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From Crisis Management to Long-term Prosperity: the Role of the Commonwealth

Paper for the Commonwealth Secretariat*

Commonwealth Secretariat
Marlborough House
London SW1Y 5HX

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Summary

As the recession caused by the global financial crisis slowly comes to an end – at very different speeds in different Commonwealth settings – countries will be left differently equipped to handle the next wave of challenges appearing over the horizon. Some will emerge from recession or slowdown with unemployment and other social indicators returning rapidly to normal, and with macro-economic indicators in a healthy state. Others will have suffered irreversible damage to social or human capital and may find themselves with large domestic and foreign debt, large balance of payments deficits, and weakened currencies. Two companion papers trace the impact of the crisis and identify some key short-term policy responses which will be necessary to sustain recovery. The group of most vulnerable countries is likely to include the poorer Commonwealth countries, as well as smaller states. In the worst cases, and for the poorest countries, achievement of the Millennium Development Goals will have been put seriously at risk. The recession will be seen to have had long-term consequences for nutrition, health, education and welfare in the Commonwealth.

2. Commonwealth economies which were weak to start with and/or which have been weakened by the crisis will inevitably struggle to make the investments necessary to deal with future change. Strong leadership and higher levels of investment will be needed to take advantage of new opportunities, but probably even more to equip economies to deal with new challenges. Neither the 'status quo' nor 'hunkering down' set out in the paper look like feasible options, leaving the third available - 'investing in change' - as a necessary but difficult approach.

3. There are many opportunities for Commonwealth countries to prosper and achieve human development targets in the future, if the right investments can be made. It is good to balance a risk framework against an opportunities framework. At the same time, Commonwealth members will have to mange such challenges as:

i. The repercussions of the food crisis;
ii. Climate change and national resource stress;
iii. Urbanisation;
iv. Demographic changes; and
v. Changes in the global economy.

4. Conditions vary very much as between Commonwealth members. It is possible to imagine some countries benefiting from some or a combination of new agricultural markets, improved climatic conditions, rapid reduction in transactions costs associated with urbanisation, the productive benefits of lower dependency ratios, and new opportunities to expand manufacturing and increase employment. On the other hand, many countries will be aware of their vulnerability to rising or volatile food prices, the mitigation and adaptation costs of climate change, the growth of urban slums, rising population, and exclusion from new cluster-based centres of manufacturing growth. Those most affected by the crisis may also be most vulnerable to the negative impact of future change – and therefore most in need of support from Commonwealth members.

5. Policy will be key to successful bridging from crisis to future growth. Commonwealth members are likely to seek a middle way between market fundamentalism and the extreme heterodox prescriptions. They will be aware, however, that overall policy debates have

become particularly sharp since the eruption of the global financial crisis, on the role of the state and on many specific policies related to the incentive and regulatory framework. A great deal of emphasis is placed on room for manoeuvre in public policy, especially on fiscal and more general 'policy space'. The companion paper addressing short-term policy challenges highlights the relatively limited number of policy choices available currently.

6. These debates play out on practical topics that are central to building bridges and investing in change. For example, how important is it to build sustainable social protection systems which help build resilience to future shocks? How far should public expenditure ceilings be stretched in order to invest in education or research and development? And when the resources are hard to find domestically, how much can be expected in the way of support from the international community?

7. To summarise, Commonwealth Finance Ministers will be asking three questions and looking for Commonwealth support in answering them:

i. What are the long-tem implications for national policy of the events of 2008-9 – not just the financial crisis and the synchronised global recession, but also the food and fuel crises? What should be done to build greater resilience at national level?
ii. Will the economy emerge from the immediate crisis in a good position to withstand future challenges like climate change – and to exploit new opportunities?
iii. What measures are needed internationally to build resilience and help all countries manage future challenges?

8. As these questions are discussed, there are three possible levels of Commonwealth engagement:

a. Global advocacy, feeding into the G-20 and G-8, and into the Copenhagen negotiations, among others;
b. Commonwealth Partnerships aimed at managing the crisis and making the transition to dealing with future challenges; and
c. A work programme for the Commonwealth.

Introduction

This paper is a companion to the two earlier papers on short-term impact and policy responses: FMM(09)3 and FMM(09)4. It is intended to highlight the policy challenges faced by Commonwealth Finance Ministers and Commonwealth policy makers, in moving from short-term crisis response to the management of longer-term economic and social change.

2. Given the diversity of the Commonwealth, the paper has focused only on some of the most important generic medium-term opportunities and challenges, where there may be the greatest gain from collective Commonwealth action.

3. There are no obvious and immediate solutions. The paper points to the trade-offs, between short- and medium-term policy choices; and to trade-offs among various policies.

4. The paper poses, with each major medium-term challenge, a number of questions for Ministers in considering the most appropriate courses for the medium-term.

5. Notwithstanding major challenges, for the present and for the future, there is much to be optimistic about. The paper explores several positive developments and inquires how the Commonwealth can collectively expand opportunities arising from these developments.

6. At the end, the paper suggests some courses of action which may be useful pathways for individual and collective Commonwealth action. These seek to maximise the strengths of the Commonwealth: its consensus-based approach, interest in sharing of experience and policy lessons, interest in supporting Commonwealth countries with the most constrained policy choices, least resources and greatest levels of poverty.

Investing in change

7. It goes without saying that the crisis is not exactly over, even in Commonwealth countries in which the recession may technically be coming to an end. It will take time for unemployment to fall and for deficits and debt levels to return to normal. In some Commonwealth countries, the recovery is yet to begin. Nevertheless, there are three kinds of questions all Commonwealth Finance Ministers may be asking:

1. What are the long-tem implications for national policy of the events of 2008-9 – not just the financial crisis and the synchronised global recession, but also the food and fuel crises? What should be done to build greater resilience at national level?
2. Will the economy emerge from the immediate crisis in a good position to withstand future challenges like climate change – and to exploit new opportunities?
3. What measures are needed internationally to build resilience and help all countries manage future challenges?

A key issue is that some Commonwealth countries will emerge from the crisis in a much better position to invest than others, while others are both less strong and less resilient. Vulnerability indicators may help to identify Commonwealth countries in the latter group, using for example the vulnerability indicators developed by the World Bank and the IMF

(**Box 1**). It will be important to support the most vulnerable Commonwealth countries, including many small states.

Box 1

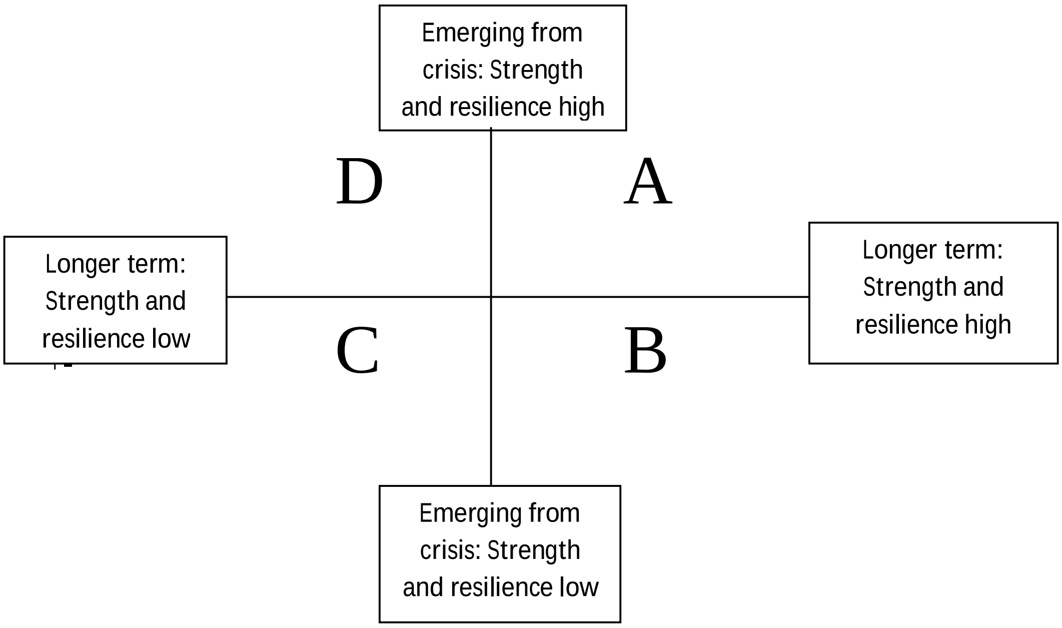
World Bank/IMF Indicators of vulnerability

