances and LICs? The renminbi has already appreciated by more than 20% in real effective terms after China introduced a crawling peg in the middle of 2005 (Figure 16), but it recently depreciated some 10% as a result of the reintroduction of the renminbi–dollar peg (Figures 15 and 16).

Many would argue that a weak exchange rate provides a boost to Chinese exports, which have been sold to other countries at cheap prices. At the same time, it raises the price of imports, keeping them out, while leading to inflationary pressures, contributing to an overheating China. Other countries, e.g. in Africa, could gain or lose depending on their cooperative trade links with China as well as competition with China in third markets. Arvind Subramanian argued that a weak Chinese exchange rate was bad for the poor.[14]

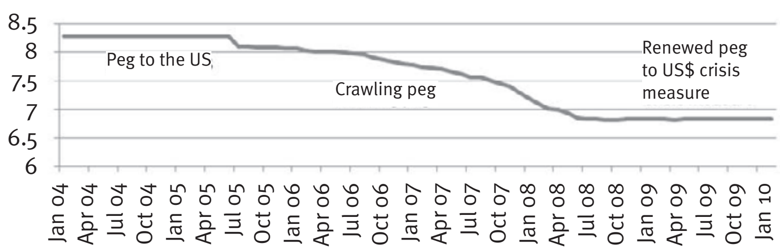
Others argue that a stable Chinese exchange rate is good for stability in the current turbulent circumstances, as it was during the East Asian financial crisis. Moreover, it might be that the real problem behind global imbalances is not the exchange rate but the fact that there is excess demand and production in developed countries, which leaves investment returns there low. And, even if the exchange rate is appreciating, this still might not solve global imbalances. For example, Japan appreciated its currency but still had large saving surpluses. The impact was that inflation lowered to deflationary levels, which made it difficult to use monetary policy in the crisis.

> **'A more flexible exchange rate would curb Chinese inflation and promote low-income growth (particularly in Africa) and may address global imbalances'**

The same could happen to China. But the question as to what exchange rate policy in emerging markets is good for LICs remains an empirical one.

We modelled[15] the impact of a 10% renminbi appreciation through a tightening of the money supply and a change in the dollar peg. This reduces the price level by 10% in the long run, leading to desirable deflationary pressures. While Chinese output declines and its current account surplus decreases by 2 percentage points in the first year, there are positive growth effects on most LICs, but these vary. For example, sub-Saharan African countries (excluding members of the Organization of the Petroleum-Exporting Countries (OPEC) such as Nigeria) stand to gain a quarter of a percentage point of GDP, which is 2.5 times the effects of a possible Doha Round conclusion on sub-Saharan Africa.[16] Countries that cooperate (rather than compete) with China, such as the rest of the Asia country group, may lose out as a result of slower Chinese growth, although Korea would be a major gainer. A more flexible exchange rate would curb Chinese inflation and promote low-income growth (particularly in Africa) and may address global imbalances.

Figure 15: Renminbi's appreciation against the dollar halted by the crisis, 2004-2010



Source: BIS.

Figure 16: Real effective exchange rate in China, eurozone and US, Jan 1994-Apr 2010

Source: BIS.

Table 13: Effects of a 10% renminbi appreciation on the level of GDP, 2010-2020

	Africa	Australia	Eurozone	Rest East	India	Japan	New Zealand	South Africa	South Korea	Taiwan	UK	US
2010	0.188	0.094	0.033	0.136	0.064	0.069	0.022	0.034	0.250	0.159	0.032	0.007
2011	00.280	0.108	0.076	-0.006	0.085	0.092	0.035	0.033	0.247	0.058	0.058	-0.019
2012	0.223	0.076	0.077	-0.084	0.123	0.091	0.055	0.029	0.130	0.029	0.049	0.009
2013	0.134	0.038	0.050	-0.082	0.135	0.069	0.072	0..014	0.079	0.072	0.017	0.034
2014	0.073	0.005	0.015	-0.035	0.116	0.042	0.075	-0.007	0.096	0.134	-0.017	0.039
2015	0.050	-0.017	-0.018	0.013	0.083	0.017	0.063	-0.020	0.147	0.175	-0.040	0.032
2016	0.055	-0.027	-0.042	0.041	0.049	0.000	0.041	-0.023	0.201	0.183	-0.050	0.023
2017	0.069	-0.028	-0.053	0.047	0.018	-0.008	0.016	-0.020	0.234	0.161	-0.049	0.014
2018	0.076	-0.023	-0.053	0.038	-0.014	-0.011	-0.007	-0.017	0.237	0.122	-0.042	0.003
2019	0.066	-0.018	-0.046	0.022	-0.046	-0.012	-0.013	-0.013	0.210	0.077	-0.033	-0.007
2020	0.040	-0.014	-0.037	0.007	-0.076	-0.014	-0.010	-0.010	0.164	0.038	-0.025	-0.014

Source: Barrell et al. (2009).

Endnotes and references

13 House prices rose 10.7% in February 2010 compared with the same month in 2009 (Anderlini and Mitchell, 2010). Consumer prices were expected to rise further this year (at 2.8% in April 2010 compared with a year before, and above 3% in May 2010). China is targeting a 3% increase this year.

14 www.ft.com/cms/s/0/1c9dd268-1146-11df-a6d6-00144feab49a.html

15 All country and regional models in NiGEM contain the determinants of domestic demand, a supply side, export and import volumes, prices, current accounts and net assets. Economies are linked through the effects of trade and competitiveness and are fully simultaneous. There are also links between countries in their financial markets, as the model describes the structure and composition of wealth, emphasising the role and origin of foreign assets and liabilities. The effects will vary depending on policy feedback rules, which require further examination.

16 See Table 17.6 in Anderson et al. (2006). Some suggest that exchange rate issues are currently the 'elephant in the room' at the World Trade Organization (WTO) – the preliminary results in this note shows their importance.

Anderson, K., Anderson, W., Martin, W. and van der Mensbrugghe, D. (2006) 'Global Impacts of the Doha Scenarios on Poverty', in T.Hertel and A. Winters Poverty and the WTO. Basingstoke: Palgrave Macmillan.

Anderlini, J. and Mitchell, T. (2010) 'Fears of China Property Bubble Grow'. Financial Times 10 March.

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Dyer, G. and Anderlini, J. (2010) 'Beijing Remains Divided over Currency Peg'. Financial Times 9 March.

10. G-20 rebalancing, international reserves and development finance

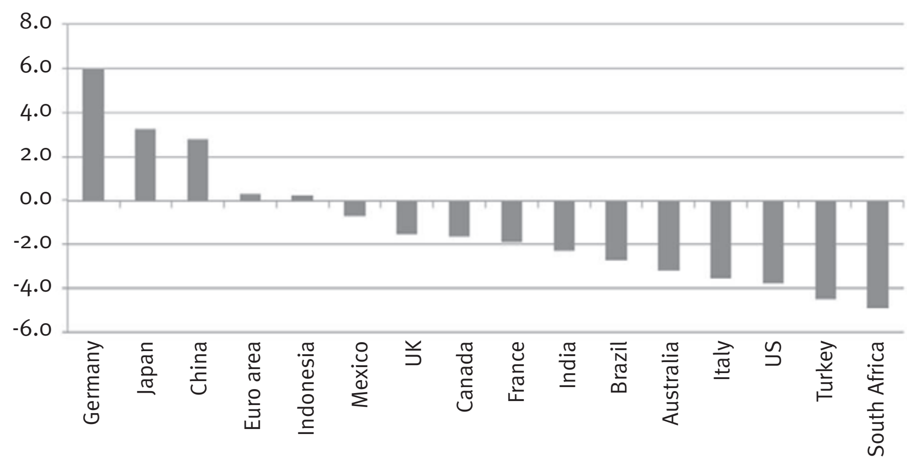
By Dirk Willem te Velde

There are at least two ways in which the G-20 can attempt to tackle global imbalances that hamper global growth and development prospects. The first and most direct route is by balancing current accounts (Figure 17). For example, deficit counties such as the US and the UK could promote further exports and rein in domestic spending, whereas surplus countries such as Germany and China could increase services productivity and boost domestic consumption so that their imports rise. Such a rebalancing could have development implications, depending on trade patterns. Unfortunately, current account deficits and surpluses are forecast to widen in absolute terms beyond 2010 (World Bank, IMF and OECD forecasts). Therefore, it will also be important to examine the flipside of the accumulation of current accounts: capital outflows, international reserves and sovereign wealth funds (SWFs). International reserves in surplus countries have a crucial role to play in promoting growth globally as well as promoting development finance to developing countries.

Figure 18 shows the level of international reserves at the end of 2009. A handful of countries, such as China, India, Japan, Korea, Russia and Saudi Arabia, have the largest reserves. These have been built up over time, indicating a shift in wealth, especially to Asian countries. In some countries (e.g. China), reserves are held mainly by the public sector; in other countries (e.g. the US), they are held mainly by the private sector. Although Asian countries have built up international reserves in part for self-insurance against another crisis, contributing to the current global imbalances, how can such reserves be used, and can these be leveraged for development purposes?

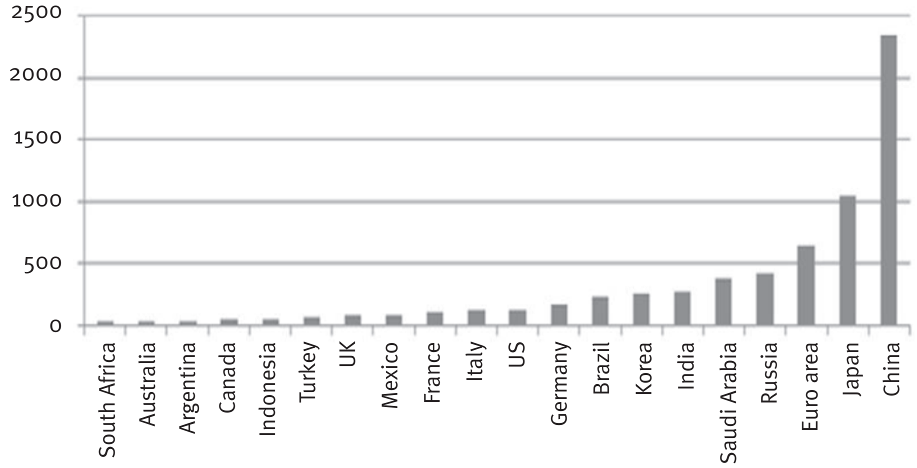
International reserves can be deployed directly by investing globally. China, for example, is the biggest

Figure 17: Expected current account balance, 2010 (% of GDP)



Source: OECD.

Figure 18: International reserves, October 2009 (US$ billions)



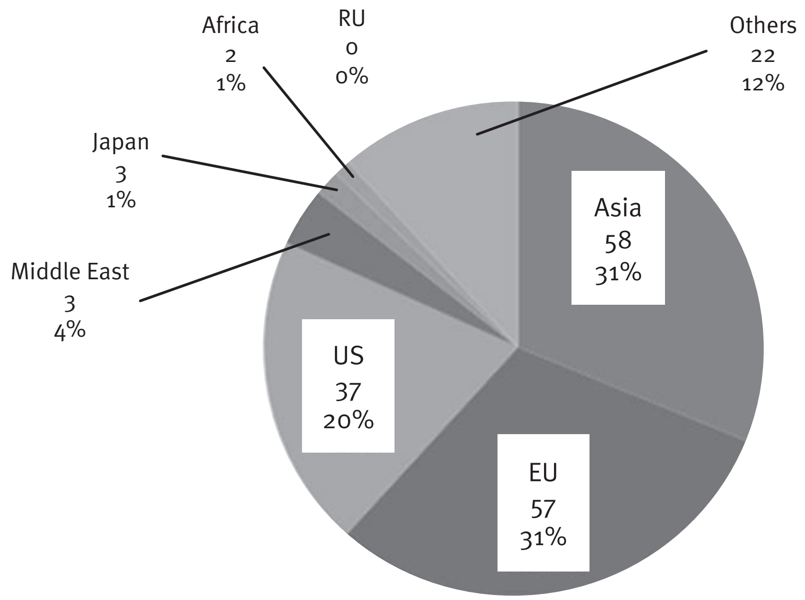
Source: IMF.

