The G-20 Growth Framework and Mutual Assessment Process (MAP), launched at the group’s summit in Pittsburgh in 2009, has emerged as the key means for members of the Group of 20 to coordinate their economic policies to achieve their shared growth and development objectives. These shared objectives include the achievement of “strong, sustainable and balanced growth” among G-20 members. They also include “raising living standards in emerging markets and developing countries.” Growth and development in the developing world are seen as “a critical element in achieving sustainable growth in the global economy.” The inclusion of development as part of the G-20 Growth Framework and MAP provides a valuable opportunity to incorporate development issues more systematically and integrally into G-20 policy discussions.

Against this background, and as an input into the consideration of development issues as part of the G-20 Growth Framework and MAP, this chapter assesses the links between G-20 economic prospects and policies and growth and development in developing countries. It identifies broad policy areas where G-20 collective actions would enhance global development prospects.
Four Key Themes

The chapter is organized around four main themes that emerge from the analysis. First, global development needs robust global growth. As a result, the most important thing that the G-20 can do for development is to secure a strong recovery in growth. Second, “reverse linkages” between developing and high-income countries have become increasingly important. Promotion of strong multipolar growth in developing countries would be a global win-win. It would support development in poorer countries and contribute to strong growth at the global level. It would also contribute to rebalancing of global growth. Third, the outlook for financing for development will be more challenging in the post-crisis environment and will require creative, innovative approaches. Fourth, keeping trade open will be essential for sustained recovery and enabling the growth rebalancing to work. Trade, together with investment and associated flows of technology, is a key channel for multipolar growth and diversification of global demand.

Theme I: Centrality of Global Growth to Development

Global growth is central to development. Through trade and finance links, economic outcomes in advanced economies have a significant effect on developing countries. As the recovery matures, the longer-term growth agenda should increasingly be the focus of G-20 policy coordination. In advanced economies this agenda includes fiscal, financial, and structural reforms that enhance long-term growth potential. In developing countries growth prospects will depend on building on past progress on reforms in macrofiscal management, investment climate, and governance and on achieving requisite investment levels in infrastructure and human capital underpinning growth. Priorities across countries will of course depend on country-specific circumstances.

Postcrisis Economic Outlook for Developing Countries

Economic Growth. Improved macroeconomic policies and structural reforms helped developing countries overall cope with the recent crisis with greater resilience than in some past crises. Nonetheless, the impact was significant. Growth in developing countries fell from an average of
about 7 percent in the five years preceding the crisis to 1.6 percent in 2009. A lingering impact of the crisis response is that a number of countries face fiscal sustainability concerns that could constrain core, growth-related spending.

At the global level the current outlook is for a moderate recovery over the coming five years as economies gradually close output gaps and return to potential growth rates, with the strength of the recovery varying across countries and country groups. From a developing-country perspective, there is concern that the recent crisis could impact potential GDP growth over the medium term for a variety of reasons. For example, increased public sector financing needs in high-income countries could raise the cost of development finance, and fiscal stress might also reduce flows of concessional finance.

The outlook for developing countries is for average growth recovering to about 6 percent in 2010–12, with a relatively strong economic recovery in the more dynamic emerging markets and a more gradual recovery in other developing countries, including most low-income countries (figure 4.1, table 4.1). Growth in middle-income countries, which were more seriously affected by the financial crisis given their

![Figure 4.1](image-url)

**Figure 4.1. Growth Is Recovering, But Sustainability Will Depend on Supportive Policies**

Source: World Bank staff calculations.
Table 4.1. Base-Case Growth Outlook for Developing Countries (percent)

<table>
<thead>
<tr>
<th>GDP Growth</th>
<th>Average</th>
<th>2008</th>
<th>2009</th>
<th>2010f</th>
<th>2011f</th>
<th>2012f</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing Countries</td>
<td>7.5</td>
<td>5.9</td>
<td>1.6</td>
<td>6.1</td>
<td>6.0</td>
<td>6.2</td>
</tr>
<tr>
<td>Middle-Income Countries</td>
<td>7.5</td>
<td>5.9</td>
<td>1.5</td>
<td>6.1</td>
<td>5.9</td>
<td>6.2</td>
</tr>
<tr>
<td>- Of which: G-20 Members</td>
<td>8.0</td>
<td>6.3</td>
<td>2.2</td>
<td>7.2</td>
<td>6.6</td>
<td>6.7</td>
</tr>
<tr>
<td>Low-Income Countries</td>
<td>6.4</td>
<td>5.8</td>
<td>4.6</td>
<td>5.1</td>
<td>6.3</td>
<td>6.3</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>10.2</td>
<td>8.5</td>
<td>7.1</td>
<td>8.7</td>
<td>8.0</td>
<td>8.3</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>7.0</td>
<td>4.8</td>
<td>–5.3</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>5.1</td>
<td>4.1</td>
<td>–2.4</td>
<td>4.3</td>
<td>3.9</td>
<td>4.2</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>5.1</td>
<td>5.8</td>
<td>3.0</td>
<td>3.4</td>
<td>4.2</td>
<td>4.8</td>
</tr>
<tr>
<td>South Asia</td>
<td>8.8</td>
<td>4.9</td>
<td>6.3</td>
<td>7.3</td>
<td>7.8</td>
<td>7.5</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>6.3</td>
<td>5.0</td>
<td>1.6</td>
<td>4.4</td>
<td>5.0</td>
<td>5.3</td>
</tr>
</tbody>
</table>

Memo:
Developing Countries excluding China and India 5.9 4.6 –1.8 4.3 4.4 4.6


deeper integration with international capital markets, is projected to recover quickly from the low of 1.5 percent in 2009 to around 6 percent, strong but still below average growth of precrisis years. Low-income countries were affected by the crisis more through the trade channel. They were initially less affected by the crisis because of their weaker capital market links, but their growth dropped, though by less than in middle-income countries, as the resulting recession depressed demand for their exports and caused export volumes and commodity prices to decline. Countries with a heavier dependence on a few commodity exports felt the recession more severely. Low-income country growth could return to about 5 percent in 2010, again with some ground to cover to return to the precrisis growth rates.

Among developing regions the recovery is projected to be most robust in Asia. The Europe and Central Asia region is expected to see more moderate growth, because several countries in the region were among the hardest hit by the crisis. Sub-Saharan Africa is expected to return to growth on the order of 5 percent in 2011, with prospects in several countries in the region tied closely to recovery in commodity markets.
Progress in developing-country policies over the past decade or so accelerated trend growth. There is evidence of some decoupling in trend growth between developing and high-income countries, with the former for a number of years now achieving appreciably higher average growth than the latter. But this does not necessarily mean cyclical decoupling (figure 4.2). As the recent crisis confirmed, the impacts on developing countries of significant cyclical developments in high-income countries remain strong. But the crisis also showed that countries with better policies and economic fundamentals are better positioned than others to withstand shocks.

Even as the recovery gathers strength, growth is expected to be insufficient to close output gaps for several years (figure 4.3). As a result, progress in raising average incomes in developing countries will remain below the precrisis expected levels, and poverty will be higher than had been expected before the crisis. In this sense, there has been a long-lasting impact on the pace of development progress.

**Poverty and the MDGs.** An estimated 64 million more people in developing countries will be living on less than US$1.25 a day (76 million more on less than US$2 a day) in 2010 than would have been the case without the crisis. Even by 2015 the number of additional poor attributable to the impact of the crisis would be 53 million and 69 million, based on these two poverty lines, respectively (table 4.2).

**Figure 4.2. Trend, but Not Cyclical, Growth Decoupling**

Source: World Bank staff calculations.
Labor market developments have been a driving force behind the increase in poverty. The International Labor Organization (ILO) estimates that over the 2007–09 period, unemployment increased globally by 34 million people, of which 21 million were in developing countries (those covered in ILO surveys). In addition, youth unemployment has increased sharply, a troubling development for future employment prospects.

Growth collapses are particularly damaging for human development outcomes. There is an asymmetric response to the economic cycle, with deterioration during downturns being larger than the improvement
during upturns. In addition, the impacts reach full severity only after a lag. As a result of the crisis, it is estimated that 1.2 million more children under five may die between 2009 and 2015, and 350,000 more students may not complete primary school in 2015 (figure 4.4). About 100 million more people may remain without access to safe water in 2015 as a result of the crisis impact.