- **Indicators of external and domestic debt**, including debt maturity profiles, repayment schedules, interest rate sensitivity and currency composition. The ratios of external debt to exports and to GDP are useful indicators of trends in debt and repayment capacity. Where public sector borrowing is significant, the ratio of debt to tax revenue is particularly important to gauge the country's repayment capacity.
- **Indicators of reserves adequacy** are central to assessing a country's ability to avert liquidity crises. The ratio of reserves to short-term debt in particular is key to gauging the vulnerability of countries with significant but uncertain access to capital markets.
- **Financial soundness indicators** are used to assess the strengths and weaknesses of countries' financial sectors. They cover the capital adequacy of financial institutions, the quality of assets and off-balance sheet positions, profitability and liquidity, and the pace and quality of credit growth. Financial soundness indicators are for instance used to assess financial systems' sensitivity to market risk, including changes in interest rates and exchange rates.
- **Corporate sector indicators** on the foreign exchange and interest rate exposure of companies are particularly important when assessing the potential impact of exchange rate and interest rate changes on corporate sector balance sheets. Indicators related to corporate leverage, profitability, cash flow, and financial structure are also relevant.

Source: http://imf.org/external/np/exr/facts/vul.htm April 2008

8. To develop this idea, imagine four scenarios facing Commonwealth countries, as in **Figure 1**. The future is shaped by the strength and resilience of economies in the short- and long-runs.

Figure 1
Four scenarios



9. In quadrant A, livelihoods and social provision have been protected during the financial crisis and financial stability has been restored without prejudice to the funding of longer term development. The Millennium Development Goals are within reach and progress has begun to be made against post-2015 goals. Climate change has been kept under control without prejudicing structural transformation. Long-term incentives have been successful in stimulating the development and adoption of new technology. Security threats have been resolved. Global imbalances and inequalities have both been reduced.

10. In quadrant B, the short-term adjustment costs have been very high, but the long term is handled better. In the short term, unemployment is high, credit remains tight, and financial systems are vulnerable. In poor countries, especially, social provision is cut, and there are sharp rises in poverty and in indicators of malnutrition and poor health. At the same time, an agreement on climate change has been reached in Copenhagen, new funding flows are available, and measures have been taken to strengthen other international regulatory frameworks, for example through the UN. Countries are able to move quickly to a sustainable development path.

12. In quadrant C, poverty and insecurity are both on the rise in all parts of the world.

13. In quadrant D, the short term has been handled well, but exchequers are starved of resources and maybe energy to deal with long-term problems. Debt payments absorb a large part of government revenue and crowd out private savings. International agreements have proved difficult to arrange. Longer-term development is weak and fragile.

14. The target is obviously quadrant A. How can the more vulnerable Commonwealth states, including many small states, be identified and supported in reaching the target?

15. Policies will vary. Commonwealth countries have different priorities and different ways of filling 'policy space', where such is available: many, small Commonwealth countries in particular, are policy-takers, not policy-makers an issue emphasised in the companion paper on short term policy choices and policy responses.

16. Nevertheless, policy choices will determine which quadrant rules. Broadly speaking, Commonwealth Finance Ministers will be concerned with:

- National policies, especially referring to public expenditure and the incentive and regulatory framework; and
- International policies, covering such topics as trade and finance and the provision of global public goods.

17. Linking the national and international and - consistent with the Commonwealth's vision - is the idea of a global deal, with rich and poor countries working to common principles and in the spirit of mutual accountability, but with differentiated responsibilities. Some generic policy positions might be:

- *Status quo ante*: a policy stance recognising the benefits of globalisation, trusting to/building on existing levels of investment and regulatory frameworks, and relying on current aid pledges.
- *Hunker down*: full or partial retreat from free trade, protection especially for the food sector, build-up foreign currency reserves if possible.
- *Invest in change*: retaining a commitment to globalisation, but taking more active steps to manage market risks, perhaps especially in the food sector, and finding resources locally and through enhanced aid, to invest in infrastructure, education and health, as well as green technologies.

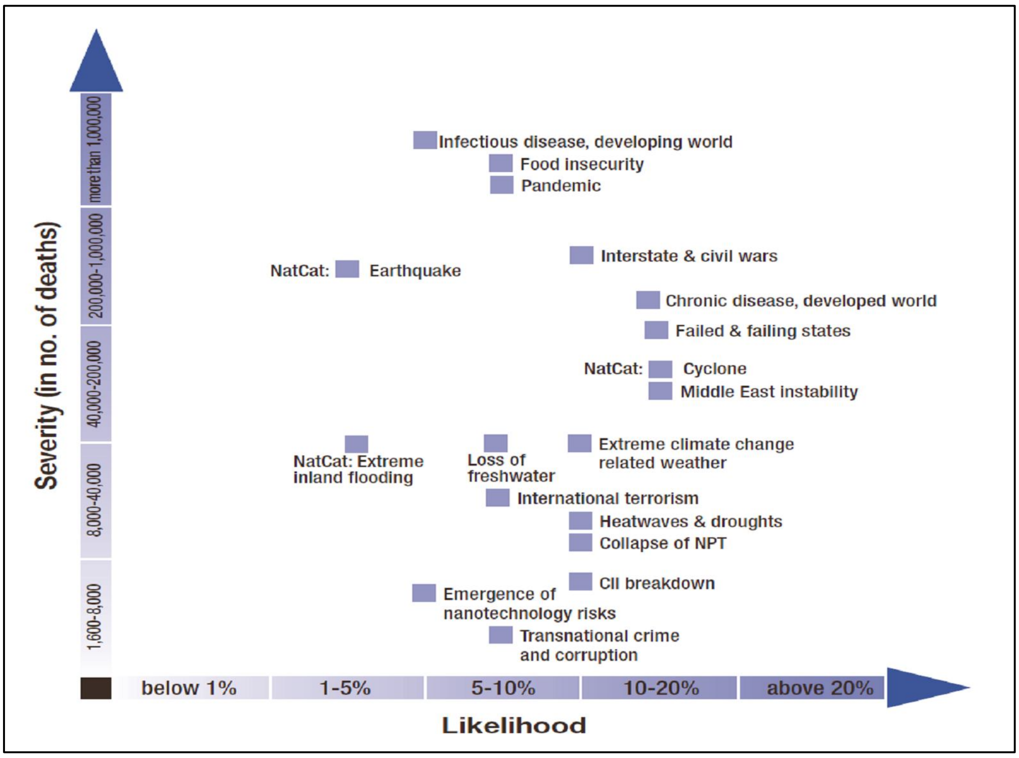
18. Only the third of these offers the opportunity for all countries to move to a stable and prosperous future

Emerging challenges

19. Before dealing with policy in more detail, it may be appropriate to focus briefly on future challenges facing Commonwealth countries, in order to answer the question 'policy, for what?'

20. Thanks to Nassim Nicholas Taleb, there is greater awareness of unexpected, unpredictable and high-impact future events, 'black swans' – the discovery of penicillin, for example, or the development of the internet (Taleb 2007). Taleb warns us not to try to predict black swans – 'it tends to make you more vulnerable to the ones you did not predict'. 'The impulse on the part of military planners, he says, 'is to devote resources to predicting the next problems'. Instead, we should 'invest in preparedness, not in prediction. Remember that infinite vigilance is not possible' (ibid:208).