Table 14: The largest SWFs, end-2009

	Assets under management (US$ bn)	Country	Inception year
Abu Dhabi Investment Authority	627	UAE	1976
Government Pension Fund – Global	445	Norway	1990
Sama Foreign Holdings	431	Saudi Arabia	n/a
State Administration of Foreign Exchange Investment Corporation	347	China	n/a
China Investment Corporation	289	China	2007
Government of Singapore Investment Corporation	248	Singapore	1981
Kuwait Investment Authority	203	Kuwait	1953
National Welfare Fund	168	Russia	2008
National Social Security Fund	147	China	2000
Hong Kong Monetary Authority Investment Portfolio	140	China (Hong Kong)	1993
Temasek Holdings	122	Singapore	1974
Libyan Investment Authority	70	Libya	2006
Qatar Investment Authority	65	Qatar	2005
Australian Future Fund	49	Australia	2004
Revenue Regulation Fund	47	Algeria	2000
Others	402		
Total	3800		

Source: SWF Institute and ISFL.

Figure 19: SWF investment by region, 1995-2009 (% of total and US$ bn)



Source: ISFL, Deutsche Bank Research.

foreign holder of US assets, holding nearly a trillion dollars in Treasury securities. International reserves can also be used to set up SWFs. SWFs result from current account surpluses from exports of oil and other commodities or manufactured goods, fiscal surpluses, public savings or privatisation receipts. SWFs currently hold around $4 trillion and are set to rise to $5.5 trillion in 2012 (International Financial Services London (ISFL)). Around 10% of Chinese reserves are being invested by the China Investment Corporation (CIC), a SWF initiated in 2007. Table 14 shows the largest SWFs.

SWFs take equity stakes in Western financial firms (some $50 billion since the outbreak of the financial crisis) and also invest in poor countries. However, only a small proportion is actually directed at poor countries, despite their high growth rates at present.

New and existing vehicles for SWFs may help channel global finance from surplus countries to

Table 15: New commitments by development finance institutions, 2005-2009

		2005	2006	2007	2008	2009	Change 2009-2008 (or closest FY)
IFC (part of World Bank)	$m	6449	8275	9995	14,649	12,405	-15.3%
EBRD	€m	4277	4936	5583	5087	7861	54.5%
CDC (UK)	£m	156	257	412	436	359	-17.7%
DEG (Germany)	€m	702	930	1206	1225	1015	-17.1%
FMO (Netherlands)	€m	699	937	1315	1314	911	-30.7%

Source: DPI annual reports.

those countries, including developing countries, where returns on investment are greatest, or it could be channelled to areas where increased liquidity is needed the most for systemic reasons. Examples include the International Bank for Reconstruction and Development (IBRD) and the IMF, which can both be used to channel funds to support growth globally.

Another example would be to co-finance with development finance institutions (DFIs), either as FDI or by taking joint equity positions in funds or projects with commercial rates of return in developing countries. One example is the recent joint investment by the China Railway Jianchang Engineering Company and the International Finance Corporation (IFC) in Tanzania. Most DFIs have seen their investments decline over 2008-2009 (with the exception of the European Bank for Reconstruction and Development (EBRD), which was able to respond proactively to the financial crisis, which hit Eastern Europe hard). Although there have been capital injections into the IMF, the IBRD and regional development banks, private sector DFIs have not been able to maintain their investment levels without additional support. This is worrying, especially as the private sector will need to pull the recovery over the medium term.

'International reserves in surplus countries have a crucial role to play in promoting growth globally as well as promoting development finance to developing countries'

11. The G-20 and trade preferences for least-developed countries

By Massimiliano Calì and Sheila Page

There is renewed interest in reconsidering the current system of trade preferences to make it more effective for the development of exports from poorest countries, and from LDCs in particular. Just ahead of the previous G-20 Summit in Pittsburgh 2009, the EU released a position paper recommending that the G-20 Leaders 'should adopt the 'Everything But Arms' (EBA) initiative without delay to support people in developing countries suffering from the crisis'. This was soon followed by other announcements, such as those of China that it would expand its LDC trade preferences for Africa and of Brazil that it would introduce trade preferences for LDCs in 2010. Along with the recognition that poor countries need help to recover from the global crisis, the forthcoming MDG review provides another important boost for this renewed interest in trade preferences as the granting of preferences to LDCs is contained in MDG 8.

A recent report by the Working Group on Global Trade Preference Reform convened by the Center for Global Development (CGD, 2010) elaborates on these statements and proposes a series of recommendations aimed at making trade preferences work more effectively for the LDCs. These include not only the expansion of the duty free quota free (DFQF) scheme to all exports from all LDCs, but also extending the pool of preference-granting countries to include their definition of advanced developing countries. They also recommend the modification of existing rules of preference programmes, including rules of origin that currently restrict accumulation of input sourcing and ensuring programme stability and predictability. In addition, the report calls for reducing the costs of regulatory requirements in preference-giving countries and tackling supply-side constraints in poor countries that constrain exporters in their ability to take advantage of market access.

While it is difficult to deny the advantages for LDCs' exports, at least in the short term, in the implementation of some of these measures, we suggest that there are conceptual and political challenges, which may undermine the success of some of the proposed reforms.

First, any extension of preferences to one group of countries implies a corresponding deterioration of the competitive position of the other developing countries exporting to the preference-granting country. Thus, expanding the preferences offered to LDCs implicitly attributes a more important value to the welfare of LDCs than to that of other developing countries. Simulations run through computable general equilibrium (CGE) models by Bouet et al. (2010) suggest that this should not be a source of concern, as the expected losses for non-LDC developing countries would be negligible. These results are encouraging, but they are subject to potentially large margins of error, stemming from the high level of aggregation in terms of both sectors and countries.[17] For this reason, they constitute too thin evidence on the likely export costs faced by non-LDC developing countries following the expansion of preference for the LDCs. Moreover, in the event of an expansion of preferences by the US to all LDCs, some LDCs themselves (i.e. the African ones) would be worse off, as their preferences in the US market through the African Growth and Opportunity Act (AGOA) would be eroded. The legitimacy under the WTO of preferences rests on consent by all countries to favouring developing countries over developed, and the Enabling Clause explicitly requires that preferences be designed 'not to raise barriers to or create undue difficulties for the trade of any other contracting parties' (E.1.4 Paragraph 3(a)).

'While it is difficult to deny the advantages for LDCs' exports, at least in the short term, in the implementation of some of these measures, ... there are conceptual and political challenges, which may undermine the success of some of the proposed reforms'

Second, granting DFQF to all exports from LDCs risks providing perverse incentives to increase the specialisation of LDCs' exports in agriculture, given the current tariff structure in many advanced countries with higher tariff rates in agriculture. Gasiorek et al. (2010) show that LDCs currently enjoy relatively high preference margins in the EU market only in a number of agricultural products. This may help explain why the same authors do not find much evidence that preferences help countries diversify their exports to the EU. This runs counter to the original objective of preferences, that is, to help poor countries diversify their exports towards the more dynamic sectors of the economy, and will impose costs on LDCs in the future in restructuring their economies away from artificially stimulated sectors (as has already happened in sugar and clothing, for instance, and for non-LDCs in bananas).

Finally, it is not clear that providing full DFQF would yield significant benefits for exports by LDCs. The current tariff rates are generally not prohibitive in most sectors of advanced economies, thus the potential for offering a preference margin is not large and is likely to decrease in the future with further liberalisation.[18] In addition, supply capacity constraints and non-tariff barriers are often the most important constraints to the exports of LDCs, but these are clearly more difficult to tackle than the actual tariffs.

Some of these conceptual challenges are likely to turn into political ones, which may make the implementation of DFQF for LDCs more difficult. In particular, the failure to address the costs faced by the potential losers from these measures could increase opposition to such extension from other developing countries. In addition, the proposal to require some advanced developing countries also to provide 100% DFQF to LDCs ignores the fact that they lost by being excluded from past preferences to LDCs. This history may affect their attitude to giving preferences to these countries, especially on the basis of a recommendation formulated by a developed country research institute. A further constraint is that, under WTO rules, it is no longer possible for developed countries to choose which developing countries to favour.

What would be required for a better package of proposals to reform trade rules to benefit poorer countries?

First, any proposal must be based on a careful calculation of potential benefits and must take seriously the concerns of those who would lose from any change in the preference system. As always in trade, this requires detailed, line-by-line, examination of the effect of the changes on both those who would benefit and those who might pay the costs. Any change will have some losers. When these are developing countries, developed countries must include provisions to compensate them. Any extension of DFQF to LDCs may in future entail costs for LDCs when preferences are granted to others.

Second, reviewing rules of origin to allow for both low enough value addition criteria and as much cumulation as possible for LDCs in order to encourage them to source their inputs from the most efficient suppliers would benefit both LDCs (because many are too small or have industries at too early a stage of integration to meet all the stages of production required by present rules) and other developing countries (who could supply the inputs).

Third, providing preferential access in services to LDCs would be much less likely to impose costs on other developing countries, because in most cases this would be new access, not diversion of access, as is often the case in goods. It would also be likely to have significant benefits, because high existing barriers would offer a significant preference margin and it would be more likely to encourage the development of more dynamic sectors, with a sustainable future, rather than locking LDCs into primary products.

Fourth, a focus on Aid for Trade (AfT) to tackle supply-side constraints is key (this can have positive effects on exports, as shown by Calì and te Velde, 2009). It was precisely the political and economic obstacles to extending preferences that led to the initial proposals for AfT (Kleen and Page, 2005).

Endnotes and references

17 The model aggregates groups of traded products into 28 macro sectors, thus computing average tariff rates over dozens of 6- or 8-digit sectors (which tariff rates are effectively applied to). Moreover the model has data only for a handful of countries, using only 30 geographical units, which comprise both regions and countries. For example it lumps together the vast majority of African countries into the "Rest of Africa" region, which contains both LDCs and non LDCs African countries.

18 Over half of the gains found for preferences in the past came not from tariff preferences, but from the benefits they received from special regimes, for example for sugar, and from exemption from controls on textiles and clothing. DFQF would not restore these advantages.

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12. The G-20's plan to remove fossil fuel subsidies and implications for low-income countries

By Nicola Cantore

The G-20 growth framework emphasises the need for growth to be sustainable, and hence consistent with environmental policy goals. As part of this, at a G-20 meeting in October 2009, world leaders committed to eliminating subsidies by 2020. The Busan June 2010 communiqué confirms the previous announcement and welcomes the strategies and timetables provided by many G-20 members for rationalising and phasing out inefficient fossil fuel subsidies that encourage wasteful energy consumption.

A worrying distortion in many OECD and non-OECD countries is that the carbon price signal is biased by subsidies to fossil fuels. The Stern Review (2006) points out that by 1998 fossil energy subsidies had declined worldwide but still amounted to nearly $250 billion per year, of which over $80 billion was in OECD countries and over $160 billion in developing countries. Iran, Saudi Arabia and Venezuela are the non-OECD countries showing the highest level of subsidy per capita (Table 16).