In brief, the outlook for achieving many of the

Figure 4.4. Impact of Slower Growth on Selected MDGs

- **a. MDG 2: primary completion**
  - The graph shows a comparison between the postcrisis base case and the precrisis trend for primary completion rates. The postcrisis base case shows a slower increase in primary completion rates compared to the precrisis trend.

- **b. MDG 4: under-5 mortality**
  - The graph shows a comparison between the postcrisis base case and the precrisis trend for under-5 mortality rates. The postcrisis base case shows a higher mortality rate compared to the precrisis trend.

*Source: World Bank staff calculations.*
Millennium Development Goals (MDGs) was worrisome before the crisis, and the crisis has imposed a further setback.

The impact of the crisis on poverty and human development outcomes is not confined to low-income countries. A large part of the rise in poverty occurred in middle-income countries, which still account for about two-thirds of the world’s poor people. Nine G-20 members are middle-income developing countries that continue to face major development challenges, such as large infrastructure and human development needs and in some cases large concentrations of poverty. They are home to 54 percent of the world’s extreme poor (58 percent based on a US$2 a day poverty line). These nine countries account for more than half of the estimated increase in global poverty resulting from the crisis. Several of these countries, based on trends to date, are not on track to achieve some of the MDGs (figure 4.5).

**Risks in the Outlook**

The growth outlook for developing countries summarized here is subject to risks and uncertainties. Domestically many countries face increased fiscal strains. Externally the risks pertain to the prospects for the global economy and financial markets.

Fiscal deficits in developing countries rose by an average of 3 percent of GDP in 2009 (figure 4.6). While some countries have put stimulus measures in place, in most countries the widening deficit resulted mainly from declining revenues. Although some emerging markets rapidly regained access to international capital, in developing countries with more limited external financing, about half of the deficit increases on average were financed domestically, mainly through bank borrowing. These developments have raised fiscal sustainability concerns in many countries. The risk of debt distress has risen in low-income countries.

Countries were able to cushion the initial crisis impact on core spending—health and education, social safety nets, infrastructure—even though spending growth slowed. But restoring growth in core spending to precrisis levels will be a challenge, especially in infrastructure and in those countries with limited access to capital markets (figure 4.7). Core social and infrastructure spending is critical for poverty reduction and growth but is likely to face particularly severe constraints in low-income countries.
Figure 4.5. Progress of Developing-Country G-20 Members toward MDGs

Source: World Bank staff calculations based on most recent data available in World Development Indicators.

Note: Poverty headcount rate at US$2 a day is included in view of its greater relevance for middle-income countries. Developing-country G-20 members are Argentina, Brazil, China, India, Indonesia, Mexico, Russian Federation, South Africa, and Turkey.
The debt situation in some European countries poses risks to the developing-country growth outlook. A crisis of confidence, default, or major debt restructuring could have serious consequences for the global economy, because the directly affected countries are likely to enter into recession, with potential knock-on effects on the financial health of creditor banks elsewhere in the world. The immediate effects of a deepening
Figure 4.7. Core Spending at Risk

Public social spending
(averages for developing countries)

Government net acquisition of physical assets
(averages for developing countries)

Source: World Bank staff estimates. The right-hand side largely represents infrastructure spending.
and spreading of the problems facing Greece are likely to be contained to other highly indebted high-income countries in Europe. However, the secondary effects of the crisis would have much wider consequences, including impacts on developing countries. Bank staff have conducted simulations of the possible implications of a crisis of confidence stemming from Greece that spreads to other high-income countries in Europe that have been the subject of market concern. These simulations show that the wider impact could be significant: world GDP could be 3–4 percent lower in 2011–12. For developing countries, the impact could be 2–3 percent lower GDP in 2011–12.

Theme II: Multipolarity—A Dynamic Force in Global Growth and Rebalancing

The second theme that emerges from the analysis is that reverse linkages—that is, how developing-country outcomes in turn affect the global economy—also are becoming more important. As noted earlier, developing countries have been growing at a much faster average rate than high-income countries have, and their weight in the global economy has been rising. Whereas their GDP represented about 18 percent of global GDP in 1980, as of 2009 their share had increased to 28 percent of world GDP when measured at market exchange rates (close to 45 percent if purchasing power parity weights are used). Their weight in global trade has grown even faster, rising from 20 percent in 1995 to nearly 30 percent estimated for 2010. Not only has their share in activity increased, their faster growth rates mean that their overall contribution to global growth is larger still. Developing countries contributed around 40 percent of global growth in the past decade. In 2010 their projected contribution will approach 50 percent (figure 4.8). Since 2000 developing countries have accounted for more than 40 percent of the increase in world import demand. They are leading the recovery in global trade, with their import demand rising at twice the rate of that in high-income countries (figure 4.9).

Links among developing countries, or South-South links, also are becoming more important. South-South trade has risen to a third of world merchandise trade. Within regions trade among developing economies has increased substantially, further strengthening regional growth poles. For example, the share of imports originating from
Figure 4.8. Almost Half of Global Growth Comes from Developing Countries

Source: World Bank staff calculations.

Figure 4.9. Developing Countries Are Leading Recovery in Trade

Source: World Bank staff calculations.
other developing countries within the importers’ own region (in 2008) was 29 percent, 20 percent, and 15 percent in Europe and Central Asia, Latin America and the Caribbean, and East Asia and the Pacific, respectively. South-South foreign direct investment has accounted for a third or more of all such investment going to developing countries in recent years. South-South migration is larger than South-North migration.

Developing countries possess a large potential for future growth. They offer abundant opportunities for high-return, high-growth-potential investments (such as in critical infrastructure and human capital that remove bottlenecks to growth), and they have undertaken important reforms in recent years to improve the development effectiveness of their programs and investments. Many, however, face a financing constraint in fully exploiting these growth opportunities. Promotion of growth in these countries through more support for investment that removes bottlenecks to their growth would be a global win-win. It would support their development, and it would contribute to stronger growth at the global level and to the postcrisis rebalancing of global growth by creating new markets and investment opportunities and hence more sources of growth in global demand.

Rebalancing needs to look beyond a narrow focus on external balances and macroeconomic policy adjustments to include structural rebalancing. Supporting multiple growth poles is a key element of structural rebalancing. Promotion of growth in developing countries should be seen as an integral element of the G-20 framework for strong, sustainable, and balanced growth.

The potential to contribute to global growth and rebalancing is not limited to the rapidly growing emerging market growth poles. Better policies have improved growth performance and opportunities in many low-income countries, including in Sub-Saharan Africa (where regional growth averaged about 6 percent in the five years preceding the crisis). These countries offer markets for investment, not just destinations for aid. Net foreign direct investment to Sub-Saharan Africa more than doubled from US$14 billion in 2001 to US$34 billion in 2008, and there is much potential for further growth in these investment flows.

Infrastructure is a key area for investment, because of its high potential for spurring growth in agriculture, manufacturing, and services. For
example, research shows that raising infrastructure services in Africa to the level in the Republic of Korea could increase the region’s growth rate by up to 2.6 percentage points. Infrastructure investment and maintenance needs in developing countries amount to over US$900 billion (6–8 percent of GDP) annually. Actual spending reaches only about half that level (box 4.1 shows the infrastructure investment needs and actual spending for Sub-Saharan Africa). Alleviating the financing constraint can boost local growth and support global demand. It could be a high-return investment in a win-win global growth outcome. Research also shows high returns on sound investments in human capital—education, health, and nutrition.

In addition to financing, the G-20 can be instrumental in promoting the sharing of development knowledge and support for capacity building in developing countries. The accumulated richness of national development experiences offers considerable opportunities for sharing development knowledge and expertise—not just North-South but increasingly also South-South and South-North.

Box 4.1. Infrastructure Investment Needs in Africa

Africa’s infrastructure investment needs relative to GDP are particularly large, at 15 percent. But more financing is not the only answer. Improvements in “soft infrastructure” (such as improvements in governance, regulation, and cost recovery) can yield significant efficiency gains. Even with such efficiency gains, however, the region’s annual funding gap would remain sizable at about 5 percent of GDP, or about US$31 billion.