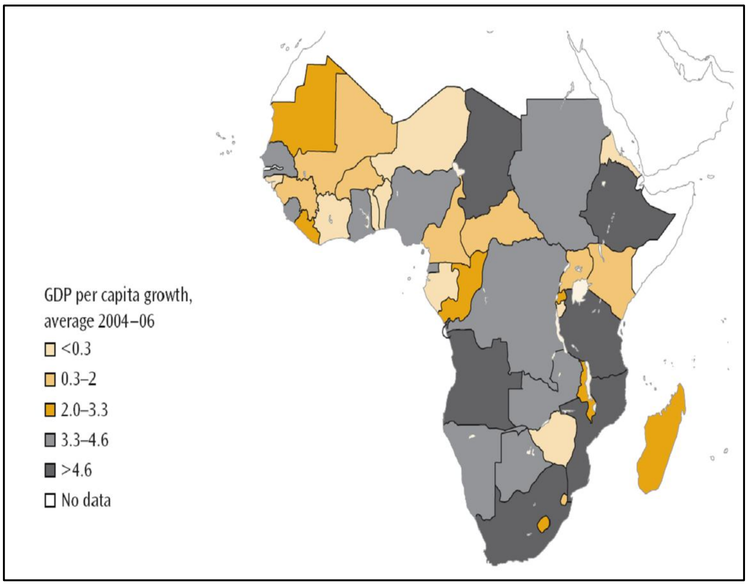
Figure 2: The 18 Core Global Risks: Likelihood with Severity by Number of Deaths



Source: World Economic Forum - Global Risks 2008

21. Some black swans may have a negative impact, but some may be positive, and it is important to see the future in terms of opportunities and not just problems. A global risk analysis is useful, as provided for example by the World Economic Forum (**Figure 2**). However, it is also useful to think about global opportunities. The Millennium Development Goals provide one framework for thinking about this, relevant to many Commonwealth countries, but there are others. Bjorn Lomberg, for example, has systematised the search for global opportunities through his Copenhagen Consensus (http://www.copenhagenconsensus.com/Default.aspx?ID=788). Nutrition interventions and immunisation rank high in this list, along with schooling and action on maternal mortality and malaria.

Figure 3: GDP per capita growth in Africa



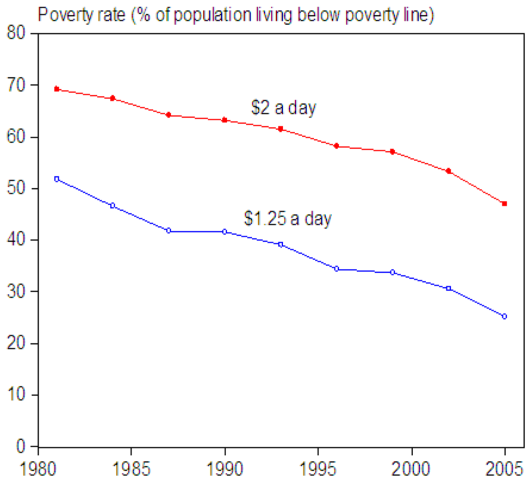
Source: World Bank, 2008a

22. In this context, it is worth remembering that:

- Some Commonwealth countries have seen extraordinary growth in per capita income. Botswana, for example, which had a per capita income of $210 in 1960, had reached $3,800 by 2005. Across the developing world, growth rates have increased, averaging 7-8 per cent in the years leading up to the current crisis. In Africa, as the map in **Figure 3** shows, more than 20 countries achieved pre-crisis growth rates in per capita income of more than 2 per cent per annum.

- Poverty is falling, including in many Commonwealth countries. The latest World Bank estimates, published in 2008 (**Figure 4**), again pre-crisis, show that numbers falling below the new poverty line of $1.25 per day fell from 1.8 billion in 1990 to 1.4 billion by 2005. With world population rising, the proportion below the poverty line fell sharply, from 42 per cent in 1990 to 26 per cent in 2005.

Figure 4

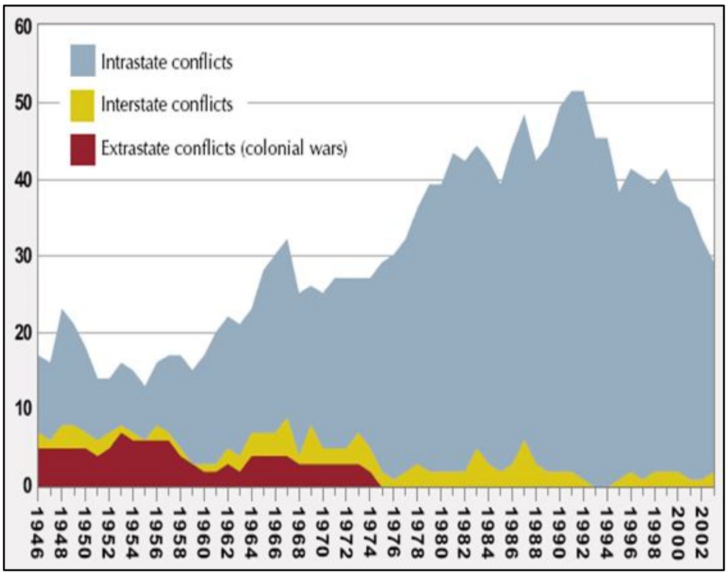


Source: Chen and Ravallion (World Bank) (http://www.voxeu.org/index.php?q=node/3520)

- Governance is improving and conflict is falling. Two thirds of states are now considered electoral democracies. The number of conflicts in the world has fallen sharply, from over 50 in the early 1990s, to fewer than 30 today (**Figure 5**). The Commonwealth's Harare Principles of 1991 provide a template in this regard (http://www.thecommonwealth.org/Templates/Internal.asp?NodeID=35773).

- Health and education are improving, in the Commonwealth and elsewhere. In the past 30 years, infant and child mortality in developing countries have both fallen by half, and life expectancy has increased by a decade, from 56 to 65. At the end of 2007, 3 million people in low income countries were receiving anti-retroviral therapy for HIV/AIDS. In the past 15 years, enrolment in primary schools in developing countries has increased to 85 per cent.

Figure 5: A less violent world: Numbers of conflicts, 1946–2003

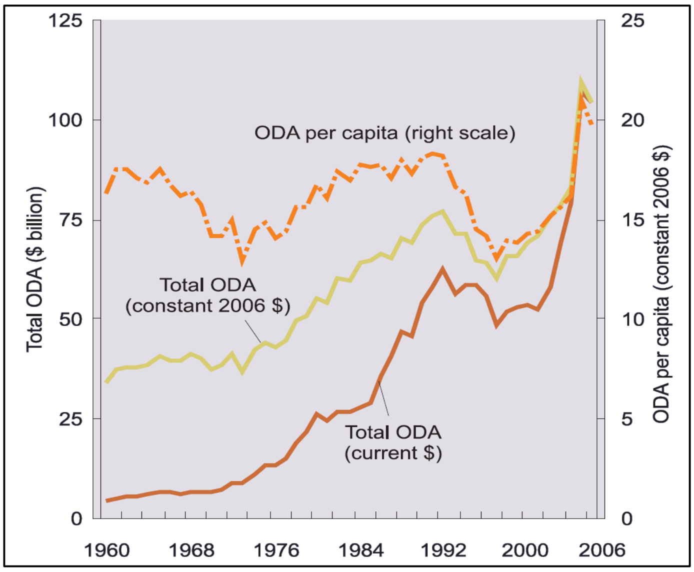


Source: Human Security Centre, 2005

23. These improvements are not independent of each other. The research evidence shows that human development gains are mutually reinforcing: women's education improves child nutrition; better fed children do better in school.