A recent Financial Times article (Blas, 2010) cites numbers from an updated forthcoming IEA publication claiming that the world economy spends more than $550 billion in energy subsidies a year. This will be the first exhaustive study of financial assistance devoted to oil, natural gas and coal consumption.

'A worrying distortion in many OECD and non-OECD countries is that the carbon price signal is biased by subsidies to fossil fuels'

Who would gain and lose from the removal of subsidies? First, according to Larsen and Shah (1992), the environment would gain as carbon emissions would be cut by 5%. Larsen and Shah assume the removal of the energy subsidies in developed and developing countries and argue that the US, Japan and Western Europe would gain $14 billion. In a short time, the removal of subsidies would raise domestic energy prices in subsidising countries. In the medium term, Western countries, as net energy importers, would gain from the reduction in world fuel consumption and prices induced by the rise in domestic energy prices in subsidising countries.

The removal of subsidies would increase energy prices and reduce fossil energy consumption and growth in non-OECD subsidising countries in the short term. Moreover, in the medium term all non-OECD energy exporters would suffer a GDP loss as a result of the reduction in world energy prices induced by the removal of subsidies (Table 17). Similar transmission channels would take place if just G-20 countries rather than the whole group of energy subsidising countries committed to remove subsidies by 2020 (Larsen and Shah, 1992).

Larsen and Shah (1992) point out that equivalent reductions (5%) in carbon emissions could also be achieved by an OECD carbon tax to the order of $50-90 per ton. To investigate the welfare effects of

Table 16: Subsidy per capita in non-OECD countries (US$)

Country	Subsidy per person
Saudi Arabia	1036
Iran	786
Venezuela	647
Kazakhstan	554
Russia	359
Ukraine	329
Malaysia	272
Argentina	240
Egypt	214
South Africa	184
Indonesia	77
Pakistan	53
Thailand	46
India	20
Nigeria	17

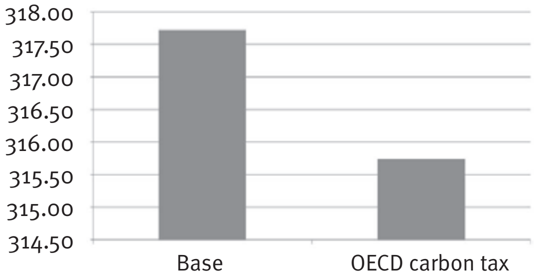
Sources: International Energy Agency (IEA), IMF, The Economist.

Table 17: Welfare effects of subsidy removal in energy exporters (US$ millions)

Country	Welfare loss
Mexico	352
Venezuela	155
Indonesia	233
Saud Arabia	1446
Egypt	167

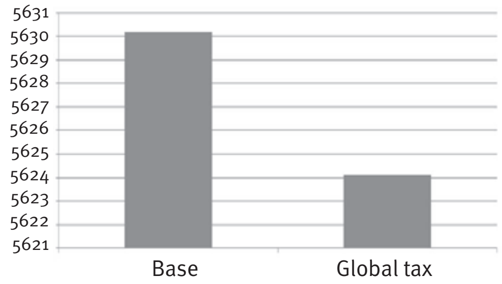
Source: Larsen and Shah (1992).

Figure 20: Baseline vs. annual $70 carbon tax in OECD countries scenario, cumulated exports in oil- and gas-exporting countries,[20] 2011-2020 (bns of barrels of oil equivalent)



Source: Author's elaboration.

Figure 21: Baseline vs. annual $70 world carbon tax scenario, cumulated GDP in low-income countries,[21] 2011-2020 (US$ bn)



Source: Author's elaboration.

a carbon tax on OECD countries, we run a simulation with the International Futures (IFs) CGE model.[19] We assume a $70 annual carbon tax for OECD countries in 2011-2020. Figure 20 suggests that an increase in energy prices in OECD countries would reduce the demand for energy. Energy-exporting countries would experience a reduction in energy exports and growth. Our simulations suggest that oil- and gas-exporting countries could lose $50 billion of GDP between 2011 and 2020 (around 0.2% of cumulated GDP).

A uniform global carbon tax as proposed by Professor William Nordhaus of Yale University before the Copenhagen negotiations represents an efficient solution because it would minimise global abatement costs, but it would hamper development prospects. Our simulations show that a uniform carbon tax would generate a $6 billion loss for the group of LICs (around 0.1% of cumulated GDP).

On the basis of the above findings, we can draw the following conclusions:

- Carbon pricing and removal of subsidies are policy options for eliminating market failures and achieving efficiency. However, they may have progressive or regressive effects.
- The G-20 decision to remove energy subsidies is welcome as it will reduce carbon emissions by some 5%, but it will have negative growth effects on various developing countries.
- According to Larsen and Shah: 'It should be noted that neither the subsidy removal nor an equivalent carbon tax would be sufficient to stabilize global carbon emissions at 1990 levels'. This means that the G-20 may need stricter environmental policies through the G-20 growth framework and that the commitment of developing countries in agreements for emissions reduction may be a necessary negotiation point in the near future.
- Strict emissions reduction policies will affect the growth of developing countries. Additional climate finance transfers are needed to achieve global environmental policies and to guarantee equity by promoting growth in LICs.

Endnotes and references

19 www.ifs.du.edu/ifs/IFs.aspx

20 The oil and gas energy exporters group is composed of Algeria, Angola, Azerbaijan, Bahrain, Brunei, DRC, Equatorial Guinea, Gabon, Iran, Iraq, Kazakhstan, Kuwait, Libya, Nigeria, Oman, Qatar, Russia, Saudi Arabia, Turkmenistan, UAE and Venezuela.

21 The LIC group includes Afghanistan, Bangladesh, Benin, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, DRC, Eritrea, Ethiopia, Gambia, Ghana, Guinea, Guinea Bissau, Haiti, Kenya, North Korea, Kyrgyzstan, Laos, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Senegal, Sierra Leone, Somalia, Tajikistan, Tanzania, Togo, Uganda, Uzbekistan, Vietnam, Yemen, Zambia, Zimbabwe.

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Part 4: The G-20 growth framework: perspectives from low-income, small and vulnerable countries

13. Bangladesh

By Mustafizur Rahman

Growth prospects in Bangladesh and effects of the global financial crisis.

The recent global financial crisis has left a footprint on the increasingly open economy of Bangladesh. While macroeconomic performance indicators remained modestly robust during the crisis, the lagged impact of the crisis started to become increasingly visible over the subsequent period. Bangladesh's export performance had somewhat weakened, as indicated by export sector earnings in FY2009/10 (July-June) (-0.8% growth over the first nine months, July-March) compared with the corresponding months of FY2008/09; to compare, export growth was 10.3% in FY2008/09. One of the reasons for this was the country's inability to allocate sufficient resources as part of the stimulus package put in place during the crisis (compared with some of its competitors such, as China, India and Vietnam). Remittance growth, although still robust, came down from 23% in FY2008/09 to about 16% in FY2009/10 (first 10 months). The number of workers going abroad (equivalent to about 40% of additional labour market entrants in 2007 and 2008) has now come down sharply, by about 40% in 2010, in view of the nature of the global recovery and the slow recovery of demand, creating pressure for the domestic labour market. GDP growth projections, earlier targeted at 6% for FY2009/10, would perhaps now be in the range of 5.5-5.7%. Many LDCs such as Bangladesh are yet to recover from the price inflation that preceded the global financial crisis (worsening of the poverty situation, impact on the hardcore poor), a fact that is often not appreciated enough.

Growth policy constraints

The need to stimulate domestic demand and production during the financial crisis (mainly by way of support and additional subsidy to agriculture and incentives for the export sector) required Bangladesh to allocate substantial additional resources, resulting in the rise of the fiscal deficit to about a 5% equivalent of GDP in FY2009/10. The fiscal burden would have been higher if not for the lower levels of implementation of public sector investment (projected to be about 80-85% of the targeted allocation in FY2009/10). Growth prospects in the near term depend on Bangladesh's ability to address the increasingly critically important area of energy shortage (the shortfall being about 25-30% of current demand). The government has to buy electricity from privately run rental powers stations, but this increases the fiscal burden in view of sale to consumers and producers at subsidised rates. Addressing energy and power issues will require substantial investment on the part of the government in terms of exploration, putting in place productive capacities and building the required infrastructure, even though some of these are envisaged to be carried out in partnership with the private sector. Lower than expected export performance and substantial energy shortages have dampened the growth outlook compared with what was envisaged earlier, perhaps hovering around 6-7% over the next two to three years.

'The G-20 meetings in Toronto and Seoul should lead to a firm pledge to fully implement the Hong Kong Ministerial Declaration with regard to DFQF market access, with a concrete timeline'

The G-20 meetings and Bangladesh

The G-20 meetings in Toronto and Seoul should lead to a firm pledge to fully implement the Hong Kong Ministerial Declaration with regard to DFQF market access, with a concrete timeline. Concrete commitments are also called for as part of the AfT initiative of the WTO. In LDCs such as Bangladesh, the diagnostic side of the huge investments required in infrastructure development (trade facilitation, port capacity development and building of new deep sea ports, capacity for compliance with sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBTs), skills development, etc) have been well articulated. In addition, in the case of Bangladesh substantial resources will be required to take advantage of regional economic cooperation (from membership of such regional trade agreements (RTAs) as the South Asian Free Trade Area (SAFTA), the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) free trade agreement (FTA) and the Asia-Pacific Trade Agreement (APTA)), and also to deepen the bilateral cooperation with India and China that promises significant dividends. Export of services (toll, rent, freight charge, etc) could become an additional source of income for Bangladesh, on top of the multiplier positive impact that could originate from these investments in terms of generating trade, commerce and investment opportunities. Aid commitments could be critically important in realising related projects. To stimulate FDI flow to LDCs, the G-20 could think of special incentives for investors from developed countries who are willing to invest in selected sectors in such LDCs.

Developing country members of the G-20 should be more forthcoming in providing duty-free market access to LDCs, as was urged in the WTO's Hong Kong Decision. As a matter of fact, some are taking initiatives towards this. But a move towards the granting of total duty-free access, at least by the leading members, is required. This would also put pressure on developed countries such as the US for speedy implementation of the WTO's DFQF Decision. Many developing countries, such as Korea, Malaysia and Singapore, are also major importers of migrant labour from LDCs such as Bangladesh and Nepal. These countries could take a decision to accord preferential treatment to LDCs while recruiting guest workers.

To be able to effectively address the problems of LICs, the G-20 should have a special meeting with LDCs. Such a meeting would enable the G-20 to learn more about the specific needs and priorities of individual LDCs and to discuss concrete steps to stimulate investment, provide market access and enhance aid to these countries. The presence of selected LDCs in the G-20 meeting cannot substitute for this, particularly because Asia-Pacific LDCs are not there.

In short, the G-20 should help LDCs overcome the impact of a crisis that was not created by the LDCs in the first place. The G-20 should also address the long-term developmental needs of these countries, which could contribute towards reducing future risks by way of expanding global markets for goods and services for the developed world itself. What is needed from the G-20 is a more enlightened view of the world, informed by its own enlightened self-interest.

14. Cambodia

By Hem Socheth

Growth prospects and the effects of the global financial crisis

The global financial crisis has disrupted the speed of Cambodia's economic growth by decelerating key yet fragile sectors such as garments, tourism and construction, all of which are very vulnerable to external shocks. The agriculture sector, on which around 70% of people are dependent, seems to have been affected mildly by the downturn.

