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# Global Governance and Growth for Human Development

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#### ABSTRACT

This paper analyses policies to enhance inclusive growth and human development through two key institutional dimensions: the articulation of multilateral, regional and national development banks, and the coordination of fiscal and monetary policies at the global level. On the one hand, the 2007/8 global financial crisis showed that the private financial system is not performing well enough to support the real economy, particularly in the context of a human development-based model. The private financial sector has been pro-cyclical, over-lending in boom times, and rationing credit during and after crises, limiting working capital and, especially, long-term finance crucial for investment. The paper explains how public development banks play a key role catalysing additional long-term private finance and thus leveraging public resources for inclusive and sustainable development, and providing counter-cyclical financing in times of crisis. It identifies some key characteristics of “good” development banks and underlines that it is desirable to expand their role in countries where they are already present and to set them up in the ones where they still do not exist. On the other hand, the paper emphasizes that large economies’ policies have important externalities on the rest of the world, and especially on developing and emerging economies’ growth and human development prospects. It recommends increased global coordination of macroeconomic policies with an expansionary bias, which could significantly increase global growth, favouring low income countries.

## Introduction

A number of key new and old challenges face the international community in the pursuit of better human development, in the context of sustainable development goals. One of the key new challenges is the significant slowdown of growth that has occurred, globally and in different regions, since the 2007/8 global financial crisis which is making the achievement of human development much harder. A somewhat older challenge, but made more difficult by the global slowdown of growth, is the urgent need to mitigate climate change.

The fact, as we analyse below that growth has become so mediocre in so many regions has made it far more difficult to continue along a path of poverty reduction and increased social spending that had facilitated higher human development in recent decades. This is particularly worrisome, as this slowdown of growth has more recently reached also poorer countries, and specifically the low-income countries of Sub-Saharan Africa, where the IMF's recent World Economic Outlook Update from July, 2016, is projecting a mere 1.6% of growth for 2016, significantly below recent levels of growth, and allowing no increase in GDP per capita. Similarly, Latin America is projected by the same IMF document to see its GDP growth fall from 0% in 2015 to -0.4% in 2016, implying also an important decline in GDP per capita, and a strong deterioration from previous trends.

This sharp decline in growth in Africa and Latin America is caused by a number of important factors, including the continued weak growth in developed economies, where growth is projected at a mere 1.8% in 2016, further declining to 1.6% in 2017, and where the Eurozone is still growing at a rate below those numbers, suffering from anaemic growth. It is also influenced by the fairly rapid decline in Asian, including Chinese growth—even though emerging and developing Asia is still expected to grow at a respectable 6.9% in 2016, which however is significantly lower than in the past. The slower growth and the rebalancing in the economic model towards more consumption demand in China as well as slower growth in the developed countries has led to a sharp fall of commodity prices, which is damaging the growth prospects of regions, such as Sub-Saharan Africa and Latin America, though clearly other factors are in play.

The fact that there is such a major slowdown in growth, and that this has become such an important barrier for the fulfilment of continued human development means that great priority must be given internationally, regionally and nationally, to restoration of growth, as a pre-condition for human development. For this reason, in the remainder of this note, we give quite a lot of emphasis (especially in section 2, but also in section 1) to the restoration of growth, and its' implications for regional and global governance.

It is important to mention that, besides policies and actions to restore growth, there seems to be a clear need to compensate, especially poorer countries, for the external shocks they receive from the

international economy, as well as from natural disasters. While such mechanisms are always important, they become far more crucial, in times when growth slows down, and the terms of trade of many countries, especially poorer ones, deteriorate. Such compensatory mechanisms, provided for example by the IMF and the European Union, need therefore to be further improved.(see Griffith-Jones and Gottschalk, 2012, for a discussion of these issues) Similarly, the possibility of new issues of Special Drawing Rights, (SDRs), by the IMF, to provide greater international liquidity to countries, whose foreign exchange reserves have been depleted, due to trade shocks or due to declines in private capital inflows or increases of their cost, becomes far more urgent.