- In addition, and following a fall in real terms in the early and mid 1990s, aid volumes have increased sharply since 1999, and especially since the Millennium Summit in 2000, which agreed the MDGs, and the Financing for Development Conference in Monterrey in 2002. Figure 6 shows that aid, including debt relief, is currently running at about $100 billion per year, 30 per cent in real terms above the previous peak.

Figure 6: Long-term trends in ODA, 1960-2006



Source: UNCTAD, 2008

24. Nevertheless, the crisis illustrates the importance of being prepared for both short-term shocks and long-term challenges. Some emerging challenges are relatively easy to predict – and may well be high-impact events for the Commonwealth. Five topics are considered briefly below. They are likely to feature high on the agenda when Heads of Government discuss 'Partnering for a Sustainable and Equitable Future' in Trinidad in November 2009[1]. They are also topics which (a) are likely to challenge Commonwealth Finance Ministries, and (b) offer the possibility of mutual support and collective action among Commonwealth countries. The five are:

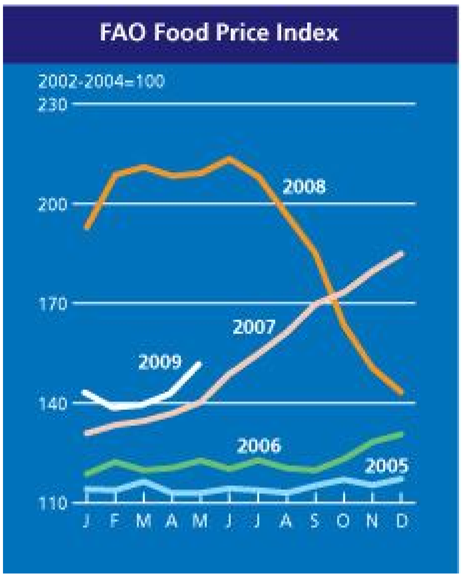
- The repercussions of the food crisis
- Climate change and national resource stress
- Urbanisation
- Demographic changes
- Changes in the global economy

[1] See http://www.thecommonwealth.org/news/33247/163102/185372/271108chogmtheme.htm

The repercussions of the global food crisis

25. The food crisis which exploded into public attention in 2008 greatly affected many Commonwealth countries – and reflects a continuing problem of food security, globally and in many individual countries. Prices of wheat and rice more than doubled in 2007-8 (**Figure 7**) – a particular concern when the poorest groups spend up to 80 per cent of their incomes on food. The World Bank estimated that more than 100 million people were pushed back below the poverty line. Prices fell sharply in 2008, but are still above 2005-6 levels and likely to remain so.

Figure 7

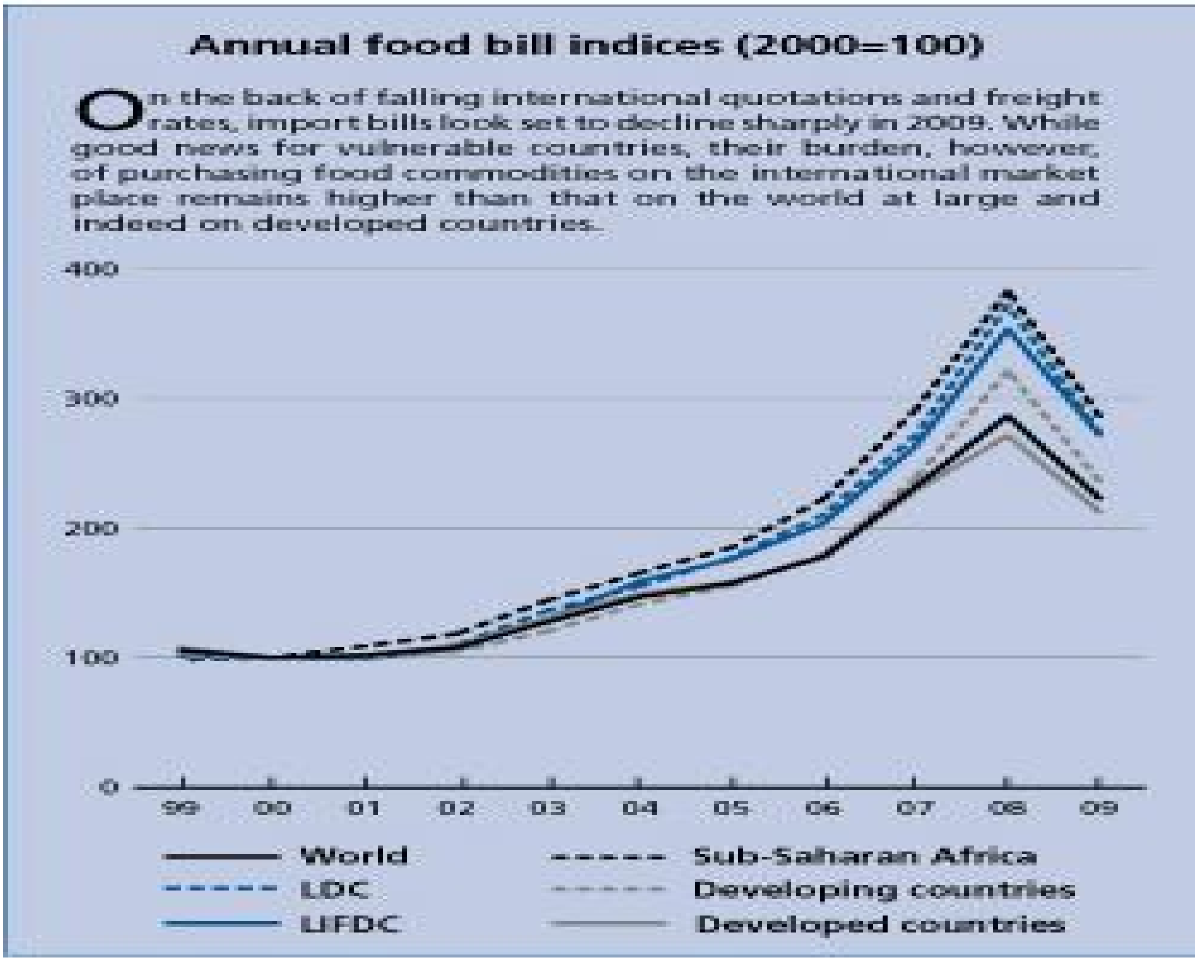


Source: FAO

26. The food price crisis illustrated an important lesson for Commonwealth countries: shocks affect poor households directly, but also cause macroeconomic and political problems which can have long-term consequences. In this case, there were long term costs to nutritional status and health; household resources were eroded; growth was disrupted; and political stability was undermined. There were food riots in more than 30 countries. These effects will outlast the fall in food prices.

27. Another lesson from the food crisis is the need for international coordination – for example in managing stocks. Shocks are intensified when markets are thin, stocks have been run down, trade is impeded and market actors stockpile. This was the case for rice in 2007, for example. Speculation may also have played a part. Import bills rose sharply in 2007-8, have fallen in 2009, but are still running at twice the pre-crisis level (Figure 8).

Figure 8



***Source**: FAO*

28. Some countries have been led to re-evaluate food strategies. For example, the UK has established a food security unit and is developing a food strategy to 2030, with the resilience of the food system as a core objective (http://www.defra.gov.uk/foodrin/security/index.htm). Many Commonwealth countries are in a similar position.

29. Internationally, food security has become a prominent topic, both for national policy-making and for international coordination (see, for example, discussions at the G8 in Italy in 2009[2]. How might the Commonwealth engage further in this debate?