<table>
<thead>
<tr>
<th></th>
<th>Infrastructure Investment and Maintenance (% of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Needs</td>
</tr>
<tr>
<td>Middle-income</td>
<td>10</td>
</tr>
<tr>
<td>Resource-rich</td>
<td>12</td>
</tr>
<tr>
<td>Low-income</td>
<td>22</td>
</tr>
<tr>
<td>Fragile states</td>
<td>36</td>
</tr>
<tr>
<td><strong>All of Africa</strong></td>
<td><strong>15</strong></td>
</tr>
<tr>
<td>$ (billions)</td>
<td>93</td>
</tr>
</tbody>
</table>

Source: Foster and Briceño-Garmendia 2010.
Theme III: Financing for Development: Challenging Outlook Demands Creativity

Outlook for Financing for Development

A third theme that emerges from the analysis is that the outlook for financing will be more challenging and will demand creativity. Although the global financial markets are recovering, the recent crisis will have longer-lasting implications for financial flows to developing countries. While some major emerging market countries are now seeing a strong rebound in capital inflows, especially nondebt flows, most developing countries face the prospect of scarcer and more expensive capital. The rise in fiscal deficits and debt in advanced economies and related concerns about crowding out, tighter financial sector regulation and banking system consolidation, and a repricing of risk are all likely to limit developing countries’ access to financing and raise the cost of capital.

Net private capital flows to developing countries fell precipitously in 2008–09 as a result of the financial crisis, dropping from a peak of about US$1.2 trillion (8.7 percent of developing countries’ GDP) in 2007 to US$480 billion (3 percent of GDP) in 2009. They are likely to recover only slowly, reaching a projected level of about US$770 billion (3.3 percent of GDP) by 2011 (figure 4.10).

While developing countries’ access to capital markets is projected to decline in the postcrisis period, their financing needs are likely to be larger. Developing countries’ external financing needs rose sharply during the crisis and are expected to decline only gradually. Even by 2011 the projected ex ante external financing gap (current account deficit plus amortization minus expected private capital inflows) will be high at about US$180 billion (figure 4.11). Relative to GDP, the projected financing gap is particularly large in low-income countries.

Bank staff estimate that the tighter conditions in international financial markets reflected in scarcer and costlier capital could depress investment and lower economic growth in developing countries by up to 0.7 percentage points annually over the next five to seven years compared with the precrisis trend. Potential output in developing countries could be reduced by up to 8 percent in the long run relative to its precrisis path. This baseline outlook is subject to further downside risks, in view of the situation in Greece and increased concerns about sovereign debt in advanced economies.
The stakes are high. Even relatively small declines in growth can have cumulatively large impacts on poverty. Our simulations suggest that a 0.5 percentage point decline in the developing-country growth rate, resulting, say, from higher capital costs and lower investment, can mean...
nearly 80 million additional people living on less than US$2 a day in 10 years (figure 4.12).

**Fiscal Consolidation, Financing for Development, Growth, and Rebalancing**

With high and rising public debt, fiscal consolidation is a key priority for the advanced economies. It would also benefit developing countries. The International Monetary Fund (IMF) expects that debt-GDP ratios in advanced economies will exceed 100 percent of GDP in the next two to three years, some 35 percentage points higher than before the crisis. Sovereign debt issuance by the United States, Japan, and the Euro Area alone exceeded US$2.5 trillion in 2009, more than seven times total net capital flows to developing countries. Simulations show that a stronger, quicker fiscal consolidation in advanced economies would produce a win-win outcome. Two scenarios were constructed to explore the impact of fiscal consolidation in advanced economies. In the first, the improvement in primary balances is calibrated so that, if applied gradually between 2011 and 2020 and then held there through 2030, the debt-to-GDP ratio would fall to 60 percent by 2030. In the second scenario, the same improvement in primary balances is achieved in the first four years and

**Figure 4.12. Impact on Poverty of a 0.5 Percentage Point Decline in GDP Growth Rate (poverty headcount, in millions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Poverty Line of $1.25</th>
<th>Poverty Line of $2.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>20</td>
<td>40</td>
</tr>
<tr>
<td>2020</td>
<td>60</td>
<td>80</td>
</tr>
</tbody>
</table>

Source: World Bank GIDD Model simulations for developing countries.
then held at that level through 2030. The results were then compared with a scenario that assumes no proactive fiscal consolidation. The results show gains in growth for developing countries in both fiscal consolidation scenarios but larger gains in the scenario with quicker adjustment; in the latter scenario, the gain in GDP in the medium to long term reaches about 6 percent. The loss for developing countries through weaker demand for their exports is more than offset by benefits from lower real interest rates and higher investment. Long-run growth outcomes also improve in the advanced economies, although the fiscal adjustment implies a loss of output in the short run. The simulations suggest that the fiscal consolidation would also go a long way in helping to reduce global trade imbalances.

Rebalancing of global growth and financing for development can be linked in a virtuous circle. Three-quarters of developing countries are net importers of capital. In aggregate, however, developing countries, including emerging markets, have in recent years run a surplus, mainly reflecting large surpluses of saving over investment in a few countries—notably China and oil and mineral exporters. So, considered as a whole, developing countries have recently been net exporters of capital to high-income countries—a phenomenon sometimes referred to as capital flowing uphill. Capital inflows from the BRIC countries (Brazil, the Russian Federation, India, and China) financed about 75 percent of the U.S. current account deficit in 2008, up from 13 percent in 2001. Success in rebalancing in advanced deficit economies, thereby reducing their borrowing requirements, would allow more of the surplus global savings to flow to support investment and growth in developing countries, which in turn would generate more import demand (and from multiple sources) to reinforce rebalancing.

Implications of Financial Sector Reforms in Advanced Economies

It is important to ensure that ongoing and planned financial sector reforms in advanced economies do not have unintended adverse effects on financial flows to developing countries or their financial sector management. There is a need for a mechanism to assess the implications of these reforms for countries that are not members of the Financial Stability Board and the Basel Committee on Banking Supervision. A number
of countries have embarked on national reform initiatives that, if not well coordinated, risk creating financial protectionism, regulatory arbitrage, and inconsistency across jurisdictions. Some of the proposed reforms that require compliance with liquidity requirements at the branch level, as opposed to a consolidated group level, might constrain global banks in funding operations in emerging markets and vice versa. Proposed reform of securitization and derivatives should not choke off financial innovation that has been beneficial for development, for example, use of these innovations to hedge crop and weather risks. On trade finance the Basel Committee could review the appropriateness of a 100 percent credit conversion factor in its proposed leverage ratio for off-balance-sheet trade finance items with a maturity of less than a year, taking into account the largely self-liquidating, low risk, and short maturity characteristics of such trade finance products. Regulations designed for banks in advanced economies may not be appropriate for banks in low-income countries, especially smaller banks that cater to smaller enterprises; some countries may require a longer phase-in period.

**Official Financing for Development**

With tighter capital markets, official flows take on added importance, both in directly providing development finance and in leveraging private capital. This includes ensuring adequate official development assistance (ODA) and supporting multilateral lending with enough capital. While ODA rose modestly in real terms in 2009, overall it is falling short of commitments and declining relative to the GDP of low-income countries for which it constitutes an especially important source of financing (figure 4.13). It would be desirable to have a coordinated position among the G-20 to maintain or increase aid levels as fiscal consolidation strategies are designed and implemented. At the same time, more can be done, by donors and partner countries working together, to further progress on the Accra Agenda for Action to improve aid effectiveness—better aid alignment and harmonization, improved aid predictability, and a stronger focus on results.

Multilateral development bank (MDB) financing rose appreciably in response to the crisis, complementing IMF financing in providing countercyclical support to developing countries. Between July 2008 and June 2010 MDBs committed about US$235 billion, of which more than half
Figure 4.13. Official Development Financing: ODA and Multilateral Lending

a. Net ODA

- Graph showing net ODA with years on the x-axis and $ billions (2008) on the y-axis.
- Shows data from 2000 to 2009.

b. MDB commitments

- Graph showing MDB commitments with years on the x-axis and $ billions on the y-axis.
- Shows data for EBRD, IFC, IADB, AfDB, IBRD, and ADB.

Source: OECD, World Bank, and other MDBs.

Note: MDB commitments include recent capital increases.
came from the World Bank Group. Thanks to recent agreements on MDB capital increases, average postcrisis commitments could reach about US$65 billion a year, compared with the average precrisis level of about US$38 billion a year (see figure 4.13). In terms of net flows, however, MDB lending will remain small compared with developing-country needs for long-term capital.

Much of the increase in MDB financing during the crisis was in non-concessional financing. Concessional financing rose more modestly. Adequate replenishment of the MDB concessional windows, especially the International Development Agency (IDA) and the African Development Fund, would enable them to meet the increased needs of low-income countries responding to the financial crisis, as well as to the aftermath of the food and fuel crises that preceded it. The need for concessional finance has risen as fiscal space in low-income countries has come under pressure, while social spending needs, including expansion of social safety nets for poor and vulnerable groups, have increased as a result of higher poverty and unemployment. Innovations such as the IDA crisis-response facility have improved the responsiveness of concessional financing to crises.