As clearly set forth in its Rectangular Strategy Phases I and II, the Cambodian government gives priority to agricultural diversification, in parallel with land reform, construction of infrastructure and energy and improvements in education. One of the fastest-growing economies in Asia, Cambodia is still not able to achieve competitiveness in its export-oriented garment industry, making it even more difficult to compete with countries like Vietnam and Bangladesh in the post-quota era. In late 2008, Cambodia suffered a serious economic contraction, making it harder to maintain the modest rate of poverty reduction achieved prior to the series of crises – food, fuel and financial. However, the economy's fourth driver, agriculture, has so far served as a social safety net for the economy, as laid-off workers from the garment industry and services sector have been able to be absorbed in agricultural jobs amid global economic panic, thanks to favourable rains and crop yields.

'In light of the increasing importance of global economic integration and the emerging role of the newly industrialised economies, ... Cambodia first needs technical assistance in both public and private sectors on governance and public financial management'

Growth policy constraints

The signs of global economic recovery, especially in the US and Europe, will lift consumer spending and allow for greater demand for Cambodia's garment products, which make up 70-80% of total export values. However, loss of competitiveness in Cambodia's garments in relation to other garment-exporting countries will limit growth in the industry: fewer orders will be placed in Cambodia, at lower prices, which will in turn limit firms' profitability. The Asian Development Bank (ADB) projects that the services sector will grow at a rate of 5% in 2010. Inflows of foreign capital will help in the construction sector, with most large real estate investments financed by offshore investors, mainly from China and Korea.

Although Cambodia's financial sector was not directly exposed to the global financial crisis, the indirect impact of the crisis on the economy is seen as a wakeup call to reconsider diversifying sources of economic growth. The focus should be shifted to the poor in rural areas, who comprise around 80% of the total population. The key challenges to overcome lie in improving competitiveness in the garment industry and tourism, diversifying crops and increasing crop yields and improving industrial linkages to add more value to products. With regard to institutional reform, adopting new laws and enforcing existing rules and regulations are key factors in achieving economic growth. Environmental protection and good management of natural resources will also play a pivotal role in sustained economic development.

Weak governance, bureaucracy and corruption have put a brake on the growth of the private sector, as investors may think twice before investing their money. The cost of doing business in Cambodia is relatively high also as a result of high costs of transportation, customs clearance and electricity. At the same time, although labour costs are relatively low, labour productivity is far lower than that of the other countries in the region. When unofficial spending is included, Cambodia's products are at a huge cost disadvantage, which pushes their price to an even more uncompetitive level in both domestic and international markets.

To mitigate this problem, the government should first focus more on institutional reforms, ranging from the adoption and enforcement of new and existing laws, to improving governance in the public sector so as to enable increased efficiency and effectiveness. Second, the government should strengthen the capacity of the private sector by offering it more opportunities to voice concerns on the business environment and help solve problems by cutting bureaucracy and unofficial spending. When the private sector prospers, more jobs will be created, and this will reflect the fact that Cambodia is more favourable to doing business. Third, as many reports have stressed, the narrow base of Cambodia's economy has limited and, to some extent, harmed self-sustaining growth, given the weak domestic market and a lack of industrial linkages, undermining domestic value addition that could benefit local producers. Hence, diversifying the sources of growth and strengthening the agricultural sector are crucial for Cambodia to turn the economy onto an upward trajectory. The vast majority of Cambodia's agricultural exports are of raw commodities, such as paddy rice, unshelled cashew nuts and unprocessed rubber and timber. Better coordination of value chains and promotion of investment into domestic processing will generate a higher value for these products. Fourth, endowed with natural assets such as oil, gas and other mineral resources, Cambodia is potentially able to transform itself from a low- to a middle-income country in the near future, provided that the allocation of resources and the sharing out of revenue are carried out fairly and equitably. In this context, accountability will be crucial, and all stakeholders must be informed on how the government manages the resources and distributes the revenues. Meanwhile, the government should build more trust in the financial and banking sector in order to open up more opportunities for investment, by making capital more easily accessible and less costly for potential investors.

Recent studies suggest that the number of Cambodian people living under the poverty line dropped to 30% in 2007, compared with 45-50% during 1993-1994. However, the series of crises impeding economic growth has already derailed the country's poverty alleviation efforts, at least in the short to medium term. This is particularly difficult given that Cambodia originally had to start rebuilding its national infrastructure from scratch after nearly three decades of internal conflict. Meanwhile, it is to be hoped that the country's rich natural resources will not curse the country in a similar way to what has happened in many other countries, especially those in Africa.

The G-20 meetings and Cambodia

Cambodia needs support from the international community and foreign governments in order to be able to achieve sustained economic wellbeing and to catch up with other countries in the region. In light of the increasing importance of global economic integration and the emerging role of the newly industrialised economies, including China, India, Korea and Russia, Cambodia first needs technical assistance in both public and private sectors on governance and public financial management. Support in the form of vocational training will also be critical in the effort to attract higher capital-intensive investment. Incubating micro-, small and medium enterprise is also an important step towards building industrial clusters for large companies, given that domestic industrial relations are still weak. As an agrarian country, Cambodia also needs help to modernise its agricultural sector, through the adoption of new technology and improved irrigation, so that it can obtain higher yields and more frequent harvests.

Investment from G-20 countries will be beneficial to Cambodia and will help open new doors for more market opportunities for Cambodia's niche market agricultural products, especially organic produce. Improvements in agriculture and light manufacturing will help Cambodia move out of poverty in the future. Countries like Korea can help Cambodia through investment in high-tech agriculture, information technology and communication, as well as in its financial market. China and India are potential markets for Cambodian products.

The G-20 meetings in Toronto and Seoul in 2010 will be a forum to address important issues that LICs like Cambodia need in order to sustain growth and move people out of poverty.

15. Bolivia

By Luis Jemio

Growth prospects and the effects of the global financial crisis

The Bolivian economy has performed well in recent years owing to the export commodity boom that has occurred since 2006. Between 2006 and 2008, Bolivia managed to attain fiscal and current account balance surpluses, and increased its international reserves. Thus far, the global financial crisis has had a mild effect on the economy. With the outbreak of the crisis, in the last quarter of 2008 export prices and volumes reduced from the historically high levels attained that year, but they recovered during 2009. Fiscal revenues, which are highly dependent on hydrocarbon taxes, went down in 2009, but without causing imbalances in the fiscal and external sectors. The economy presented positive growth rates in 2009. The large availability of fiscal resources gave the government the necessary room to undertake countercyclical policies aimed at offsetting the negative effects of the crisis on economic activity and at ameliorating negative effects on the poorest segments of the society. To this end, the government created a number of unconditional transfers that benefited the poorest. These measures have had positive impacts in terms of improving the incomes of the poorest and reducing the recessionary effects of the crisis.

> **'Emerging G-20 economies, such as Brazil, China, India and Korea, will demand raw materials and other semi-manufactured inputs from less developed countries such as Bolivia, which are rich in energy and other natural resources'**

Although the economy has presented very positive macroeconomic indicators thus far, and has managed to cope very well with the negative effects of the crisis, there is no clear strategy or development plan that could guarantee much higher growth rates in the future. Recent years have not seen the investment flows necessary to attain sustainable high growth rates and maintain the positive macroeconomic conditions that exist at present.

According to the IMF in 2009, economic growth prospects are 4% a year flat for the period 2010-1014. These figures, according to the IMF report, have been discussed with government officials. These growth rates are clearly insufficient to solve the problem of insufficient job creation and to improve the living conditions of the population. At this rate, per capita GDP would increase at an annual rate of 1.7%. However, these low growth rates cannot be ascribed to the global financial crisis, but instead reflect extremely low investment flows in recent years. Public investment has increased in recent times, owing to the much larger availability of fiscal revenues, but there is no systematic way of measuring its effectiveness in terms of accelerating growth or contributing towards other strategic objectives, such as poverty reduction. Private investment has lagged and has been directed mostly towards non-tradable sectors such as construction, commerce and services. There has been no significant investment into tradable activities such as hydrocarbons. As such, low investment rates could pose a significant constraint to the future growth prospects of the economy and its capacity to create employment.

Growth policy constraints

Despite the favourable economic situation that Bolivia has enjoyed in recent years, investment has remained at extremely low levels, in both labour- and capital-intensive sectors. This brings uncertainty with regard to the future capacity of the economy to attain sustainable economic growth and create good quality jobs, which is the most effective way to defeat extreme poverty. Furthermore, investment flows to commodity-producing sectors, which are basically not labour intensive, have also experienced significant reductions, causing output and export volumes to remain stagnant. The significant boost experienced by fiscal revenues in recent years has basically been the result of higher prices. Given the high reliability of fiscal revenues on hydrocarbon taxes, the government's social policies, including the highly positive cash transfer policy, will not be sustainable in the long run.

Bolivia's main challenge is to defeat extreme poverty by creating high-quality jobs. To this end, the key growth policy constraints that need to be addressed are:

- *Create good quality jobs and increase labour productivity*: 80% of Bolivia's labour force is occupied in low-productive subsistence jobs in the commerce and services informal sectors. Low investment rates are barely sufficient to replace depreciated capital and to marginally increase the capital per worker ratio. Thus, over the long term productivity has stagnated at very low levels. Bolivia needs to make a great effort to improve labour productivity. This will require the government to work in different policy areas, as follows.

- *Invest in human capital to enhance productivity*. This can be achieved through measures such as raising the quality of the education system for the poor, filling coverage gaps in universal basic education, improving secondary education transitions and access to private higher education for poor students and addressing low quality and inequalities in educational achievements at all levels. Bolivia also needs to make significant efforts to achieve the MDGs. To this end, significant efforts need to be made in order to improve the efficiency and effectiveness of public expenditure.
- *Promote investment opportunities*: Bolivia needs to increase its investment rate in order to improve labour productivity, create jobs and increase competitiveness. This can be achieved through measures such as strengthening the investment climate by improving the regulatory environment; introducing the legal foundations for a modern business environment; strengthening property rights; guaranteeing rule of law and institutions; and simplifying procedures and lowering the cost of business registration.
- *Develop the physical infrastructure*: Bolivia is a large under-populated landlocked country, with a population of 10 million and an area of more than 1 million square kilometres. Markets tend to be dispersed, making transport costs high, which in turn reduces the competitiveness of the tradable sector of the economy. Bolivia needs to make a significant investment effort in order to improve the quality and quantity of its roads, which are necessary to integrate domestic markets and to integrate the economy with external markets. To this end, significant financial resources need to be secured to complete the large infrastructure projects that need to be implemented.
- *Enable access to enlarged markets*: Given the small size of its domestic market, Bolivia needs access to larger markets with much higher purchasing power. This will promote the development of productive activities in export-oriented sectors, such as manufacturing and agro-industry, which are more labour-intensive sectors. The development of these activities will gradually promote the migration of the labour force from low-productive sectors in informal activities to export-oriented manufacturing activities with much higher productivity and income levels. Increased participation in world markets in particular, by enacting free trade agreements, will deepen exports and promote investment and technology transfer.

The G-20 meetings and Bolivia

As discussed above, Bolivia has various strategic goals in the economic and social arenas. In the social arena, Bolivia's main aim is to achieve the MDGs in poverty reduction, universal access to education, health, access to basic services, etc. The positive fiscal position attained in recent years has put the government for the first time in the position to increase MDG-related social expenditures in such large quantities as to have a significant impact in terms of putting the country on track to achieve the MDGs. High commodity prices, which in turn have represented larger fiscal revenues, were the result of China's and India's high growth rates in the past. The high growth prospects of these two countries in the coming years will contribute towards maintaining high commodity prices in world markets and thus will benefit commodity-dependent countries such as Bolivia.

However, despite high growth rates in MDG-related public spending in recent years, Bolivia has not improved on some key MDG indicators, such as those related to universal primary education enrolment and attainment. This suggests that there are large inefficiencies in the way the sizable additional resources are at present being spent. Lack of efficiency in public expenditure is augmented by the fact that a large part of these public expenses is undertaken at the decentralised level, by municipalities and regional governments. A large number of small municipalities do not have the capacity to use these resources in a more efficient way and thereby accelerate MDG-related achievement.