Climate change and natural resource stress

30. Climate change is both a medium-term challenge, and an immediate threat to many Commonwealth countries, including island states. Both mitigation and adaptation are high on

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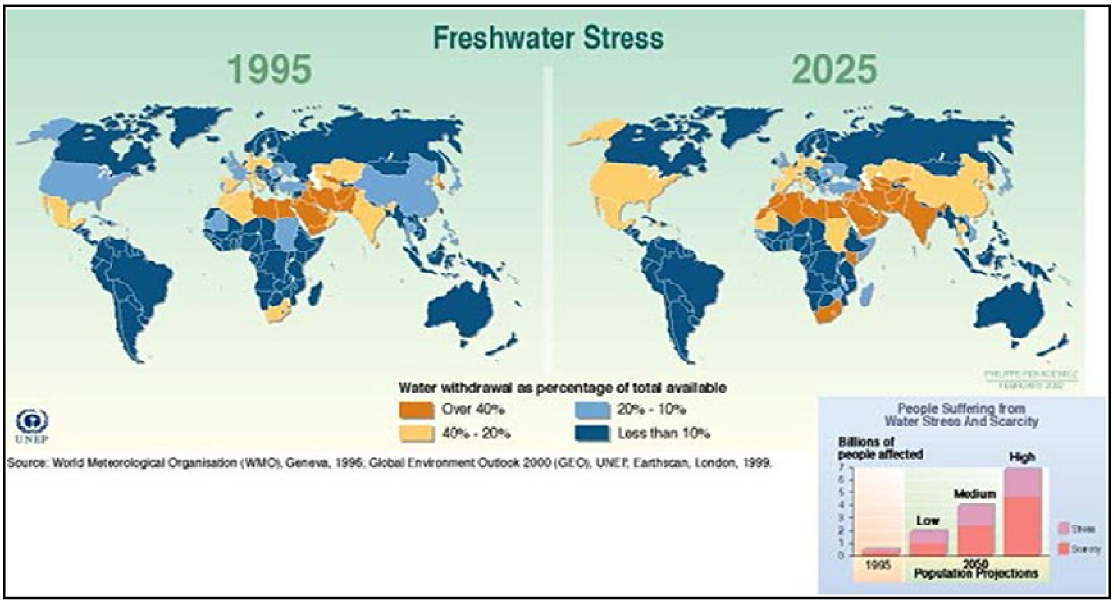
[2] See: http://www.g8italia2009.it/static/G8_Allegato/LAquila_Joint_Statement_on_Global_Food_Security[1],0.pdf

the agenda in the run-up to Copenhagen[3]. If climate change is to be tackled, economic models will need review and transition plans will need to be put in place. If carbon dioxide in the atmosphere is to be held at 450 or 500 parts per million, and temperature rise to 2 degrees, then by 2050 the average carbon 'ration' per person will be around 2 tonnes per annum. This compares with a figure for the US today of 20t, for the UK of 10t, for China of 5t and for India of 2t. Only the very poorest countries fall below the threshold. Stabilisation will still result in warming of at least 2°C, which will cause significant adaptation problems for developing countries. And developing countries will also be affected by global policies to reduce emissions, for example if support for biofuels pushes up the price of food. The estimates of how much this will cost are growing all the time. For example, the UNDP Human Development Report for 2008 estimated that adaptation alone would cost some $86 billion by 2015.

31. Climate change is a driver of resource scarcity, but other factors contribute, including population growth and rising income. Water scarcity is increasing as a result of these pressures. Figure 9 shows rapidly increasing freshwater stress and rapidly rising numbers of people affected.

Figure 9: Freshwater Stress



Source: United Nations Environment Programme website, accessed Feb 2009

32. The combination of climate change and natural resource stress is likely to lead to an increased number of natural disasters and to an increased humanitarian case load. The World Economic Forum Global Agenda Council on this topic has called for a new business model of humanitarian relief, involving better disaster planning and preparedness at national level. See also the International Disaster Reduction Strategy (http://www.unisdr.org/). The Commonwealth, of course, has been active on disaster risk mitigation, including through the establishment of the Commonwealth Disaster Management Agency, established in 200 to help provide insurance against disaster to small states (http://www.cdma.org.uk/).

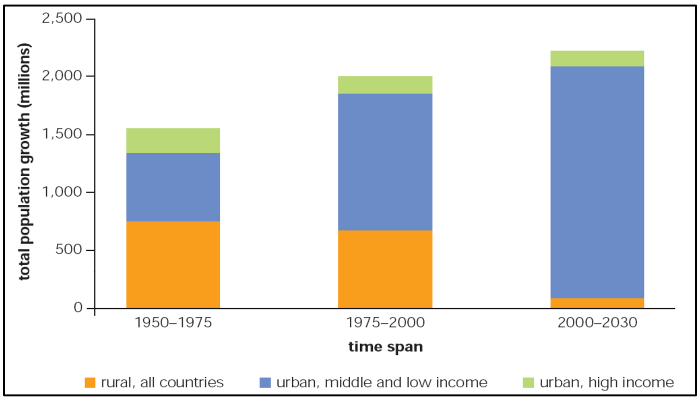
[3] See, for example, the 2010 World Development Report: http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/0,,contentMDK:20227703~pagePK:478093~piPK:477627~theSitePK:477624,00.html

33. Some questions arise for Commonwealth Finance Ministers. Among the many competing medium-term policy challenges in addressing climate change, can any be identified as the most easily achievable (e.g.: access to technology, practical assistance, capacity support, etc for the poorest)? Which among the challenges can be best addressed through collective action? Are there issues which Commonwealth Finance Ministers consider appropriate to lobby for and advocate at a global level?

Urbanisation

34. Urbanisation will reshape the social and economic landscape of many Commonwealth countries in the years ahead. Projections show developing countries with 80 percent of the world's urban population by 2030, with Africa and Asia hosting almost seven out of ten urban inhabitants in the world (**Figure 10**). Historically, urbanisation has played an important role in economic and social development: the recent UNIDO Industrial Development Report presents results showing that transactions costs are 25 per cent lower in urban areas compared to rural. However, World Bank data show that poverty is increasingly an urban phenomenon, with most of the urban poor living in slums. By 2030, on current trends, the numbers in slums will double, to 2 billion people.

Figure 10: Population Growth to 2030: Low- and Middle-Income versus High-Income Countries



Source: Commission on Growth and Development, 2008

35. Seen in these terms, urbanisation is both a threat (escalating poverty, slums) and an opportunity (concentrated social safety net and social sector provision, living environment close to employment opportunities, breeding ground for innovation and enterprise). Can more urbanised Commonwealth countries help others through the inevitable transition?

Demographic change

36. A demographic window of opportunity is opening in some low income regions, as dependency ratios fall, allowing higher consumption and investment. This could be a major opportunity for some Commonwealth countries. The opportunity is not universal, however. In Sub-Saharan Africa particularly, populations in countries such as Uganda are expected to triple in size by 2050. Globally, the number of 15-24 year olds will double by 2050. Population ageing is also a major factor, in both developed and developing countries, with the number of people over 60 expected to rise more than 50 per cent in developed countries and more than 200 per cent in developing countries.

Figure 11

TABLE I.5. AVERAGE ANNUAL RATES OF CHANGE OF THE TOTAL POPULATION AND THE POPULATION IN BROAD AGE GROUPS, BY MAJOR AREA, 2009-2050 (MEDIUM VARIANT)

Major area	*0-14*	*15-59*	*60+*	*80+*	*Total population*
World	-0.08	0.57	2.44	3.30	0.71
More developed regions	-0.09	-0.35	1.11	2.07	0.08
Less developed regions	-0.08	0.73	2.96	4.14	0.83
Least developed countries	0.73	1.99	3.57	4.18	1.69
Other less developed countries	-0.33	0.47	2.89	4.14	0.65
Africa	0.71	1.99	3.35	4.00	1.66
Asia	-0.38	0.37	2.75	3.94	0.58
Europe	-0.21	-0.66	0.98	1.93	-0.14
Latin America and the Caribbean	-0.67	0.36	2.88	3.83	0.55
Northern America	0.21	0.34	1.67	2.44	0.62
Oceania	0.31	0.76	2.03	2.96	0.91

Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat (2009). *World Population Prospects: The 2008 Revision. Highlights*. New York: United Nations.