Supplementing Traditional Financing with Innovative Forms of Finance

The conjuncture of tighter capital markets and fiscal stress in donor countries implies the need for supplementing traditional modes of financing with innovative forms of finance. Ensuring adequate financing for development in these circumstances will require innovations in leveraging private capital. With a rise in market perception of risks, demand for guarantees and insurance mechanisms (multilateral and bilateral) to mitigate the risk faced by long-term private investors in developing countries will rise. Such instruments can provide significant leverage. For example, the World Bank Group issued about US$7.7 billion in guarantees between 2000 and 2008 to support investments in financial and productive sectors of developing countries. These guarantees leveraged total investments of about US$20 billion, a leverage ratio of roughly 2.6. Public-private partnerships offer much potential and a variety of possibilities. A potentially important source of development financing is the multitrillion-dollar-strong sovereign wealth funds
(SWFs). An innovative example that offers scale-up possibilities is the recent investment by several SWFs in an International Finance Corporation (IFC) equity fund. A complementary element is the strengthening of international financial safety nets to reduce the demand for reserves as a form of self-insurance against risks of economic volatility and capital flow reversals, which could help free up more of developing countries’ own resources for investment.

There are increasing possibilities for South-South financing and investment from SWFs, corporations, and governments. Some countries, such as China, are trying to improve the standards governing these flows. For example, China has outsourced several environmental assessments to European firms to gain experience with global best practice in this area. It has also worked with the IFC to introduce Equator Principles into its operations. China and the World Bank are collaborating on investments in infrastructure, industrial zones, and health in Africa.

At about US$330 billion annually, officially recorded remittance flows to developing countries are almost three times as large as ODA. The 5x5 initiative that followed from the 2008 G-8 summit in Hokkaido and that aims to reduce remittance fees by 5 percentage points in five years can increase remittance flows by an estimated US$15 billion annually. Diaspora bonds are another innovation that seeks to tap into the wealth of the stock of migrants from developing countries.

**Financing of Global Public Goods and Programs**

Innovation and partnerships will be particularly important in the financing of global public goods and development-linked global programs. Private aid, which on some estimates approached US$50 billion in 2007 (close to one-half of ODA in that year), has been playing an increasingly important role in partnership with public funding in programs to combat communicable diseases (such as the Global Fund to Fight AIDS, Tuberculosis, and Malaria and the Global Alliance for Vaccines and Immunizations). Other important innovations include the International Finance Facility for Immunization (IFFIm) that front-loads financing needed for immunization programs in poor countries, the Advance Market Commitment (AMC) mechanism that subsidizes private costs of vaccine production for developing countries, and voluntary solidarity contributions such as the UNITAID international solidarity levy on air
Travel. There are good examples of innovation and public-private partnerships in other areas as well, such as the Global Agriculture and Food Security Program. Carbon markets are emerging as a potentially important source of development finance, especially in helping to meet the large investment needs to increase developing countries’ access to affordable and clean energy.

Estimated financing needs in some of these areas are large. For example, the High Level Task Force on Innovative Financing for Health Systems estimates that, in addition to current domestic and external health financing, about US$36 billion annually is required to achieve the health MDG and support national health systems to address communicable diseases in the 49 poorest countries. The International Food Policy Research Institute estimates the incremental public agricultural investment needed to reach the MDG on reducing hunger to be about US$14 billion a year. The World Bank’s World Development Report 2010 estimates that current climate-dedicated financial flows to developing countries cover less than 5 percent of what these countries will need to spend on climate change mitigation and adaptation in coming years. The scale of the resource needs, especially in the postcrisis environment for financing, calls for both a renewed commitment of support by the G-20 to such key global programs and for renewed vigor and creativity in exploiting the potential of innovative approaches in development financing and partnerships that leverage private capital.

**Domestic Resource Mobilization and Financial Sector Development**

The financing outlook also implies the need for stronger domestic resource mobilization by developing countries themselves, including continued progress on reforms to improve public resource management and the environment for private investment, domestic and foreign. Tighter and costlier access to external finance reinforces need to strengthen developing countries’ own financial systems. Strong financial systems are important both for effective engagement with globalized finance and for better mobilization and allocation of domestic resources for development. Inefficiency in domestic financial sectors can make borrowing costs in developing countries as much as 1,000 basis points higher than in advanced economies. Simulations suggest that if developing countries
can improve domestic financial intermediation to lower interest rate spreads by an average of 25 basis points a year, they can raise their long-run potential output by 7.5 percent, with the largest gains accruing to countries and regions currently facing the highest spreads. Some aspects of financial sector development, such as improving access of the poor to financial services and strengthening small and medium enterprise (SME) finance, have already been the subject of attention in the G-20 under the theme of inclusive finance. This is important: almost 70 percent of the adult population in developing countries, or 2.7 billion people, lack access to basic financial services, and surveys show that SMEs are at least 30 percent more likely than large firms to rate financing constraints as a major obstacle to growth. But there is also the need to strengthen financial systems in developing countries more broadly. Expanded technical and capacity-building assistance to financial sector reforms in developing countries can be a key area for G-20 collective action in support of development—including, for example, expanding participation in and contributions to the Financial Sector Reform and Strengthening (FIRST) Initiative.

Theme IV: Open Trade—Engine of Growth and Facilitator of Rebalancing

Finally, the fourth theme holds that an open trade environment is essential for a sustained economic recovery and for enabling the growth rebalancing to work. Keeping trade open will be important for sustaining the recovery as the fiscal and monetary stimuli are withdrawn. Trade, supported by investment and associated technology flows, is a key channel for multipolar growth and diversification of global demand.

Trade Flows: Changing Patterns, Collapse, and Recovery

The recent crisis made clear how the evolution of international trade patterns has created more economic interdependence. Parts and components are now one-third of all manufacturing trade, and this share rises to nearly one-half in East Asia. These more integrated supply chains imply that trade shocks in one country transmit more rapidly and strongly across countries. Trade fell fast after the onset of the financial crisis. The low point was in the first quarter of 2009, when the value of
global trade was down about 30 percent from the same quarter in the previous year. To place the collapse in historical context, figure 4.14 compares trade growth (month over same month in the previous year in constant US$) in this crisis with previous downturns in 1975, 1982, 1991, and 2001. Data are matched so that year zero is the lowest point of each contraction. Growth leading up to the crisis was higher and the fall deeper in this episode than in previous downturns. The recovery also appears to be much steeper in this crisis than in previous episodes. The figure shows that a V-shaped recovery is well under way, although the global trade value still remains below its precrisis level.

The trade collapse was primarily the result of a large demand shock, which affected trade more than it affected GDP. The bulk of traded goods are manufactures (80 percent of nonoil trade), where inventories can be cut and consumption can be postponed. Global supply chains and lean retailing contributed to spreading the shock rapidly across countries. While the drop in trade was synchronized across countries, the recovery

Figure 4.14. Collapse and Recovery of World Trade: Current versus Past Crises

Source: World Bank staff calculations.
has been less balanced. The recovery in Europe is particularly fragile, where worries over increasing debt in the Euro Area have raised uncertainty about future growth. The rest of the world shows strong and steady growth. A number of Asian countries, including China, India, and Indonesia, have demonstrated remarkable resilience, with imports now above precrisis levels. These large and growing emerging markets may be the future engine of trade growth.

The financial crisis and resulting trade collapse have brought about a reversal in the large global trade imbalances that characterized trade patterns in recent years. In part this reversal is purely mechanical. If both imports and exports decline by a given percentage, then the difference must also shrink by the same percentage. The value of global trade declined by about 15 percent in 2009, suggesting there should be a similar drop in imbalances. In fact, the global trade imbalance—measured as the sum across countries of the absolute value of the trade balance—plunged 30 percent (this figure is calculated using data from 58 countries that reported data through 2009 and that make up over 75 percent of world trade). This finding implies that in addition to the drop in trade, net rebalancing of exports and imports accounted for half of the improvement in trade imbalances. In other words, trade deficit countries tended to experience relatively larger declines in imports, and trade surplus countries larger declines in exports. This is important because as trade recovers, improvement in imbalances attributable to the trade drop alone is likely to disappear, while adjustment attributable to rebalancing is likely to be sustainable.