A much larger impact could be made in the economic arena. Bolivia needs to improve its growth prospects in order to create high-quality jobs and thus improve the living conditions of its population. To this end, the country needs to attract large amounts of FDI and technology, not only in commodity-producing fields, such as hydrocarbons and mining, which are capital intensive, but also and more importantly in sectors such as manufacturing and agro-industry, which are labour intensive.

To complement this policy, Bolivia needs to enlarge its access to export markets, because no sustainable growth is possible if the country produces only for its extremely small domestic market. Emerging G-20 economies, such as Brazil, China, India and Korea, will demand raw materials and other semi-manufactured inputs from less developed countries such as Bolivia, which are rich in energy and other natural resources.

Bolivia also needs large amounts of financial resources to improve its physical infrastructure. Brazil could help the country in this endeavour, because much better infrastructure in Bolivia will facilitate Brazil's access to the Pacific Ocean and thus favour its exports to Asian countries.

16. Mauritius

By Ali Mansoor

The post-2000 era has been characterised by increased openness and integration of world economies, giving rise to new challenges. Notwithstanding significant improvements in a number of areas, including progress towards achieving the MDGs, recent experience from repeated crises has signalled the risks and vulnerabilities associated with increased global openness and interdependence. Containing the spillover effects of crises on the global economy requires a prompt and comprehensive response from the international community and actions from every state to address vulnerabilities through good economic management and governance. Preparedness to address the challenges is fundamental.

Mauritius has been implementing deep-seated reforms in the 2000s with a view to transforming the economy into a duty-free island and securing transition from trade preferences to global competitiveness. In this respect, bold initiatives have been taken to improve the ease of doing business, increase fiscal space, empower the population and further democratise the economy. These have helped improve living conditions and push the country up in international rankings. In spite of the country's vulnerability to changes in the global economic environment and the erosion of trade preferences, GDP per capita has almost doubled this decade, reaching around $7000 this year. However, recent crises have emphasised that sound economic management needs to be supported by strong commitment from the international community, especially the economic powers, to insulating economies from the spillover effects of crises and to supporting reforms aimed at sustaining quality growth, development and economic progress.

Impact of the crisis on medium-term growth

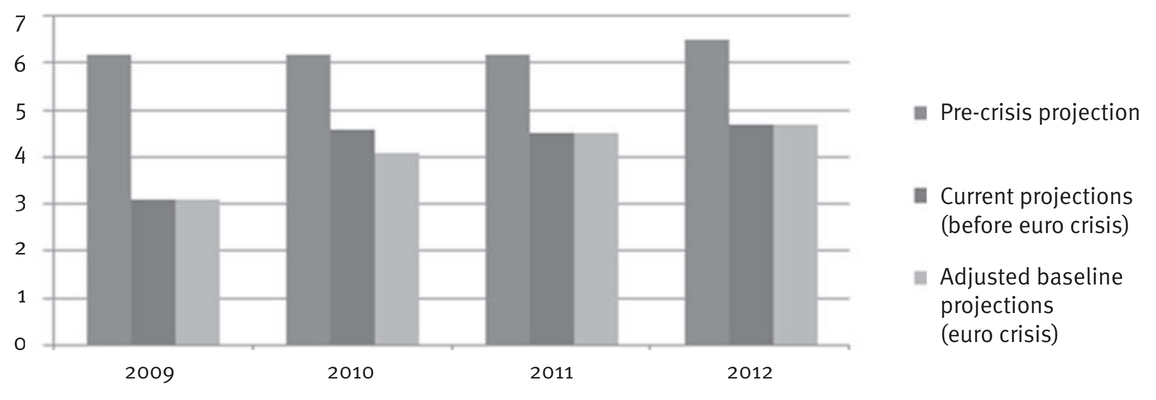
Prior to the crisis, the reforms undertaken to further diversify the economy and to put it on a higher growth trajectory helped improve sectoral growth prospects and consolidate the new growth poles, such as seafood, construction, financial services and the ICT/business process outsourcing (BPO) sectors. On the basis of the domestic and international economic conditions prevailing in 2007/08, the Mauritian economy was projected to grow by around 6.2% annually in the medium term (2009-2012). However, with the advent of the crisis in 2008, the economy's export-oriented sectors, mainly textiles and tourism, suffered at the end of 2008 and in 2009.

'an appropriate framework to support small economies like Mauritius, the sub-Saharan African region and the African subcontinent at large will help address growth development challenges in the 2010s'

Figure 22 shows actual growth in 2009 and medium-term projections compared with pre-crisis projections. In the absence of stimulus measures, the economy's growth was expected to go down to around 2% in 2009 and to around 3% of GDP in 2010. However, stimulus measures, mainly an expansionary fiscal stance and monetary easing, helped in realising growth of 3.1% in 2009, half the level expected prior to the crisis.

Ongoing problems in the eurozone have also put recovery at risk. Baseline projections indicate that textiles and tourism will most likely stagnate, thus

Figure 22: Economic growth in Mauritius, 2009-2012 (% of GDP)



bringing down growth to around 4% or even below. Government along with private sector stakeholders is working on a set of measures to mitigate the short-term impact on the economy's growth prospects for 2010, addressing challenges from the global financial crisis and newly emerging problems from the crisis in the eurozone.

Growth constraints

The current development strategy provides for the expansion of new sectors while at the same time consolidating existing sectors that have been driving the economy since the early 1990s (i.e. sugar, textiles, tourism and financial services). However, major challenges remain, such as traffic congestion, remoteness of key markets, limited competitiveness, poor infrastructure and shortage of local manpower, skills and technical capacity to support potential sectors like seafood, land-based oceanic industry and ICT/BPO. Initiatives have been taken to improve the business climate, reform labour market conditions, invest massively in infrastructure (roads, ports, airports, a new administrative city, projects under 'Maurice Ile Durable', etc) and support the emergence of a new generation of entrepreneurs to sustain growth and progress on the human development side. In the long run, growth can be fully implemented and successful only if the international and regional economic environments are favourable and financing needs are addressed.

The G-20 and Mauritius

The following initiatives from the G-20 may help Mauritius address short- as well as medium- and long-term growth constraints:

Immediate measures

- Support from the EU V-Flex mechanism (2010) and its extension for another one to two years, to make up for the drop in export earnings from the ongoing eurozone crisis and further strengthen export-oriented sectors heavily dependent on the eurozone.

Medium-term measures

- Appropriate mix of concessional financing (loans and grants) from development partners, other than the EU, to meet investment financing gaps in the medium term;
- Support to initiatives aimed at the creation of new SEZs and at improving access to the African market.

In addition, an appropriate framework to support small economies like Mauritius, the sub-Saharan African region and the African subcontinent at large will help address growth development challenges in the 2010s. The G-20 could support this in the following key areas:

- Inject additional liquidity into regional financial institutions and regional development banks to meet African economies' financing needs for investment. This needs to be supported through concessional financing and technical support;
- Review the debt relief strategy, especially in the context of the global financial crisis, in order to support highly affected African economies;
- Support the development of SEZs in the context of accelerated Regional Integration. The SEZ would be an area where Common Market rules immediately apply (see also pages 42-3);
- Encourage fair competition and sound exchange rate policies;
- Put in place a mechanism to address vulnerabilities in small states, especially climate change issues, and a framework for disaster insurance and risk management;
- Implement measures consistent with commitments taken by the G-20 in its previous meetings which include: reforming the financial system to reduce the risk that financial excesses will again destabilise the global economy; avoiding destabilising booms and busts in asset and credit prices; ensuring that the regulatory system for banks and other financial firms reins in the excesses that led to the crisis; raising capital standards; implementing strong international compensation standards aimed at ending practices that lead to excessive risk taking; stepping up actions to reduce the development gap among regions; maintaining openness; moving towards greener, more sustainable growth; and fighting protectionism.

17. St. Lucia

By Isaac Anthony

Impact of the crisis

St. Lucia is a small and highly open island economy that has been hit hard by the global financial and economic crisis. As in most small developing countries, the crisis led to a significant deterioration in St. Lucia's economy, resulting in a contraction in GDP, a rise in the level of unemployment and a weakening of the government's fiscal position.

The decline in economic activity was driven mainly by a fall in stay-over tourist arrivals, lower production in the agricultural sector and a sharp downturn in construction. The decline in activity in construction was attributable to a fall in FDI inflows as the freeze in international credit adversely affected financing of a number of hotel construction projects.

As in most Caribbean countries, the downturn in economic activity in St. Lucia resulted in higher levels of unemployment and a reduction in spending, which was reflected in lower volumes of imports of consumer and investment goods. While this development had a positive impact on the current account of the balance of payments, it resulted in deterioration in the public finances, as approximately 60% of St. Lucia's revenue is based on imports.

Notwithstanding the decline in revenue collection, expenditure outlays increased, resulting in deterioration in the fiscal position. This outturn led to a widening of the overall central government fiscal deficit to 4.8% of GDP in FY 2009/10, compared with a deficit of 1.9% of GDP in the previous year. Public debt as a percentage of GDP rose from 66% in 2008 to 71% in 2009, associated with increases in borrowing to finance the budget deficit.

'The 'beyond aid' policies of the G-20 in creating the enabling environment for development are especially critical'

Small developing countries like St. Lucia did not cause the crisis, yet are most susceptible to its effects, and the negative impact of the crisis will last longer in countries such as this than in the more resilient economies. The crisis exposed structural weaknesses in the economy, reflected in the unsustainable fiscal and debt positions. At more than 70% of GDP, St. Lucia's public debt is projected to increase as expenditure pressures mount, in the context of a narrow tax base characterised by a low level of tax buoyancy. However, as St. Lucia undertakes significant structural and fiscal reforms over the medium term, growth in the public debt is projected to slow, reflecting improved fiscal performance.

While St. Lucia was largely spared the adverse effects of the crisis of the global financial environment, the decline in the domestic economy was compounded by the collapse of a large regional insurance company with branches in St. Lucia.

The adverse impacts of the combination of global and regional shocks prompted the government of St. Lucia to implement a number of measures designed to mitigate the social, fiscal and regulatory challenges that arose. To mitigate the impacts of the price shocks, the government implemented a number of measures to protect the most vulnerable, including:

- The creation of short-term employment programmes;
- The suspension of import duties and other taxes on basic consumer items;
- The establishment of controls on retail mark-ups and profit margins;
- The provision of limited commodity price subsidies to vulnerable groups.

Medium-term prospects and strategies

The crisis has adversely affected St. Lucia's medium-term growth prospects as uncertainty has emerged about several major projects financed by FDI. Over the past 10 years or so, foreign-financed investments have been the main drivers of growth in the economy, through the construction of hotels and other commercial entities. These investments have driven activity in the construction sector, with significant spillover effects on a wide segment of overall economic activity, supporting increases in employment and consumer spending. However, the crisis has resulted in a sharp drop in foreign investments, as several pipeline projects have been delayed or are unlikely to start soon.

The crisis has exacerbated an already weak growth performance. Over the past 10 years (2000 to 2009), St. Lucia's GDP growth rate has averaged only 1%, with the highest rate of 4.8%, achieved in 2006, attributed to the hosting of the Cricket World Cup. This level of performance falls far short of the 6% annual growth rate required to transform the country into a modern competitive economy and to reduce poverty and strengthen resilience to adverse external shocks. Achieving this level of growth will require enormous increases in competitiveness and productivity, particularly in the services sectors, such as tourism.