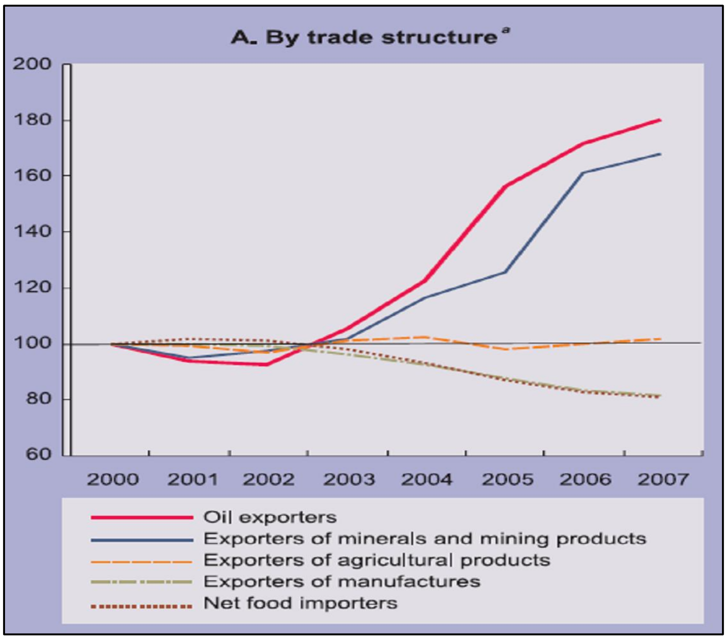
Source: (http://www.un.org/esa/population/publications/wpp2008/wpp2008_highlights.pdf)

Changes in the global economy

37. Significant changes can be expected, central to the policy-making dilemmas of Commonwealth countries. On pre-crisis growth trends, the number of middle income countries will increase sharply, with a corresponding reduction in the number of low income countries. The World Bank's long term strategic exercise of 2007 estimated that by 2015, the number of IDA-eligible countries would fall from 49 to 38, with the number of people in such countries falling from 2.5 to 1.1 billion. Poverty will be concentrated increasingly in fragile states.

Figure 12: Net barter terms of trade, selected countries, 2000–2007

(Index numbers, 2000 = 100)



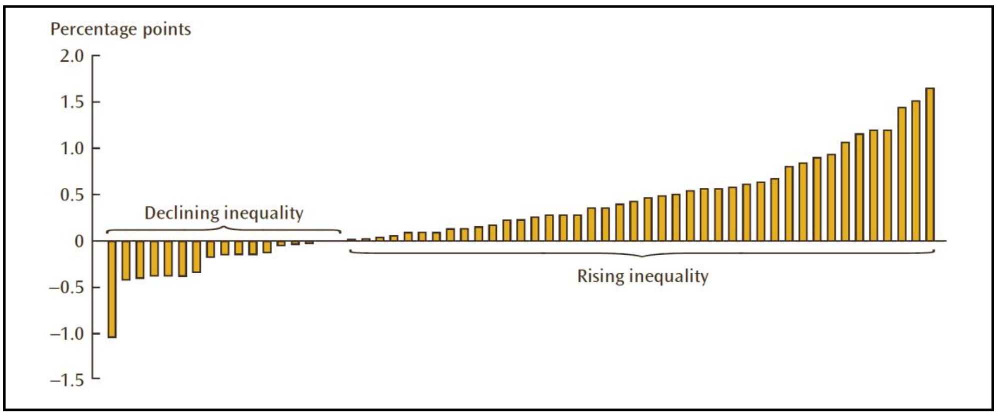
Source: *UNCTAD, 2008*

a) Developing and transition economies

38. Meanwhile, China's entry into the world economy has doubled the world labour: capital ratio and led to a commoditization of manufactures which has complicated the industrialization of poor countries. As Figure 12 shows, the terms of trade of manufactures have deteriorated, whereas those of agricultural exporters and oil and mineral exporters have increased. This stands conventional thinking on its head and requires new thinking on industrial policy. As UNIDO have emphasised, manufacturing offers the possibility of explosive growth and rapid reductions in poverty – but is lumpy in products, space and time, and therefore a difficult option for the poorest countries.

39. Around the world, income inequality has been increasing, partly as a result of high returns to skilled labour in open economies (**Figure 13**).

Figure 13: Annual change in Gini coefficient in 59 developing countries



Source: World Bank, 2008a

Implications

40. Put these changes together, adding in the probability of unexpected 'black swans', and it is apparent that the future will not be very much like the past. This makes the policy dilemmas more acute for Finance Ministers. The 'hunker down' and 'status quo' options look unattractive – indeed infeasible since future challenges will force a reaction from Commonwealth Governments – individually and collectively. As the ILO 'Global Jobs Pact' has put it[4]:

41. 'The world should look different after the crisis. Our response should contribute to a fair globalization, a greener economy and development that more effectively creates jobs and sustainable enterprises, respects workers' rights, promotes gender equality, protects vulnerable people, assists countries in the provision of quality public services and enables countries to achieve the Millennium Development Goals.'

42. Put this way, investing in change looks like the only option. But do Finance Ministers agree, with the thrust of the argument, but also with the priority challenges suggested? And where does the balance lie between national and international action?

Policy frameworks

43. In moving from problems (and opportunities) to challenges, it is important to note that the policy debate is (a) very active, and (b) moving fast. Given the size of the global crisis, it is not surprising that contributions are flooding in, from academics and policy-focused international institutions. For example, the debate between 'freshwater' and 'seawater' economists in the US has attracted a good deal of attention; as has the orthodox versus heterodox debate within the United Nations[5]. It is also not surprising that the crisis should have reopened or reinforced debates about national policy, particularly regarding the role of the state and the incentive and regulatory framework. A middle way exists, however, which may fit well with Commonwealth priorities.

44. The G-20 represents a consensus view, concluding at the April Summit that:

> 'We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions.'

45. Meanwhile, reporting to the UN General Assembly, the Stiglitz Commission argued that

> 'The ideas and ideologies underlying key aspects of what has variously been called neo-liberalism, market fundamentalism, or the Washington consensus doctrines have been found wanting.' (Para 136)

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[4] See : http://www.ilo.org/global/What_we_do/Officialmeetings/ilc/ILCSessions/98thSession/pr/lang--en/docName--WCMS_108456/index.htm

[5] See, for example, the 2009 Trade and Development Report, published by UNCTAD in September: http://www.unctad.org/Templates/Meeting.asp?intItemID=2068&m=17648&info=&lang=1

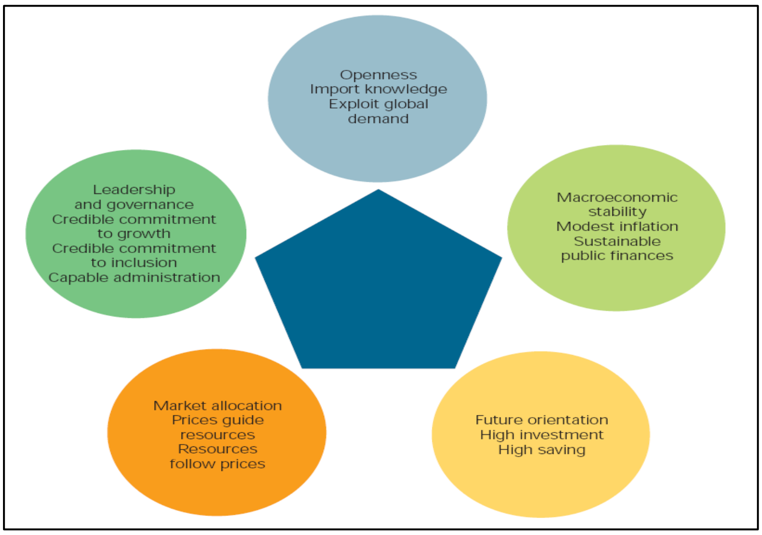
46. These differences play out at sectoral level, for example regarding the desirability of industrial protection – see a recent debate on this topic between Justin Lin and Hae-Joon Chang (Lin and Chang 2009).