**Trade Policy Response**

Notwithstanding the difficult circumstances of the recession and rise in unemployment, G-20 members have by and large adhered to the commitment made at the outset of the crisis to avoid protectionism. Although restrictive actions have been taken by practically all G-20 countries, the trade coverage of these actions has been small. However, while open protectionism has been resisted relatively well, there is concern that opaque or murky protectionism has been on the rise.

Between November 2008 and May 2010 governments worldwide have implemented close to 700 trade measures, including about 500 discriminatory measures. G-20 members have imposed close to two-thirds of the
discriminatory measures (figure 4.15). More recently, quarterly data show a declining trend in the imposition of discriminatory measures: in the first quarter of 2009 a total of 120 measures were taken; in the same quarter of 2010 the number had declined to 63 measures.

Among the trade measures implemented, there has been a sharp rise in the incidence of antidumping actions, use of safeguards, preferential treatment of domestic firms in bailouts, and discriminatory procurement. Altogether, the major G-20 users of antidumping, countervailing duties, and safeguards made 25 percent more import product lines subject to these trade barriers than they did in 2007 (figure 4.16). Such actions are not just North-South. About half of such barriers in 2009 were South-South in nature. Another risk to watch out for is that, as fiscal retrenchment occurs, countries might be tempted to replace subsidies and preferential treatments granted in bailout programs with new trade barriers.

**Priorities in the Trade Agenda**

G-20 leaders recognized early on the potential systemic risks stemming from protectionist policy responses. They can boost market confidence

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**Figure 4.15. Trade Measures Implemented Worldwide and by G-20, November 2008–May 2010**

![Bar chart showing trade measures implemented worldwide and by G-20, November 2008–May 2010. The chart indicates the number of measures that are discriminatory, may discriminate, and are trade liberalizing.](Source: Global Trade Alert.)
by renewing their commitment to refrain from protectionist measures. An even stronger signal would be a collective pledge to unwind the protectionist measures that have been put in place since the onset of the crisis in August 2008.

Trade rules matter. Areas that are not subject to multilateral discipline or where the coverage is unclear or limited are the ones that have seen more restrictive actions. Strengthening multilateral trade discipline and bringing the Doha Round of trade negotiations to an early and successful conclusion therefore are important. Conservative estimates put the global real income gains from a successful Doha agreement at US$160 billion.
Harmonizing the programs of trade preferences granted by developed and emerging countries to the least developed countries would help increase their overall usefulness. Currently, trade preference programs provide high levels of product coverage but with important exceptions, mostly related to agricultural products and apparel. The G-20 could consider extending 100 percent duty-free and quota-free access to the least developed countries, with liberal rules of origin.

For less developed countries, building trade capacity can be at least as important as improved market access in boosting trade. So a complementary priority is the strengthening of support for trade facilitation to address behind-the-border constraints to trade—improvement of trade-related infrastructure, regulations, and logistics such as customs services and standards compliance. Research shows that raising logistics performance in low-income countries to the middle-income average can boost trade by 15 percent or more. In support of trade facilitation, aid for trade should be scaled up substantially. Aid-for-trade public-private partnerships can make the resources go further by leveraging the dynamism of the private sector in strengthening trade capacity.

**Conclusions**

Global growth is central to development. The most important thing that the G-20 can do for development is to restore strong growth. As the recovery matures, the longer-term growth agenda should increasingly be at the center of G-20 policy coordination, with a shift in focus from demand to supply stimulus—fiscal, financial, and structural reforms that enhance medium- to long-term potential growth. Successful collective action by the G-20 along these lines would boost global growth with benefits for all.

Growth in developing countries increasingly matters for global growth. Led by the fast-growing emerging markets, developing countries are now contributing about half of global growth. They are leading the recovery in world trade. South-South links also are becoming more important. Developing countries offer abundant opportunities for high-return, high-growth-potential investments, such as in critical infrastructure that removes bottlenecks to growth. Many, however, face a binding financing constraint. Promotion of growth in these countries through more support for investment that removes bottlenecks to their growth
The G-20 and Global Development

would be a global win-win. It would support their development, and it would contribute to stronger growth at the global level and to the rebalancing of global growth by creating new markets and investment opportunities and more sources of growth in global demand. Promotion of stronger, multipolar growth in developing countries should thus be seen as an important and integral element of the G-20 framework to achieve strong, sustainable, and balanced growth in the global economy.

The global financial crisis will have long-lasting implications for financial flows to developing countries. Some emerging markets are seeing a strong rebound in capital inflows, but most developing countries face the prospect of scarcer and costlier capital. The rise in fiscal deficits and debt in advanced economies and concerns about crowding out, tighter financial sector regulation, and a repricing of risk will all likely raise the cost of capital and limit developing countries’ access to financing, with adverse implications for their growth.

With tighter capital markets, official flows to developing countries take on increased importance, both in directly providing development finance and in leveraging private flows. The need for concessional finance has risen as fiscal space in low-income countries has come under pressure while social spending needs have increased in the aftermath of the crisis. These developments reinforce the need to ensure adequate ODA, achieve satisfactory replenishments of MDB concessional windows, and follow through on MDB capital increases. They also point to the need to ensure more effective use of resources to achieve development outcomes.

The tighter outlook for private capital flows and the fiscal stress in donor countries imply the need for supplementing traditional financing with innovative forms of finance. These include, for example, risk-mitigation guarantees; sovereign wealth fund investments; innovations such as the IFFIm and AMCs that support global public goods in health; public-private partnerships in development-linked global programs, such as for food security; carbon finance; and South-South investments. The scale of resource needs calls for both a renewed commitment by G-20 members to key global programs and renewed vigor and creativity in exploiting the potential of innovative approaches that leverage private capital.

The financing outlook also implies the need for stronger domestic resource mobilization by developing countries, including continued
efforts to improve public resource management and the climate for private investment. There is a need to strengthen developing countries’ own financial systems. Expanded technical and capacity-building assistance to financial sector reforms in developing countries can be a key area for G-20 collective action. It is also important to ensure that financial system regulatory reforms in advanced economies do not have unintended adverse effects on financial flows to developing countries.

The G-20 can demonstrate leadership in championing an open trade and investment regime. Achieving an early and successful outcome on the Doha Development Round is one clear priority. For the least developed countries, extension of 100 percent duty-free and quota-free access could be considered. Improved market access for poor countries needs to be complemented with a strengthening of trade facilitation and aid-for-trade programs to enhance these countries’ trade capacity.

At the Pittsburgh summit G-20 leaders designated the G-20 as “the premier forum for our international economic cooperation.” If the G-20 is to perform this leadership role in the global economy, the global development agenda must be an integral part of its remit.

Notes
2. This chapter is based on work conducted by World Bank staff as part of the G-20 Growth Framework and Mutual Assessment Process. Contributions from a number of Bank staff are gratefully acknowledged.
3. Chapter 3 discusses the concept of multipolarity in more detail.

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Comments by Danny Leipziger
The George Washington University

When considering the role of the G-20 in addressing international development issues, there are four main questions to be addressed. They are:

1. Why is development a critical G-20 agenda item?
2. How different is the postcrisis world from the precrisis world as one looks at development prospects and policies?
3. What has changed in development thinking and development policy advice?
4. What can the G-20 contribute to developing economies’ growth prospects?

Why Is Development Such a Critical Agenda Item for the G-20?

Development is a matter to be addressed by the G-20 for at least five reasons. First, in reference to the economic and financial crisis, there is the innocent bystander problem. While developing countries bore the effects of the global recession through increased food prices and decreased demand for exports, they had little to no involvement in the events that precipitated the crisis. They were, in effect, innocent bystanders to an event beyond their control. Second, developing economies are important centers for future growth. Third, demographic trends will mean more people movement in the future, whether this process is managed by governments or not. Fourth, issues of the global commons (such as those covered by the G-20) involve all countries, not just G-20 members. Developing economies could be the ones most affected by new international financial and economic agreements. Last, the legitimacy and legacy of the G-20 are at stake if the voices of poor countries are not sufficiently recognized or considered in discussions.

Comments on the paper “The G-20 and Global Development,” by Zia Qureshi in chapter 4 of this volume.
How Different Is the Postcrisis World and What Have We Learned?
If the international system has learned anything from the crisis, it is that countries with good fiscal policy dominated recovery. Those governments with fiscal space managed to cope better with the impact of the crisis than those that were constrained. Finance and treasury ministers need to be aware that future borrowing costs will rise because of increased regulation, risk aversion, and debt levels in advanced countries. We have accepted that slower global growth prospects will be the new normal for many countries and that excessive savings may actually impede needed rebalancing. We have also learned that sources of growth shifted before, during, and after the crisis and that they will not revert soon. Last, and perhaps most important for developing countries, we have learned that effective institutions matter everywhere.