The government of St Lucia, in its strategic response to the crisis and in laying the foundation for growth, is pursuing a medium-term growth strategy focusing on emerging new sources of growth, such as offshore education, health and wellness tourism and high-end ICT, and expanding existing critical sectors, such as tourism, agriculture and manufacturing.

The signing of an economic partnership agreement (EPA) with the EU in 2008 and the implementation of the Caribbean Single Market and Economy (CSME) will bring new sets of challenges and opportunities for St. Lucia. The government's strategic priority is to develop meaningful partnerships with the private sector in meeting these challenges and taking advantages of the opportunities provided. However, the government recognises that this will require a host of general improvements in the business environment, including strengthening the investment climate, expanding the skills base, promoting innovation and technology adoption and improving international transport services and other infrastructure.

The government has responded to the challenges by developing specific programmes and projects to improve the business climate in St. Lucia.

Role of the G-20 in promoting growth

The role of the G-20 countries in stabilising the global economy and restoring growth is critical for small developing countries like St. Lucia. As the focus of the Toronto G-20 summit is on laying the foundations for sustainable and balanced growth, St. Lucia is keenly interested in benefiting from policies of the G-20 countries that will lift the growth prospects of the global economy. Resumption of sustainable global growth and increasing consumer and investor confidence are essential to the return of foreign private capital inflows that are absolutely necessary for a resumption of growth in St. Lucia.

The decision by the G-20 in 2009 to triple the resources of the IMF was to the benefit of St. Lucia and other small developing countries, through the availability of a greater amount of resources for lending. Already, St. Lucia, like most other IMF member countries, has benefited from an increase in special drawing rights (SDRs) allocations by the IMF.

The support of the international community, and of the G-20 countries in particular, is necessary if St. Lucia is to fulfil its goal of sustainable development, thereby improving the standard of living of its population. The 'beyond aid' policies of the G-20 in creating the enabling environment for development are especially critical in this regard.

Part 5: The G-20 growth framework: regional and group perspectives

18. How the G-20 can accelerate growth in Africa: a regional investment and growth compact

By Ali Mansoor

Among the key issues for developing countries in Africa is how to increase their share in global exports and FDI.

The Doing Business and Competitiveness indicators (and others such as the World Bank's Country Performance and Institutional Assessment) have been helpful in allowing countries to benchmark their current situation and progress relative to good practice around the world. However, use of these indicators to improve policy has been ad hoc and uneven. Moreover, many countries, particularly those in the lower-income group, have difficulty setting their own priorities for reform as a result of coordination problems among policymakers.

Indicators offer an opportunity to address the coordination problem and to accelerate and lock in reform if it is embedded in an organised operational programme. Moreover, to enhance ownership, there may be high value added from linking such a programme to the regional integration agenda, particularly in sub-Saharan Africa.

The G-20 may assist in bringing prosperity to Africa by helping replicate earlier progress in China and East Asia and drawing on the lessons from Eastern Europe after the fall of the Berlin Wall. These efforts can be undertaken under AfT, with efforts to mobilise additional financing (to the International Development Association (IDA) and the African Development Fund (ADF)) from the existing commitments of donors in this respect.

A newly proposed G-20 initiative would provide a fast track to lower barriers to cross-border activity while making Africa a more attractive investment destination. It would borrow on the successful approach to regional integration in Europe and the positive development experience of China. It would also provide a practical way to rapidly improve the investment climate of countries in Africa and accelerate the implementation of regional infrastructure projects. This would be accomplished in an innovative manner that emphasises:

- Ownership by the regional economic communities (RECs) (both Secretariats and member states);
- Identification of the most significant barriers to economic activity in the countries in consultation with the private sector;
- Peer-to-peer learning, support and capacity building to formulate and implement the programme;
- Immediate attainment of common market rules in zones, converging over time with the lowering of barriers in the rest of the region and acting as a precursor to what could be achieved in the sub-regional RECs envisaged under the Abuja Treaty;
- Development of a five-year implementation programme for each country that is driven by domestic and foreign investors and the RECs, with support from the international community.

'A newly proposed G-20 initiative would provide a fast track to lower barriers to cross-border activity while making Africa a more attractive investment destination'

These objectives would be achieved by improving the business environment, by drawing on direct and indirect feedback from domestic and foreign investors and through peer-to-peer learning and capacity building (customised workshops, bilateral technical assistance, study tours and attachments).

To move ahead on this agenda, development partners would need to focus assistance on unlocking policy reform at the regional level (lowering barriers to achieving a common market and creating a conducive business environment), in addition to regional (infrastructure) projects and capacity building of RECs. This could be done by mobilising the AfT commitments of the international community in favour of a pilot in Eastern and Southern Africa (where work is more advanced).

The specific proposal is for the G-20 to build on ongoing discussions as follows:

Overview

- Under the auspices of the G-20, interested countries and the Secretariat(s) of the relevant REC meet

with interested development partners.
- A commitment is taken by participating countries to implement in annual tranches over five years the policy package that they negotiate with the RECs and that is approved by the development partners. The programme would consist of some elements that are directly and indirectly identified by the private sector.

Measures directly indentified by the private sector

Regional projects to be undertaken by the private sector

- The participants agree on a limited but ambitious set of regional projects to be undertaken by the private sector as purely private or as public-private partnership projects.
- Where feasibility studies exist, these are used to mobilise the private sector to identify a lead promoter for each project. Where needed, feasibility studies are commissioned by the development partners.
- The main private sector promoter of each agreed regional project communicates to the relevant REC Secretariat the reforms that each country must implement so that the infrastructure project is viable and can be rapidly implemented.

The most significant barriers to economic activity across borders within Eastern and Southern Africa

- Each country identifies 20 barriers (to the flow of goods, services, capital or labour) that would not exist in the fully functioning tripartite agenda common market and that are the most bothersome to participating countries. These barriers are identified through consultations with the private sector of each country and with potential or actual foreign investors.
- The barriers are dismantled on a most-favoured nation (MFN) basis among participating countries and are extended on this basis to other countries that join the programme later.

Measures indirectly identified by the private sector

- In addition to the barriers directly identified by the private sector, the G-20 identifies barriers that would need to be lowered to unlock growth or equity. In particular, this includes aligning within three to five years each of the ADB/WEF/World Bank Doing Business and Competitiveness indicators to best practice in Africa as of 2010.

Special economic zones

- Countries are encouraged to set up at least one common market zone, along the lines of the SEZs of China, where the rules of the common market (as envisaged by Abuja) would immediately apply. This would not be a requirement to participate in the scheme but only an additional potential enhancement. Also, the zones would not be enclaves. Instead, they would be open to all investors from across the globe and all labour from any participating country. These zones, like in China, would be fully residential, with housing to be built for the workers as part of setting up the zone. The zone would be a precursor to what the whole region would look like and, as barriers fall under the initiative proposed here, there would be a convergence and eventual integration of the national and regional economies and the zones.

19. Giving voice to the 'residual': putting the least-developed countries on the G-20 Agenda

By Debapriya Bhattacharya

Against the backdrop of uneven and faltering global recovery – underpinned by debates on fiscal consolidation and coupled with the threat of sovereign debt crisis – the fourth summit of the G-20 is to take place in Toronto at the end of June 2010. Following up on the work carried out since Pittsburg (September 2009), the high conclave is expected to address a whole gamut of issues relating to entrenched global imbalances and reforms of international economic and financial governance. The outcome of the summit will have ramifications for economies far beyond those represented in the group.

Inclusion of the residual

It may be recalled that the summit-level G-20 was created as a default option of the G7 (+1), reflecting recognition of the role of the key emerging market countries – often enjoying large foreign exchange reserves and current account surpluses – in devising responses to global economic and financial crisis. However, the number 20 was never sacrosanct (currently, there are 19 core members); rather, it embodies the attempt to cover the 'systemically important industrialised and developing countries'. It is often mentioned that these countries represent 90% of global gross national product (GNP), 80% of world trade and two-thirds of the world's population. These numbers not only indicate the overwhelming nature of representation of the platform, but also points to existence of a 'residual'.

It is largely the UN-designated LDCs that constitute this residual: 49 LDCs currently host 12% of the world's population, with more than 52% living on less than $1 a day (PPP). The countries account for less than 2% of world GDP and around 1% and 0.5% of the world's trade in goods and services, respectively.

Throughout the 2000s, the LDCs have been hit by the fuel, food and financial crises – which for the most part originated in international markets. As a result of the recent financial crisis, the number of the poor in these countries is set to rise by 6.1 million in Africa and 1.2 million in Asia. The absence of 'innocent victims' in the G-20 creates a moral hazard: the decision-making process is dominated by those who are largely responsible for the current economic and financial crisis. This issue of representation becomes particularly pertinent as the G-20 is engaged in a norm- and standard-setting exercise of universal relevance.

In this connection, the invitation to the Toronto meeting extended to Malawi and Ethiopia, which are both LDCs, is a welcome development. These two countries are being brought in to ensure regional balance, as they are currently chairing the AU and NEPAD, respectively. Similarly, Vietnam is being invited as the Chair of ASEAN.

Nevertheless, the rightful inclusion of Africa in the G-20 process does not address the need to give a voice to structurally handicapped LDCs, nine of which are in Asia and another six of which are island states in the Pacific. In fact, the recent earthquake in Haiti – the only LDC in the Caribbean – further exposed the vulnerabilities of this group in the face of exogenous shocks.

While recognising the sensitivity involved in participation and representation in the G-20, it could safely be suggested that the coordinator of the LDCs in the UN system, which currently happens to be Nepal, should be invited to the high table.

'While recognising the sensitivity involved in participation and representation in the G-20, it could safely be suggested that the coordinator of the LDCs in the UN system, which currently happens to be Nepal, should be invited to the high table'

The agenda for structural transformation

The rationale for securing a voice for the LDCs is motivated primarily by the need to put their developmental concerns on the agenda of the G-20. A recent study by UNCTAD shows that, notwithstanding high pre-crisis growth, the LDCs have failed to experience any structural transformation of their economy over the past decade that would have positioned their economies on a sustained and inclusive development trajectory. Economic growth in these countries has been dictated largely by external factors, including volatile commodity prices, inefficient trade preferences and concentration of foreign investment in extracting industries. Foreign remittance flows have also played an important role. Accessing foreign aid has remained a problem in terms of both quantity and quality. A number of the countries have experienced squeeze in trade finance. Most importantly, stimulus packages deployed in certain countries are having negative spillover on the competitiveness of the LDCs. Thus, the group's average growth rate is going to fall from 7% in 2008 to 4% in 2009 and even lower in 2010.

The LDCs are a major stakeholder of the G-20's core agenda for reviving economic growth, ensuring market stability and pursuing reform of global economic governance. But the G-20 needs to give active and concrete attention to the current developmental concerns of the LDCs. Some of the priority areas are: committing DFQF access for all products from all LDCs (as the Doha Round remains inconclusive); ensuring disbursement of foreign aid as per international commitments; incentives for encouraging foreign investment flows to the LDCs; a moratorium on stimulus measures that affect the competitiveness of LDC economies; and calibrating global financial regulations to the needs of the LDCs.

The agenda for the transformative growth of the LDCs will gain prominence as the MDG Summit (New York, September 2010) and the fourth UN Conference on the LDCs (Istanbul, May 2011) draw near. It will only be appropriate for the Toronto meeting of the G-20 to take cognisance of the LDCs' concerns and put them substantively on the agenda for the Seoul meeting at the end of the year.