47. The Washington Consensus was never intended to provide a development blueprint, but it does provide an insight into the consensus and a convenient starting point for discussion. This macroeconomic "consensus" was in favour of a separation of responsibility for monetary and fiscal policy. Macroeconomic advice centred on prudent fiscal management. Fiscal policy was considered best structured "on autopilot" of sustainable public deficit and debt rules. Monetary policy, independently overseen by central banks and the orientation of monetary decisions specifically aimed towards targeted inflation. Structural policies were characterised by significantly reducing government intervention, notably of import substitution policies, increased privatisation (notably of utilities), and trade and investment reform to a more open market oriented environment.

48. John Williamson himself, the author of the Consensus, has written that equity was a major omission from the Consensus. He has also called for expanded analysis of four major topics: pro-active stabilisation; active labour market deregulation; building institutions, including through the active application of thinking about 'innovation systems' (an approach he prefers to 'industrial policy'); and, again, efforts to achieve greater equity. (Williamson 2004).

49. Many have highlighted that no one policy set could determine a growth and development model, but "successful development" largely reflected a confluence of policy, politics, institutional structures and interventions. This kind of approach was reflected in the conclusions of the Growth Commission, which similarly emphasised a range of different factors underpinning growth (**Figure 14**): openness; macro-economic stability; functioning markets; good governance; and, highly relevant to this discussion, 'future orientation', with high investment and savings rates.

Figure 14: The Common Characteristics of High, Sustained Growth



Source: Commission on Growth and Development, 2008

50. The recently-published report of the Stiglitz Commission can perhaps be seen as challenging this thinking in some respects. It builds on Stiglitz' own insights about the Washington and post-Washington Consensus. The Commission's critique emphasises *inter alia*

- A misplaced belief that economic agents are rational, and that markets are efficient and stable and able to absorb shocks;
- Growing interdependence of the world economy leading to an increase in vulnerability;
- Growing global income inequality, leading to a reduction in aggregate demand, only offset by unsustainable household indebtedness;
- Global imbalances and imbalances in global aggregate demand, leading to a global version of the paradox of thrift;
- The weakening of automatic stabilisers, leading to greater instability in the world economy; and
- The loss of 'policy space' as a result of international agreements, especially on trade.

51. Some observers think that the rising sense of insecurity, coupled with climate change and other challenges, will strengthen the political case for increasing control over markets. They believe this is likely to see a shift "towards the national and away from the global" (Wolf, 2009) - already clear in financial intervention and protectionism as well as pressure to underpin national producers. The protectionist tendencies evident during the food crisis provide some evidence, as does the tendency to protection during the crisis: as early as March 2009, the World Bank reported that 47 trade-restricting measures had been introduced around the world (http://www.voxeu.org/index.php?q=node/3183).

52. There are real risks, however, that growth will be stifled and that 'beggar-your-neighbour' policies will become, to use Stiglitz' phrase, 'beggar thyself'. The G-20 statement of the consensus may be right in this respect. In its latest annual report, published in July 2009, the WTO has laid out some practical options for 'contingency measures' which enable countries to react to the crisis without undermining a rules-based trading system (http://www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report09_e.pdf).

53. Do Finance Ministers share this 'middle-way' analysis, seeking room for manoeuvre in managing markets? Are there priorities for new policy? And what international support and coordination is needed?

Policy specifics post-crisis

54. When it comes to specifics for Commonwealth countries, there is something of a divide, even on the consensus middle ground, between those outside observers whose main preoccupation is with the restoration of growth, and those more concerned with social provision. Thus, in a recent article in Finance and Development, the Director of the IMF's Research Department, Olivier Blanchard, focuses on the first, arguing that for recovery to be sustained

> 'Two rebalancing acts will have to come into play. First, rebalancing from public to private spending. Second, rebalancing aggregate demand across countries, with a shift from domestic to foreign demand in the United States,

> and a reverse shift from foreign to domestic demand in the rest of the world, particularly in Asia'[6].

55. Under the first head, the emphasis is on cutting government deficits and debt, in order to protect debt sustainability and keep interest rates low. This implies lower government spending and higher taxes, hence an interest in containing entitlement programmes. Under the second head, the emphasis is on replacing US domestic demand with demand for exports, principally from Asia – mainly achieved by means of appreciation of Asian currencies vis-a-vis the dollar.

56. This approach contrasts with the writings of those primarily concerned with poverty. For example, in a review of the poverty impacts of the crisis, Chen and Ravallion, both of the World Bank, predict that an additional 64 million people will fall below the $US2 per day poverty line as a result of the crisis, and draw particular attention to issues like families being unable to pay school fees, or children being forced into labour, or the impact on the nutrition and health of young children in poor families. They report that 'the balance of the evidence suggests that crises have a negative effect on child health and mortality in most poor and middle-income countries'.

57. Others have a more long-term focus, which resonates with the requirement to move into Quadrant A of **Figure 1**. Thus, a contribution by UNCTAD, for the Trade and Development Board meeting in May 2009, concludes that

> 'Developing countries need to continue to address income inequality and to invest more in education, training, trade-adjustment assistance, health care, community development and tax policy.'
> (http://www.unctad.org/en/docs/cicrp1_en.pdf).

58. ILO, similarly, has agreed a 'Global Jobs Pact', focusing on protecting employment, delivering public services, and building social protection for all[7].

59. Relating these priorities to the future challenges presented in the previous section, this kind of approach implies an agenda for Commonwealth countries which includes:

- Strengthening social protection;
- Protecting public services;
- Investing in research and development;
- Investing in education and training;
- Building the infrastructure needed for urbanisation and adaptation to climate change;
- Supporting key productive sectors, including agriculture.

60. In some Commonwealth countries, the 'demographic gift' may provide some breathing space and allow the redirection of resources. However, the problem for the Commonwealth is that some developing country members have very few macroeconomic policy options for the

[6] http://www.imf.org/external/pubs/ft/fandd/2009/09/blanchardindex.htm
[7] See : http://www.ilo.org/global/What_we_do/Officialmeetings/ilc/ILCSessions/98thSession/pr/lang--en/docName--WCMS_108456/index.htm

future, even if they have been able to manage the crisis. They find themselves at risk of falling into quadrant D or even C of **Figure 1**. They are likely to find themselves increasingly resource constrained, and their policy response will depend virtually entirely on access to international liquidity. However, as the international banking sector continues to realign balance sheets combined with this implied financial protectionism suggests that access to foreign savings is unlikely to sufficiently ameliorate in the near future. In addition, official financing through aid is also likely to become tighter (declining in normal and possibly real terms) as developed country growth declines and as countries look to restructure and reduce their deteriorated fiscal positions and public indebtedness. According to World Bank figures, external financing needs in 2009 are expected to exceed private sources of financing in 98 of the 102 developing and emerging countries.

61. International support will inevitably be necessary, with additional funding delivered through accountable and effective channels. In this connection, the G-20 made initial and relatively modest proposals, promising $50 billion for poor countries. This is not enough to compensate for the $750 billion of lost growth in 2009 alone -- $50 billion of that in Africa. It is important that the money be additional to aid already promised, including Aid for Trade. And money given as grants by donor countries to the international institutions should not turn into loans by them that then set up a new debt crisis. That said, new money makes it more likely that social protection measures will be implemented, and that new investments can be made to help Africa trade. Since the G-20 Summit, five working groups have been preparing more detailed proposals various aspects of the international agenda, and it will be interesting to hear Commonwealth Finance Ministers who are also members of the G-20 report on:

- Strengthening transparency and accountability;
- Enhancing sound regulation;
- Promoting integrity in financial markets;
- Reinforcing international cooperation; and
- Reforming the International Financial Institutions[8].