What Is New in Development Thinking and Advice?
Developed countries do not have all the answers and are demonstrating increased humility in the face of economic recovery. As was witnessed in the financial crisis, the high-income countries can actually be the source of international economic instability and decline. For the most part, governments are being lauded for their quick response in stabilizing their economies and stimulating the rebound in growth, steps that have revived the public’s appreciation for government action, both in the developed and developing world. Focusing just on developing countries, there is a greater need for domestic resource mobilization and local sources of growth. Reliance on the developed world is no longer the singular strategy. As the Growth Commission pointed out, however, there is still no other alternative to the global market for exports. South-South trade, for example, can yield large returns as well as establish a more diversified trade portfolio. There is also a general acceptance that greater distinction among various types of capital flows is smart policy and that, rather than impede capital flows across the board to protect a competitive exchange rate, for example, countries would be well advised to focus on discouraging short-term, reversible, and volatile flows. Last, bolstering a country’s fiscal position is perhaps even more important than the accumulation of international reserves because, similar to nuclear deterrence, once reserves are used, confidence is affected. Fiscal stances, on the other hand, provide stronger international assurances of solvency.
What Can the G-20 Contribute to Enhance Developing Economies’ Growth Prospects?

The G-20 has a significant potential to contribute to the growth of developing countries. Some G-20 members can begin by getting their own houses in order to reduce large potential output gaps. This implies that an early exit from expansionary fiscal policies may be short-sighted, particularly since growth generates tax revenues and helps to reduce the fiscal deficits. Meanwhile, other G-20 countries can turn to a more balanced pattern of growth that allows for export space for new entrants. All G-20 countries should resist the urge to slip into economic nationalism and thereby cut out potential new trading partners, as well as institute better financial risk management to control speculation, rather than impede all capital flows. G-20 countries have the responsibility to pave the way for the development of clean technologies in order to foster sustainable growth, as well as champion the conclusion of the Doha trade agreement. By taking up the Doha mantle, G-20 members can kick-start momentum in world trade and help the poorest countries gain access to international markets. The G-20 members can also demonstrate that they are increasingly sharing in the custodianship of global public goods.
It is a privilege to be a witness to the emergence of a new world, one in which the G-8 is no longer an appropriate representation of the current global political and economic power. The G-20 is increasingly reflecting global economic shifts, which have translated into global political shifts. While these changes are not a direct consequence of the recent financial crisis, their validity was confirmed by it. The global financial crisis also clarified what we have been witnessing during the past 25 years in terms of the increasingly important role of the lenders of the G-20, as well as of the developing and emerging economies. Despite its mandate, however, the G-20 is still a work in progress and its final shape is yet undetermined.

The paper by Mr. Qureshi is refreshing in its discussion about sustainable, long-term growth, especially after the overwhelming number of proposals and suggestions finance ministers received for short-term measures in response to the crisis. While some of these policies were useful as quick fixes, they are not sufficient for more robust growth in the postcrisis world. My comments will reflect and comment on the four important themes highlighted by Mr. Qureshi.

The G-20 needs to be clear that it is not singularly concerned with recovery from the recent financial crisis. Two other important crises preceded this one, both of which also had very negative impacts on developing countries—the food and the fuel crises. Similar to the financial crisis, those two crises required government intervention, but the measures imposed were very different in nature and scope. Furthermore, like the financial crisis, the issues of food and fuel continue to be relevant and persistent problems that are far from being resolved. Volatility in food prices and lack of food security persist, as does the issue of fuel price volatility.

Before the financial crisis, developing countries were facing a number of related nonfinancial challenges, one of which was achieving the Millennium Development Goals by 2015, a target that the crisis made even more difficult to attain. In addition, some politicians in developing countries have used the financial crisis as an excuse for their domestic
problems and delays in reforms. These policy makers argue that reforms were proceeding well before the crisis and that external shocks were very much responsible for the subsequent derailing of reform efforts. As Mr. Qureshi astutely noted, not only those who were responsible for the crisis are paying its costs. The burden is falling largely on developing countries, where the aftermath of the financial crisis is taking a significant toll on human welfare. It is projected that millions of people will fall into the poverty trap and millions more will be unemployed. This outcome is contrary to what was heard at the onset of the crisis, when developing countries were said not to be affected.

While developed countries were suffering massive economic melt-downs, initial reports indicated that developing countries were holding themselves together nicely and experiencing minimal turbulence in their economies. There was little evidence of financial sector problems, which many viewed as logical given that most developing countries did not have fully developed financial markets that would be susceptible to a crisis of this magnitude. This reaction is analogous to a person who is grateful not to have been a victim of a car accident simply because he or she does not own a car. Furthermore, the effects of the crisis on developing countries were not immediately observed because many of the financial institutions were already reformed or were being restructured during the crisis; moreover, most of them were not well integrated in the global economy, which saved them.

As global leaders our current challenge is to determine what lessons can be distilled from the observed effects and what kinds of measures and actions can be implemented going forward to mitigate the negative outcomes. The first theme of economic growth is clearly central to this discussion, but certain concerns must be taken into consideration. Some of the cures that were initially put forward to bring about stability resulted in increases in public debt. Now public doubts about future sustainability of such debts are mounting and are coupled with concerns about protectionism. Mr. Qureshi highlighted both classical and new protectionist measures that have been adopted by many countries, including some of the members of the G-20. In many ways these measures are counterproductive to the Group’s agenda, especially considering the fourth theme of the paper on expanding trade in support of developing countries.
The second theme focused on the multipolarity of growth and the importance of having more than one source of global growth, which was initially discussed in chapter 3 of this volume. A critical component of the multipolar growth strategy is infrastructure development, and while there are win-win aspects of advancing it, especially in developing countries, there are many elements that require careful attention. Infrastructure is essential for economic purposes as well as for social needs. The infrastructure in developing countries, however, is largely underdeveloped and requires more investment, particularly in road networks, ports, energy-producing plants, and natural gas pipelines. To this end, the public-private partnerships (PPP) approach has been mentioned. I recall the discussions of the Growth Commission and its final output, the *Growth Report*, which stressed warnings of so-called “bad ideas.” The commission contended that in times of difficulty, countries should not compromise or sacrifice spending on infrastructure in order to control budget deficits. Despite these warnings, that is what is currently happening.

Policy makers and finance ministers are being advised that public-private partnerships can solve their spending problems by bridging funding gaps and compensating for the drop in public outlays on infrastructure. Unfortunately, in practice these partnerships have not addressed such a challenge. While some countries, such as South Africa, are advanced in their use of the PPP framework, other countries, including my country, the Arab Republic of Egypt, have just started using the PPP approach. For newcomers, it takes ages to establish the contractual framework, hold discussions with potential developers, and iron out all logistical trappings. The concern is that countries often rely on the PPP framework and drop infrastructure funding expecting that the partnerships will make up the difference tomorrow. This is wishful thinking, at least in the short term. Instead of pushing the PPP approach, I think there is need for a balanced approach that would require a continued level of public finance for infrastructure projects, coupled with the possibility of future PPP implementation. This recommendation is given in full recognition and appreciation of the kinds of challenges national budgets are currently facing, namely, deficits. From a policy perspective, however, considerations of this kind are important to address.

On the third issue of finance and financial development, many measures that have been discussed today remind us of the regressive
interventions of the past and their effects on the mechanics of the financial sector. While these measures may sound attractive from a regulatory perspective, some of them could be distortive in practice. More attention should be given to the financial sector even when witnessing growth because there are issues related to access and the concentration of assets. Mr. Qureshi provides an interesting description of global finance, not only at the local level but also on financial flows across borders. Despite periods of rapid financial growth, we have not observed an increase in funding for investment. In fact, the world fixed-investment rate was almost constant or even declining between 1995 and 2005. Meanwhile, the United Nation’s 2010 World Economic and Social Survey showed that cross-border funds were increasing during this period. Hence, the issue becomes one of funding and high incremental capital output ratios. For a country that aims to attain an average growth rate of 6–7 percent a year (for example, in Africa or the Middle East), an investment-to-GDP ratio of at least 24 percent would be required. Given very low saving rates in developing countries, governments would face a funding gap of roughly 8–12 percent of GDP. Therefore, the problems we are seeing today regarding the crowding out of capital flows to developing countries and the debt crises of some sovereign bonds, including Greece, are worrying.