20. The G-20 and the Pacific

By Derek Brien and Nikunj Soni

Vanuatu has been able to ride out the worst of the global financial crisis to date, thanks largely to its performance in recent years, which resulted in an annual average growth rate of 6.6% between 2003 and 2008. The Vanuatu example has dispelled the widespread belief that small Pacific island economies cannot grow and confirms the range of factors that are important for growth in the Pacific: tourism, active land markets, construction, deregulation and macroeconomic and social stability. Vanuatu's resilience in the face of the deepest global economic crisis in 70 years is no accident. A combination of sustained private sector investment and a supportive regulatory environment provided the scope to build up sufficient reserves, which could be drawn on to counter the effects of the global downturn. The Vanuatu economy continues to perform relatively well, with growth forecast at 4% for 2010. The prospects for the medium term will depend on the continued confidence of inward investors, especially in tourism and construction.

As with all Pacific island countries, however, the Vanuatu economy is perilously linked to global markets, with little or no room for the government to influence international actions or policy decisions that affect the lives of its people. The rise in rice and oil prices in 2008 was a significant wakeup call vis-à-vis the Pacific's dependence on imported food and fuel products.

Other countries in the region have not been as fortunate a Vanuatu, with many Polynesian states in particular relying heavily on aid to support their response to the global economic meltdown. Small island states are challenged by the need to embrace closer integration in the global community while maintaining their own unique cultural identity. The sheer diversity of the Pacific, in terms of land size, population, culture, distribution of natural resources and economy size, presents a unique set of development and resilience challenges for small island states.

'It is somewhat staggering that the Pacific islands – with an area that encompasses one-third of the globe and holds the majority of the world's marine resources – have been overlooked for so long by the global community'

Across the region, the impact of the global financial crisis has resulted in reduced or negative economic growth, lower government revenues, increased debt service burdens, declines in the value of offshore investments, decreased private sector activity, loss of jobs and reduced remittances. Moreover, the public sector across the Pacific is typically characterised by weak institutions and capacity constraints that further hinder the implementation of necessary programmes to mitigate the effects of global crises and/or improve resilience. The impacts of climate change have amplified the development challenge in many Pacific island countries, placing additional strains on already limited resources to develop and implement adaptation strategies.

A number of Pacific countries have developed policies and programmes to address the impact of the global crisis. In some cases, governments have pursued a combination of measures, covering: fiscal stimulus packages; accelerated structural reforms; exchange rate management; realignment of budget expenditure; promotion of private sector investment and infrastructure development; social protection policies targeting health and education; and promotion of enterprise development, including through microfinance.

Although the Melanesia states (Vanuatu, Fiji, Papua New Guinea and the Solomon Islands) account for over 80% of the Pacific's population and resources, it is essential for the G-20 countries to start considering the Pacific region for what it is: three distinct sub-regions (Melanesia, Micronesia and Polynesia). The one-size-fits-all approach that has dominated the international development landscape has failed to acknowledge the importance of diversity. As these are some of the youngest nations in the world, it is hardly surprising that it has taken time for the machinery of modern nation building to take hold across the Pacific, something that can perhaps be better appreciated and supported by the emerging global powers – the BRICKs (Brazil, Russia, India, China and Korea).

It is somewhat staggering that the Pacific islands – with an area that encompasses one-third of the globe and holds the majority of the world's marine resources – have been overlooked for so long by the global community. This is an oversight that is rapidly reversing, however. Many international players are now seeking a foothold in the region, to tap into its relatively untouched resources, including deep-sea minerals and access routes. How the Pacific islands manage this newfound interest will in part depend on the support offered by its traditional and new development partners. It is clear that Pacific island nations will never be in a position to compete with the major economies. However, with greater strategic use of their membership of multilateral organisations and bilateral relations, Pacific governments should be seeking to engage more effectively with global policymakers in order to develop mutually beneficial programmes for trade and investment and redress global environmental degradation and climate change.

A more nuanced understanding of the geopolitical role of the Pacific in the global economy will benefit both the small island states and the dominant economies as they attempt to coordinate their responses in an extraordinarily uncertain economic climate.

21. G-20 summits: how can Asia collectively strengthen its voice?

By Pradumna Rana

The G-20 provides an unprecedented opportunity for Asian countries to be heard on matters related to international economic policies. How can Asia further strengthen its voice collectively at the G-20 summits?

The G-20 summit, first held in Washington DC in November 2008, is a process that is still evolving. No one can predict how and where it will end up. The group was self-appointed as the 'premier forum for international economic cooperation'. Important questions related to membership and agenda need to be addressed. But, like it or not, the process is here to stay.

In Pittsburgh, President Obama categorically announced that the G-20 would replace the G-8. Two G-20 summits are planned for this year – in Toronto next month and in Seoul in November. While the Toronto summit is to take stock of the implementation of exit strategies from the expansionary monetary and fiscal policies, the Seoul summit is to focus on two additional longer-term issues. The first is financial safety nets to better insulate emerging markets from systemic instability; the second is actions to close the development gap, especially for the poorest. Issues related to climate change could also be addressed in the G-20. So how should Asia respond?

How should Asia respond?

Asia is represented in the G-20 by six countries – China, India, Indonesia, Japan, Korea and – if it is defined as part of Asia – Australia. In addition to pursuing their bilateral agenda, say with the US or the EU, how can the Asian members of the G-20 jointly synergise and leverage their growing economic and political clout into more effective participation in the G-20? How can Asia collectively strengthen its voice in the G-20? Three suggestions could be offered.

First, realising the centrality of ASEAN in the Asian regional architecture, Asian countries should lobby to formalise the membership of the ASEAN representatives in the G-20. Under the present G-20 practice of inviting representatives of regional groupings, the ASEAN Chair and the ASEAN Secretary-General participated at the London and the Pittsburgh summits. The ASEAN Leaders Statement from the Hanoi summit of 9 April 2010 states that 'ASEAN strongly believes that it can contribute to the deliberations of the G-20 through the continued participation of the ASEAN Chair and the ASEAN Secretary-General in the future G-20 summits'. In addition, however, strong diplomatic efforts are required by Asian countries to formalise and regularise the participation of ASEAN representatives in future G-20 summits

Second, Asian countries should organise meetings of the 'expanded' ASEAN+3 just prior to the G-20 summits to coordinate policies and develop common views and opinion to support the participation of the ASEAN representatives in the G-20. Since the Asian financial crisis, a number of fora for policy coordination have been established such as the Executives Meeting of East Asian and Pacific Central Bankers and the ASEAN Surveillance Process. Among these, the most comprehensive and the one with the strongest technical support is the ASEAN+3 Economic Review and Policy Dialogue (ERPD), which brings together finance ministers and deputies of 13 countries (ASEAN plus China, Japan and Korea). A system to monitor financial sector vulnerabilities and early warning systems of banking and financial crises has also been established. Recently, Singapore announced that it would establish an ASEAN+3 Macroeconomic Research Office by May next year to support the ASEAN+3 ERPD.

'The G-20 has provided an unprecedented opportunity for Asian countries to be heard on the reform of international monetary and financial architecture and other issues. The onus is now on the Asian countries'

Reflecting their growing economic weight and linkages with other countries in the region, Australia, India and New Zealand should also be invited by the ASEAN+3 to join its policy coordination meetings. The deliberations of the 'expanded' ASEAN+3 prior to the G-20 summits would provide a robust agenda for the ASEAN representatives to table at the summit.

Third, Asian countries should coordinate their views and positions with those of developing countries in other regions of the world by joining and supporting the informal Global Governance Group (or the 3G) convened by Singapore under the auspices of the UN. This currently comprises about two dozen small and medium states from around the world (of which six are from Asia – Brunei, Malaysia, New Zealand, Philippines, Singapore and Vietnam) which have come together to develop a constructive dialogue on coordination and cooperation between G-20 and non-G-20 members.

The 3G has put forward several important ideas in a UN document. The UN Secretary-General should be an active participant in all aspects of the G-20 process. The G-20 should also undertake consultations as widely as possible with the non-G-20 members before the G-20 summits. The G-20 should allow non-G-20 states to participate in ministerial and other gatherings and other working groups involving senior officials/experts on specialised issues. Finally, the G-20 should continue the practice of inviting established regional groupings to the summits.

The G-20 has provided an unprecedented opportunity for Asian countries to be heard on the reform of international monetary and financial architecture and other issues. The onus is now on the Asian countries.

22. Towards a partnership between the G-20 and low-income countries for strong, sustainable and balanced growth

By Dirk Willem te Velde

The previous three essays have suggested a number of ways through which the G-20 and non-G-20 countries (here LICs, with a broad definition) can work together:

- The non-G-20 to work via the UN to have a formal seat at the G-20 (the 3G proposal, as discussed by Pradumna Rana);
- The LDC group to have a seat via the LDC Group at the UN (e.g. Nepal), and the G-20 to acknowledge the fourth UNCTAD conference on LDCs in Turkey (as discussed by Debapriya Bhattacharya);
- An African investment and growth compact to be set up (Ali Mansoor).

Each of these ideas require a different way of working together, which would need to be discussed in detail (e.g. geographically, formally). There are advantages and disadvantages to each in terms of legitimacy, complexity and ambition.

It is important that the proposals are as specific as possible with respect to growth. We think a set of principles behind a successful partnership between the G-20 and LICs on growth should:

- Improve the legitimacy of their joint actions;
- Not lead to an undue amount of new bureaucracy;
- Lead to improved collective action to promote strong, sustainable and balanced growth;
- Focus on the medium term (three to five years).

To reflect these principles, we suggest that there could be a new partnership between the G-20 and LICs, with at its heart the promotion of strong, sustainable and balanced growth, and which consists of a set of veritable and mutually reinforcing policy commitments on both the G-20 and the LIC side. We call this a G-20–LIC charter for crisis-resilient and transformative growth. The type of commitments on the G-20 and LIC side can be informed by discussions in this volume. For example, Part 2 discusses which G-20 core economic policies are important for LICs, and Part 3 discusses the key growth constraints at country level for the medium term.

The G-20 has initiated a development working group, and one of the first tasks could be to flesh out how the G-20 and LIC can work together on growth, e.g. by meeting annually. It would need to agree some simple indicators to measure progress and commitments (e.g. total factor productivity, degree of investment, research and development (R&D) spending, workers with technical tertiary education, degree of diversification).

The development working group could also aim to share experiences and information through organising joint business meetings and learning on growth and industrial policies.

The proposed growth charter for crisis-resilient and transformative growth has the following elements:

A G-20–LIC 20-point charter for crisis-resilient and transformative growth

- **The G-20 to recommit to the framework of strong, sustainable and balanced growth and follow core policies in order to achieve this, including:**
  - Deficit countries to increase savings (US);
  - Europe to consolidate its budgets and engage in structural reforms to boost growth;
  - Emerging economies to revalue the exchange rate (e.g. China);
  - Emerging economies to boost domestic demand by raising social safety nets ensuring that households save less; and
  - Germany and Japan to provide greater incentives for their companies to invest.

- **LICs to provide plans, and benchmark their efforts, to promote transformative growth by:**
  - Building productive capacities and fostering productivity change;
  - Promoting economic diversification and competitiveness;
  - Promoting private sector development;
  - Providing energy and road infrastructure, and responding to the challenges of development in a carbon-constrained world;

- Investing in good quality and appropriate human capital to improve labour productivity;
- Ensuring and improving technological capacity to adopt new and implement old technologies;
- Streamlining governance and bureaucracy.

- **The G-20 to consider the effects of its core economic policies on LICs and, where appropriate, make its policies more developmentally friendly in areas such as:**
  - Exiting fiscal and monetary stimuli in a developmentally friendly way;
  - Appropriate financial regulation taking into account the capital needs of poor countries; and
  - Rebalancing the global economy, using reserves for global growth and promoting flexible exchange rates.