62. In addition, the analysis suggests a menu of topics for discussion:

- Are current vulnerability indicators adequate to measure the resilience and preparedness of Commonwealth economies emerging from crisis?
- What level of public expenditure will be needed to invest in the social protection, infrastructure, human capital and technology needed to manage future challenges in Commonwealth countries? How can it be funded?
- What changes to the incentive and regulatory framework are needed to manage external shocks and create strong economies? Is there sufficient policy space available?
- What kind of national planning process is appropriate to deal with post-crisis economic and social policy in Commonwealth's member countries?

63. To summarise, it can be taken as read that Commonwealth countries would like to find themselves in Quadrant A of Figure 1, strong and resilient in both the short and long terms. It seems evident, too, that 'investing in the future' is the only policy option, given the scale of likely challenges. Both those ambitions will be hard to realise, however, especially in smaller, poorer and more vulnerable Commonwealth states. What, then, can the Commonwealth do?

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[8] See: http://www.g20.org/about_working_groups.aspx

Options for the Commonwealth

64. The Commonwealth provides a good forum for discussion of these issues, offers opportunities for mutual aid and partnership, and may also provide a vehicle for collective action. It can play a particular role in supporting the most vulnerable members, including some small states, and also regional organisations.

65. It is important that the Commonwealth brings together developed and developing countries, along with some G-20 members and others outside the G-20. From a climate change perspective, there are Annex 1 and Annex 2 countries. There are also countries in all these groups which fall in different places on the strength/resilience spectrum, both short and long term.

66. It is also highly relevant that Commonwealth Heads of Government will be focused on ‘Partnering for a Successful and Sustainable Future’, when they meet later in 2009.
The Commonwealth should not duplicate the work of other fora, but should be explicit about value-added. Some immediate options fall under three headings:

a. Global advocacy, feeding into the G-20 and G-8, and into the Copenhagen negotiations, among others;
b. Commonwealth Partnerships aimed at managing the crisis and making the transition to dealing with future challenges; and
c. A work programme for the Commonwealth.

Global advocacy

67. There have been many successful examples of Commonwealth countries acting together in global advocacy, as for example when Finance Ministers meet prior to the Annual Meetings of the World Bank and the International Monetary Fund. In June 2008, a task force of Commonwealth leaders met in London and issues a Marlborough House Statement on Reform of International Institutions, which concluded *inter alia* that

> ‘Well designed international institutions have a fundamental role to support all countries to meet their economic, political, humanitarian and security challenges. Through collective co-operation, embodied in international institutions, the global community will foster the conditions for a fully inclusive and equitable global society. The commitment of the world’s major powers to multilateralism and its underlying values remains central to any successful settlement on a new architecture of international institutions in this century.
> As members of the Commonwealth, we recognise the strength of multilateral co-operation founded on consensus amongst countries with diverse backgrounds, interests and cultures. We believe that reform and construction of new international institutions should be built on the following guiding principles:
>
> - Institutions must enjoy the legitimacy not only of their member states but also of the wider international community in order to command confidence and commitment.
> - It is essential that all countries have equal voice and fair representation.
> - A voice for all countries is only valuable if it is listened to and is reflected in decision-making. It is essential that institutions are responsive, with the interests of all members, especially the smallest and poorest, being taken into account.

- The activities and governance of institutions must be flexible, responding to new challenges, national priorities and the specific circumstances of member states, and changing global realities.
- Institutions must have clear responsibilities and the conduct of their business must be transparent and accountable to the entire membership and the wider public.
- It is essential that they be effective and capable of addressing today's global challenges.

We are committed to reform that creates an effective multilateral system, and that supports a more democratic global society with greater equity and fairness. The new generation of international organisations should reflect a new cooperative spirit.' (http://www.thecommonwealth.org/document/34293/35144/180216/marlborough_house_statement.htm).

68. Taking these principles into account and pursuing the idea of a North-South deal to help manage the transition from short- to long-term, Finance Ministers will no doubt wish to explore:

- Coordination of positions on financing.
- Coordination of positions on trade.
- Coordination of positions on climate change.
- Formal Commonwealth contributions to G-20 Working Groups.
- New solidarity or financing mechanisms.

Commonwealth partnerships

69. The Commonwealth has an important network function, linking countries and regional organisations. Member countries may wish to consider:

- Technical contacts on macro-economic transitions and sectoral policy;
- Financial assistance, especially to poorer and more vulnerable members.

Commonwealth work programme

70. The Secretariat could help with both analysis and technical support:

- A work programme on indicators, building on existing vulnerability indicators, but with an emphasis on longer term resilience and readiness to deal with global challenges.
- Regular reporting of resilience and readiness.
- Reporting on emerging policy debates, a kind of 'policy watchtower'.
- Reporting on major global trends.
- Assistance to countries in national longer term preparedness, including with the use of scenario planning.
- Sectoral initiatives, for example on food security or manufacturing.
- Facilitating direct inter-Commonwealth country partnerships

Conclusion

71. A striking feature of the crisis has been the different speed at which countries were affected by the global recession, the different impact the crisis has had in different countries, and the different speed at which recovery is taking place. This suggests that global inequality may well worsen as a result of the crisis. The asymmetric nature of future shocks is likely to exacerbate this trend. Growing global inequality should be a concern for the whole global community, but may particularly concern the Commonwealth.

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Appendix

The Washington Consensus

1. Fiscal Discipline
Budget deficits, properly measured to include those of provincial governments, state enterprises, and the central bank, should be small enough to be financed without recourse to the inflation tax. This typically implies a primary surplus (i.e., before adding debt service to expenditure) of several percent of GDP, and an operational deficit (i.e., disregarding that part of the interest bill that simply compensates for inflation) of no more than about 2 percent of GDP.

2. Public Expenditure Priorities
Policy reform consists in redirecting expenditure from politically sensitive areas, which typically receive more resource than their economic return can justify, such as administration, defence, indiscriminate subsidies, and white elephants, toward neglected fields with high economic returns and the potential to improve income distribution, such as primary health and education, and infrastructure.

3. Tax Reform
Tax reform involves broadening the tax base and cutting marginal tax rates. The aim is to sharpen incentives and improve horizontal equity without lowering realised progressivity. Improved tax administration (including subjecting interest income on assets held abroad – flight capital – to taxation) is an important aspect of broadening the base in the Latin context.

4. Financial Liberalisation
The ultimate objective of financial liberalisation is market-determined interest rates, but experience has shown that, under conditions of a chronic lack of confidence, market-determined rates can be so high as to threaten the financial solvency of productive enterprises and government. Under that circumstance a sensible interim objective is the abolition of preferential interest rates for privileged borrowers and achievement of a moderately positive real interest rate.

5. Exchange Rates
Countries need a unified (at least for trade transactions) exchange rate set at a level sufficiently competitive to induce a rapid growth in non-traditional exports, and managed so as to assure exporters that this competitiveness will be maintained in the future.

6. Trade Liberalisation
Quantitative trade restrictions should be rapidly replace by tariffs, and these should be progressively reduced until a uniform low tariff in the range of 10 percent (or at most around 20 percent) is achieved. There is, however, some disagreement about the speed with which tariffs should be reduced (with recommendations falling in a band between 3 and 10 years), and about whether it is advisable to slow down the process of liberalisation when macroeconomic conditions are adverse (recession and payments deficit).

7. Foreign Direct Investment
Barriers impeding the entry of foreign firms should be abolished; foreign and domestic firms should be allowed to compete on equal terms.

8. Privatisation
State enterprises should be privatised.

9. Deregulation
Governments should abolish regulations that impede the entry of new firms or restrict competition, and ensure that all regulations are justified by such criteria as safety, environmental protection, or prudential supervision of financial institutions.

10. Property Rights
The legal system should provide secure property rights without excessive costs, and make these available to the informal sector.

Source: Williamson (ed) 1994