With regard to financial inclusion, we should consider the joint International Monetary Fund–World Bank Financial Sector Assessment Program (FSAP) as an important tool to increase the effectiveness of efforts to promote the soundness of financial systems. The program works to identify the strengths and vulnerabilities of a country’s financial system, to determine how key sources of risk are being managed, to ascertain the sector’s developmental and technical assistance needs, and to help prioritize policy responses. In my opinion, there is an overemphasis on the stability side of FSAP, rather than on promoting development finance. This viewpoint is consistent with statements made by the United Nations that the goal for financial sector intermediaries should not be to exist simply as stable entities but to also play a role in the intermediation between savers and investors. I recognize, however, that in a time of financial crisis the issue of financial stability takes priority.

Finally, on the issue of trade, I share the view expressed by Mr. Qureshi. In the discussion of chapter 3, I raised the question about excess capacity
and trying to get trade to help growth for developing countries. As the author notes, the challenges to expanding trade are not only evident after the crisis but had been long-standing agenda items before the crisis as well. Trade promotion in developing countries is strongly linked to infrastructure development, since one of the main constraints to developing-country trade is the high transaction costs associated with transporting goods to market. I am also in favor of completing the Doha Round of trade agreements.

Overall, I am very pleased with the work in progress. I believe the G-20’s development agenda is both necessary and very promising and that the policy measures prescribed here will be extremely useful if taken seriously and implemented effectively by policy makers.
Comments by Robert Vos
United Nations

Let me thank the organizers for inviting me to this conference and for giving me the honor of serving on such a distinguished panel. I very much liked Zia Qureshi’s presentation and agree with many of the issues he raised. For the sake of brevity, let me not reiterate those, but focus on four issues that I believe may need some additional reflection.

Multipolar Growth and Decoupling
Let me first turn to the notions of a multipolar pattern of world growth and decoupling of growth between developing and developed countries. I have never been a great fan of the concept of decoupling. When decoupling first surfaced in International Monetary Fund and World Bank documents before the global financial crisis, it gave the suggestion that somehow developing countries would be insulated from the slowdown of growth in the United States and Europe that had already set in at that point. The crisis made clear that was rather misleading. The second reason I do not like the concept is because it could give the false impression that global economic interdependencies would become less intense. The distinction that is now made between cyclical and structural decoupling does not necessarily remove that impression. The heart of the matter is, of course, that those interdependencies are changing. In that sense, approaching it through the lens of multipolar growth may be more promising.

Indeed, in modern history the world has never before experienced a situation in which, given the current weakness of industrial countries, major developing countries have become the principal engine of world economic growth. Continuing expansion of these economies is therefore crucial for the world. But that said, the question that needs to be raised is about the current and future capacity of developing economies to transmit their growth dynamics to the rest of the world.

China holds the largest share of global trade among developing countries, which makes it into something like a test case. China’s ability to

Comments on the paper “The G-20 and Global Development,” by Zia Qureshi in chapter 4 of this volume.
induce growth in the rest of the world inevitably depends on its capacity to turn its large trade surplus into a balance or even a trade deficit. This problem is absent in other large developing countries, like Brazil and India, that tend to run current account deficits. In the case of China, the transition from export-led to domestic-led growth raises a myriad of questions, including the capacity to shift domestic demand dynamics from investment to consumption and therefore substantially increase wage shares and reduce the significant overcapacity generated by the highest investment rate ever recorded in history. Also, given that large parts of its trade links are associated with the demand for inputs for its export sector, the shift from export-led to domestic demand-led growth may actually reduce Chinese import demand.

Under any scenario, however, it is essential that we do not throw the baby out with the bathwater as China reorients its pattern of growth. In particular, although some real appreciation of the renminbi should be part of this process, a very strong and disorderly appreciation could seriously affect Chinese economic growth. Looking back in history, a strongly appreciating currency to reduce export surpluses is one, not implausible interpretation of how Japan’s dynamic growth came to a halt and its costly financial crisis was incubated. In any case, it is the one interpretation that Chinese authorities seem to have in mind when trying to avoid repeating that history. The more desirable scenario is a Chinese economy that transmits its stimulus to the rest of the world through rising imports generated more by the income effect (through rapid economic growth and real wage increases) than by the substitution effect (through strong real exchange rate appreciation). Opening more space for Chinese investment abroad should also be an essential part of this strategy.

The subsequent question is whether multipolar growth will not induce further income divergence among developing countries. In a sense, if current trends are projected, East Asia and India (not South Asia as whole) are likely to be among the more dynamic poles of the new world economy. But that may leave many developing countries behind, not only those with weak links with these dynamic poles and those that are competitors with them in global markets, but also those that merely provide primary commodities to the growth poles and that should expect to see volatile growth because of the instability of commodity prices in world markets. So, a major issue going forward is to guarantee
that the world is not on the verge of another major divergence in development, now not between industrial and developing countries but among the group of developing countries. Indeed, this has already been one part of the pattern of global development in recent decades, which can be characterized as one of a “dual income divergence.” This implies, in particular, serious thinking about the specific mechanism through which the most dynamic poles of the developing world are going to disseminate their growth to the developing world at large.

Global Imbalances
A second and related issue is the implication of current trends for the global imbalances. One of the major paradoxes of the current global economic crisis is that accumulating foreign exchange reserves in the developing world contributed first to the buildup of the global imbalances during the boom years. Over time this dampened global demand, and global demand itself became increasingly dependent on the United States as “the consumer of last resort.” The global imbalances that were fomented this way formed part of the multiple factors that led to the financial bubble that caused the current crisis. When the bubble burst, however, the strong external balance sheets subsequently provided a buffer of resilience to many developing economies, thereby becoming an important factor behind the recent recovery. Yet, a return to the old pattern of widening global imbalances is undesirable, because it has proven to be unsustainable.

Moreover, the counterpart trend has been a sustained pattern of net transfers of financial resources flowing from developing countries to industrial countries running large deficits. In 2008 those transfers bordered US$1 trillion. The major surplus countries in East Asia and the Middle East of course contributed most, but Africa also saw more financial resources flowing out of its region than flowing in (figure 4.17). Because of the crisis, the United Nations estimates that net financial outflows fell back to around US$600 billion in 2009 (United Nations 2010b). The United Nations expects the outflow to rise again in the coming years because of the current pattern of the recovery and the return of massive, mostly short-term capital flows toward emerging markets. This return to precrisis patterns of international financial flows runs the risk of generating future busts, following well-known patterns.
Going forward, the worst global scenario would be one in which all or most countries, including the developed countries, aim at improving their current accounts through fiscal consolidation or otherwise, as current IMF projections indicate, since this is nothing but a scenario of weak global demand and even a new recession.

A more desirable global scenario would be one in which most developing countries (and not only China) run current account deficits. This scenario would be consistent with the idea of continued strong growth in developing countries and efforts to deal with global poverty and climate change. For that, not only the large-scale infrastructure investments to which Mr. Qureshi referred in his presentation are needed. Also needed are substantial increases in public expenditures for achieving the MDGs as well as large-scale investments in renewable energy and sustainable agriculture so that developing countries can address climate change and ensure that high growth is low on carbon

emissions. Similarly, all the calls for additional development financing needs and enhanced international cooperation point in the same direction. In other words, moving toward a world of multipolar growth consistent with income convergence across all nations and with broad-based poverty reduction and the greening of global growth, would require not a balancing but in fact a reversal in the pattern of global imbalances over the medium run.

Achieving such a reversal in an orderly fashion will not be easy. It will be demanding on our mechanisms for global economic governance (United Nations 2010a).

First, it will require much stronger international policy coordination built around common principles and goals and sustained over the long run. But, given what I have just said, such coordination cannot be merely about managing exit strategies from the extraordinary stimulus measures or managing aggregate demand. It is even more important to address such issues in conjunction with industrial and energy policies, poverty reduction strategies, strategies for international development financing and cooperation, and trade policies. The G-20 framework for “strong, sustainable and balanced global growth” thus should include all of the above.