- **The G-20 to consider the policy coherence and effects of its external policies on growth in LICs in areas such as:**
  - Aid to address global challenges and transformative growth (AfT, e.g. supporting technical change and infrastructure, or filling the skills capabilities gap);
  - Provision of global financial liquidity, stimulating financial inclusion and investing international reserves for global growth;
  - Providing incentives for outward FDI to LDCs and support for SEZs drawing on local capabilities;
  - Promoting open trading rules; and
  - Removal of fossil fuel subsidies.

Conclusions

By Dirk Willem te Velde

The aim of the G-20 growth framework is to encourage G-20 countries to implement coherent medium-term policy frameworks to attain a mutually beneficial growth path and avoid future crises. While the position of LICs in the growth framework is not well defined, this volume has shown that LIC growth clearly depends on G-20 policy actions to promote strong and sustainable growth. This paper has combined a number of essays considering the role of low-income, small and vulnerable countries in the G-20 growth framework, ahead of the Toronto and Seoul G-20 summits. It offers food for thought for those interested in the development dimension of the G-20 and informs countries such as Ethiopia, Malawi and Vietnam for upcoming summits. It provides views from around the world, based on work with experts, officials and think-tanks.

> **'The G-20 growth framework affects LICs and it is therefore important that they are involved; even though the main discussions and policy decisions will be among the G-20 there may be opportunities to promote a development dimension'**

The briefings have brought up a number of clear conclusions:

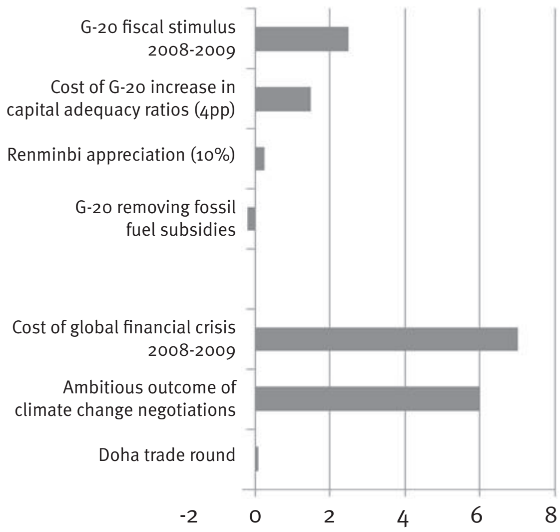
Global economy, emerging markets and low-income countries

- Emerging markets play an increasingly important role in the world and within the G-20. Asian countries are leading the global recovery, increasing their share of global GDP fast. China and India alone are expected to increase their share in world income from 15% in 2007 to 21% in 2014. Asian countries have most of the international reserves (four of the top six are Asian) and have significant current account surpluses.
- The rise in emerging markets has implications for LICs. Emerging markets have maintained imports from LICs more than developed countries have (developed country imports from LICs fell by twice the amount of emerging market imports from LICs); emerging markets have ramped up FDI and bank lending to LICs (doubling in the case of Brazil and Turkey's lending), whereas developed countries have withdrawn investments and bank lending (-5%); and there are some indications that remittances from emerging markets to LICs have also held up better. The correlation between growth in emerging markets and LICs has also grown recently.

The effects of G-20 economic policies on low-income countries

- There is a fine balance between stimulating the economy and ensuring a global recovery in the short run on the one hand, and fiscal sustainability and reliance on the private sector on the other. A rapid withdrawal of fiscal stimuli might contribute to a double-dip recession. This could also have severe negative spillovers for LICs, which we suggest could be around 2.5% of African GDP.
- The quick introduction of new G-20 rules on bank capital and liquidity ratios (Basel III) may lead to less bank lending and hence less growth in LICs – we suggest that this could be around 1.5% of African GDP. Against this, there would be a likelihood of fewer banking booms and busts over the longer term.
- A rebalancing of the global economy involves exchange rate changes that will affect LICs – we suggest that a 10% appreciation of the renminbi (which is currently pegged to the US dollar) would boost African incomes by 0.25%. There should be more attention towards using international reserves, e.g. via investing reserves through SWFs in poor countries rather than investing in US treasuries.
- External policies such as the extension of DFQF by

Figure 23: Effects of G-20 own and G-20-supported economic policies on sub-Saharan African GDP



Sources: Own calculations and reviews in this paper.

all of the G-20 to LDCs would benefit those that receive new preferences but weaken old preference takers (WTO) or competitors. The G-20 could provide new political impetus to the stalled Doha Round (this broke down in 2008 as a result of disagreements among G-20 members), which could boost African GDP by around 0.1%. A simple reiteration of the need to avoid protectionism might be easier to achieve.
- The G-20 has agreed to cut fossil fuel subsidies; although this would cut emissions and increase developed country welfare, welfare in LICs would decrease; on the other hand, the G-20 (and the BASIC countries fall within this grouping) might lend support to climate negotiations which, when successful, could (Cantore at al. 2009) increase African incomes by 6%.

Country views
- Medium-term growth prospects vary and have been affected in differing ways by the global financial crisis; prospects differ from 1% in St Lucia, to 4% in Bolivia, to 4-5% in Mauritius and 6-7% in Bangladesh.
- The country briefs suggest a number of growth constraints that can be addressed by national governments:
  - Build productive capacities;
  - Promote economic diversification and competitiveness;
  - Promote private sector development;
  - Provide energy and power infrastructure;
  - Invest in human capital to improve labour productivity;
  - Ensure and improve technological capacity;
  - Streamline governance, bureaucracy and corruption mechanisms.
- The country papers suggest that there is a role for the G-20 in promoting growth in LICs, e.g. by using:
  - G-20 incentives for FDI and support for SEZs in LICs;
  - Market access and AfT;
  - Strong market growth free from protectionism;
  - Sufficient financial liquidity;
  - Technical assistance, vocational training and promotion of new technology;
  - G-20 meeting with LDCs;
  - A regional compact among LICs and the G-20 for investment and growth.

Bumps in the road to Seoul

The G-20 growth framework affects LICs and it is therefore important that they are involved; even though the main discussions and policy decisions will be among the G-20 there may be opportunities to promote a development dimension, e.g. via a permanent formal seat at the G-20 or informal meetings of the G-20 development working group. Measures directly under the control of the G-20 could raise African incomes by 4.1%, and the G-20 could provide impetus to global negotiations that would add a further 6.1%. Low-income, small and vulnerable countries need a permanent seat at the G-20 table and would need to follow the same sherpa process and be informed by analyses.

Several development issues require urgent attention before the G-20 meeting in Seoul:
- How do LICs take part in G-20 preparations? What support do they need?
- What are the most development-friendly ways of withdrawing fiscal stimuli?
- What are the most development-friendly ways of regulating financial systems while ensuring sufficient capital flows to LICs?
- How could the G-20 promote FDI and SEZs in LICs?
- How can the G-20 rebalancing best benefit LICs (e.g. using international reserves to promote global growth, appropriate use of DFIs).

The G-20 meetings are also a reminder that economic power is shifting towards emerging markets, especially in Asia, and implications for LICs need to be considered:
- Emerging markets have maintained imports from LICs more than developed countries; what is the structure of trade patterns and how can this best facilitate diversification and technological change in LICs?
- Emerging markets have increased FDI and bank lending to LICs, whereas developed countries have withdrawn investments and lending; how can emerging market funds best promote LIC growth and technological change?
- Remittances from emerging markets to LICs have also held up better; are they a significant force in LIC growth?
- South–South development cooperation is increasing; what are the implications for the development policies of the other G-20 countries to promote LIC growth?

What are appropriate targets for LIC national governments in the following areas? And how can these be measured?
- Building productive capacities;
- Promoting economic diversification and competitiveness;
- Promoting private sector development;
- Providing energy and power infrastructure;
- Investing in human capital to improve labour productivity;
- Ensuring and improving technological capacity;
- Streamlining governance, bureaucracy and corruption mechanisms.

We hope that this volume of essays will help strengthen the development dimension of the G-20 framework for strong, sustainable and balanced growth, leading to a growth compact between LICs and the G-20.

Table 18: Country views – summary

	Medium-term growth prospects after the global financial crisis	Growth constraints and role of national government	Role of the G-20
Bangladesh	GDP growth projections, earlier targeted at 6% for FY2009/10 would perhaps now be in the range of 5.5-5.7%. Lower than expected export performance and substantial energy shortages have dampened growth outlook compared with what was envisaged, perhaps hovering around 6-7% over the next 2-3 years.	Addressing energy and power issues will require substantial investment on the part of the government in terms of exploration, putting in place productive capacities and building the required infrastructure, even though some of these are envisaged to be carried out in partnership with the private sector.	Fully implement the Hong Kong Ministerial Declaration with regard to DFQF; commitments on AfT; to stimulate FDI flow to LDCs, the G-20 could consider special incentives for investors from developed countries who are willing to invest in selected sectors in the LDCs; the G-20 should have a special meeting with the LDCs.
Bolivia	4% a year flat for the period 2010-1014; low growth rates cannot be ascribed to the crisis, however, but to extremely low investment.	Good-quality jobs and increased labour productivity; human capital; investment opportunities; physical infrastructure; access to enlarged markets.	Emerging G-20 economies, such as China, India, Korea and Brazil, will demand raw materials and other semi-manufactured inputs from Bolivia; attract FDI and technology not only in hydrocarbons and mining but also in manufacturing and agro-industry, which are labour intensive.
Cambodia	The crisis has severely disrupted the speed of Cambodia's economic growth by affecting key yet fragile sectors such as the garment industry, tourism and construction, all of which are very vulnerable to external shocks.	Diversification; competitiveness in garments and tourism, diversify crops and increase crop yields and improve industrial linkages; environmental protection and good management of natural resources; weak governance, bureaucracy and corruption; labour costs are relatively low but labour productivity is far lower than in other countries in the region.	Technical assistance in the form of governance and public finance management; support in vocational training; incubating micro, small and medium enterprises; modernising agriculture industry by adopting new technology and improving irrigation; investment from countries in the G-20.
Mauritius	The financial crisis and euro crisis cut growth by 1.5-3% cent over 2009-2012.	Traffic congestion, remoteness of key markets, weak competitiveness, poor infrastructure and shortage of local manpower, skills and technical capacity.	Injecting additional liquidity in the regional financial institutions; reviewing debt relief strategies; supporting development of SEZs; encouraging fair competition and sound exchange rate policies; putting in place mechanisms to address vulnerabilities of small states, especially climate change issues and a framework for disaster insurance and risk management; implementing measures consistent with commitments taken by the G-20 in previous meetings.
Pacific/ Vanuatu	Vanuatu has been able to ride out the worst of the crisis to date, thanks largely to its performance in recent years that resulted in an annual average growth rate of 6.6% between 2003 and 2008. Other countries in the region have not been so fortunate, with many Polynesian states in particular relying heavily on donors to support their responses to the global economic meltdown.	Fiscal stimulus packages; accelerated structural reforms; exchange rate management; realignment of budget expenditure; promotion of private sector investment and infrastructure development; social protection policies targeting health and education; and promotion of enterprise development including through microfinance.	Acknowledge diversity of Pacific, perhaps best done by the emerging markets.
St. Lucia	The crisis has exacerbated a weak growth performance of 1% GDP growth over the past decade.	Government needs to improve the business environment, skills base, innovation and technology adoption, transport services and infrastructure,	A stable global economcy, with resulting capital flows is critical for St. Lucia. An increase in the IMF SDR allocation was helpful; 'beyond aid' policies are critical.

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Cantore N., Peskett L. and te Velde D.W. (2009) Climate Negotiations and Development: How Can Low-Income Countries Gain from a Climate Negotiation Framework Agreement? Working Paper 312. London: ODI.

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ISBN: 978-1-907288-24-1

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