The second reason why this will be demanding is that it cannot be done without major reforms in the global financial system. Reversing the pattern of global imbalances will remain difficult without touching the global reserve system. Continued reliance on the U.S. dollar and the perceived need of countries to accumulate strong reserve positions as self-insurance against world market instability is bound to sustain the current pattern of global imbalances rather than reverse it. A system less reliant on one national currency and more reliant on common reserve pools and true international liquidity, such as special drawing rights (SDRs), likely would be more conducive of a reversal of the current unsustainable pattern. Such reforms could also form the basis of innovative development financing such as issuance of SDRs for climate and development financing.

Such a reversal will also require more urgent progress in the coordination of reforms of financial regulation and supervision. Some emerging market countries have already responded to the return of speculative capital flows by introducing capital controls, a logical response to avoid their macroeconomic policy space being overridden by boom-bust capital
flows that can be so devastating for growth and poverty reduction, as indicated by Mr. Qureshi. Yet a serious discussion of capital account regulations in the world is still surprisingly missing at the forefront of the current discussions of global financial reform.

**Trade and Development**

A third set of questions relates to what could become the weakest link in the current recovery: international trade. There are two possible scenarios. The first would be a continuation of the rapid recovery of trade that started in mid-2009 and that will generate a return to the situation that prevailed in recent decades; that is, world trade that is more dynamic than world GDP. The other is a situation in which this does not happen, and we see a world in which trade is not particularly dynamic in the immediate future—and not necessarily because protectionism is back on the agenda.

The latter scenario may in fact not be as undesirable as it seems. And I do not mention this because I do not believe in the benefits of open trade. Here’s the story: As I already mentioned, large surplus economies like China would try to focus more on the domestic economy, which, as I suggested earlier, could slow import demand. But also many of the poorer economies would need to refocus their economies away from their high dependence on primary exports or footloose manufacturing export production and toward a strengthening of the backward and forward links of their export industries. The Republic of Korea is a lighting example of successful export-led growth following a more inward-looking stage. As many studies have shown, countries that have more diversified trade and stronger links with their own or regional economies are less prone to trade shocks (figure 4.18) and grow faster in the long run as they gain more from trade (figure 4.19). Along with the increased spending on nontradables (infrastructure and energy investments, spending for MDG-related services), creating such links may require slowing export growth during the process of structural adjustment. In such a scenario a slowing of world trade would be a transitory but benign phenomenon.

For such a scenario to emerge, low-income and a range of middle-income countries will need to benefit not only from greater market access and the aid-for-trade initiative but also from greater breathing space in World Trade Organization rules and regional and bilateral
Figure 4.18. Trade Shocks in Developing Countries by Product-Based Export Specialization, 2007–10

Source: UN-DESA 2010.
Note: Export specialization is defined by shares of 40 percent or more for indicated groups of commodities in total merchandise exports.

free trade agreements to apply temporary support measures (such as export subsidies) so that they can climb further up the trading ladder. Easing impediments to technology transfers, especially those affecting access to green technologies, would need to be part of the same package (see United Nations 2010a, chs. 2 and 4, for further discussion of these issues).

Multipolar Growth and the G-20
Finally, what all this implies is that the world we are looking forward to is going to be much more dependent in economic terms on the developing world than any world observed in history. Never before has the call of the 2002 Monterrey Consensus on Financing for Development to increase the participation of developing countries in global economic decision making been more important.
Managing this world will require, therefore, major reforms of the existing mechanisms of global economic governance that were invented more than 60 years ago and that have not fundamentally changed much since. The formation of the G-20 has been a step forward in this regard, but its representation is inadequate. In particular, many medium and small-size countries are not represented at all, and the currently poor economies of Sub-Saharan Africa are heavily underrepresented. To acquire the sense of mutual accountability and legitimacy that is needed for global consensus building on all these issues that are so critical for the world’s future, it will be important to bring these G-20 deliberations into the broader multilateral framework. This need not necessarily be done on a one-country, one-vote basis, but one could consider doing so on the basis of caucuses of groups of countries, as is currently already the case in the Bretton Woods institutions. Reflective of the changing world we are discussing today, the voice of developing countries necessarily would become predominant with time. The policy coordination challenges ahead will be no less daunting, however.
References


It is a pleasure to chair the session on “G-20 and Global Development,” which centers on the paper by Zia Qureshi.

For five years in the middle of the decade, developing countries grew at their fastest rate in 40 years. At that time, the main policy debates were over the global transfer of skill-enhancing technologies, the scale of international capital flows, and whether there was decoupling between developing and developed countries.

In the last four years we have witnessed three major crises: a food crisis, a fuel crisis, and a financial crisis. We have learned that the world is much more fragile and interdependent than previously thought. It is a world of increasing multipolarity, with multiple sources of growth and with powerful reverse linkages between developing and developed countries and between developing countries themselves. We have witnessed large changes in the international architecture—including the reemergence of the G-20, the formation of the Financial Stability Board, and substantial new financing for the International Monetary Fund. We have seen a significant increase in voice and participation in dialogue and decision making in the World Bank Group, and the same process is under way with voice and quota in the IMF.

The G-20 garnered substantial success in London in 2009 when it mobilized US$1.1 trillion in financing to help manage the global financial crisis. At the G-20 meeting in Pittsburgh, leaders referred to the G-20 as the key body for global economic coordination. They committed to enhanced multilateral surveillance to help achieve strong, balanced, and sustainable growth worldwide. To this end, the primary focus has been on the analytical work done by the International Monetary Fund and the World Bank under the G-20 Growth Framework and Mutual Assessment Process. Nearly all of the projections and the scenarios (base case, low case, high case) have been completed. The next steps will undoubtedly be the hardest. Policy makers will need to identify supportive policies.
and act collectively to put these policies in place to support and sustain strong and balanced growth within the G-20 and to promote development and poverty reduction globally. This is a huge test for the G-20. The key issues are the maturation of the mutual assessment process and whether the G-20 can be effective in “peacetime.”

Can the G-20 be effective in a postcrisis environment? All eyes are on fiscal policy, but can one policy instrument carry so much of the burden? As the global economy recovers, attention has been on implementing exit policies, particularly from an expansionary fiscal stance. Policy stimulus in developed and emerging market countries has been instrumental in pulling the world out of global recession. However, government balance sheets in developed countries are dangerously overextended, with G-7 ratios of public debt to GDP projected by the IMF to exceed 100 percent on average by the end of 2010. We have witnessed a sovereign debt crisis in southern Europe. The IMF is now calling for fiscal consolidation in the developed countries, ideally starting in 2011, and the World Bank’s analysis shows that fiscal consolidation would benefit developing-country medium-term growth as well. A key question is how to make the transition from fiscal stimulus to consolidation. The IMF has noted the heterogeneity among the G-20 countries and the need for a differentiated approach (for example, advanced deficit vs. advanced surplus countries), but it also stresses the importance of ensuring coordinated exit strategies. A second key question is how to carry out the consolidation. The IMF analysis, backed by the OECD, has highlighted the potential of growth-enhancing policies, such as the shift from taxes on labor and income to consumption taxes, while others have pointed out that this shift could worsen inequality. What are the trade-offs regarding fiscal policy, and how can the many potential pitfalls be avoided?

The multipolar world is already upon us. Developing countries have contributed about 40 percent of global growth over the past decade and account for more than 40 percent of the increase in world imports. The question for G-20 policy makers is not whether to support multipolar growth but how to do that most effectively. World Bank analysis points to the importance of increased infrastructure investment in the developing world (see chapter 8), but more roads and bridges need to be complemented by increased investment in human capital. The OECD has identified education (years of schooling, international test scores) as the
structural reform with the single-highest growth dividend in OECD countries. What is an appropriate mix of hard and soft investment in developing countries?

Financial flows are important to developing countries’ growth, but financial inclusion can transform their impact. Financial markets have expanded their reach tremendously over the past 20 years, but in most developing countries, individuals’ participation is limited to labor markets and consumption. According to World Bank analysis, two-thirds of the adult population in developing countries (2.7 billion people) lack access to formal financial services. Evidence shows that financial access is not only progrowth but also pro-poor. How can the G-20 support the financial inclusion agenda while promoting expanded financial flows and development of financial sectors in developing countries?

Finally, open trade matters more than ever. The historically sharp fall-off in trade during the financial crisis demonstrated the increasing degree of global integration—the value of global trade declined an unprecedented 15 percent in 2009. The collapse in trade was the main channel for transmitting the impact of the financial crisis to low-income countries. What can the G-20 do now in the recovery phase to promote trade that will amplify the impact of the global recovery on the poorest countries? Key areas for action include the completion of the Doha Development Round and strengthening trade facilitation and aid-for-trade programs to enhance poor countries’ trade capacity.