Given the focus of this note, we will not explore here such valuable mechanisms, but will focus first on the policy challenge of trying to restore growth worldwide and in developing as well as emerging economies. Furthermore, given the gaps in development finance, including for funding the urgently needed structural transformation to achieve both more inclusive and more environmentally sustainable development-so essential for human development, - even more in the light of declines in private capital flows to emerging and developing countries, as well as increase in their cost, we will secondly focus in much detail on the importance of a greater role for public development banks, multilaterally, regionally and nationally; we will do this mainly in section 1, but will also in section 2, show how they can contribute to a strategy for more rapid growth, especially if their actions are more coordinated).

This note will therefore explore two key themes relating global governance to human development: 1) multilateral, regional and national development banks, and their roles in supporting continued inclusive and sustainable growth 2) impact of developed economies' fiscal and monetary policy on developing and emerging economies on emerging and developing countries' growth potential, as one pre-condition for achieving more and better human development.

## Multilateral, regional and national public development banks

After the 2007/8 global financial crisis, the very serious limitations and problems of a purely private financial sector to fund inclusive, sustainable and dynamic development have become far more evident, even to mainstream economic thinking.

It became obvious that the private financial system is not performing well to support the real economy, particularly in the context of a human development based model. The private financial sector has been pro-cyclical, over-lending in boom times, and rationing credit during and after crises, limiting working capital and, especially, long-term finance crucial for investment. In both tranquil, but

even more in turbulent times, it has not funded sufficiently long-term investment in innovation and skills needed for growth and job creation; key sectors like infrastructure, essential for dynamic and inclusive growth, as well as renewable energy and energy efficiency, key for sustainable growth, have been insufficiently funded. Small and medium enterprises get insufficient credit, which is often costly and short-term, – problems accentuated in low-income countries. (see Griffith-Jones and Gottschalk, 2016, for recent evidence in those countries).

Furthermore, the private financial sector, particularly if not properly regulated, has been a major factor in causing frequent and developmentally as well as fiscally costly crises in both developing and developed countries. These crises have been devastating for poverty reduction and for human development.

These limitations of the private financial sector have increasingly drawn attention to and increased support for the positive role for inclusive and sustainable development that effective and well-run public development banks can play, at national, regional and multilateral levels. The recent creation of two very large multilateral development banks, the Asia Infrastructure Investment Bank (AIIB), -where 57 countries, including all the major European countries and most important Asian countries have joined as members, - and of the BRICS (Brazil Russia India China and South Africa) NDB (New Development Bank) also reflects the shift in the development finance paradigm towards a more balanced public private mix, for provision of long-term funding.

In this sense, it can be argued that this more balanced and diversified institutional development, which gives a greater role than in the recent past to public development banks, represents a return to the type of financial system, more prevalent in the decades after World War II, - of a mixed financial system, which was more successful in funding dynamic and inclusive development.

It is also interesting that the role of development banks has, especially recently, not just been highlighted as important in developing and emerging economies, but also in developed ones. Thus, as private lending fell, the European Investment Bank (EIB) has played a prominent role in the provision of lending during the Eurozone debt crisis. At a national European level, Germany's public development bank, KfW, now the second largest commercial German bank, has played a very positive role in increasing lending counter-cyclically—for example to small and medium enterprises (SMEs)—during the crisis, as well as funding on a significant scale key sectors, such as investment in renewables. In Europe, these actions are perceived and highlighted as a valuable model for other countries. France has just created a new public development bank and Ireland has created a large special public vehicle for funding SMEs.

The third United Nations International Conference on Financing for Development held in Addis Ababa in July 2015 underscored strongly the role of development banks today and in the future in the

achievement of sustainable development, in the sense of a process that helps fund economic investment, jobs, growth, social inclusion and environmental sustainability. This support for development banks was clearly reflected in the Addis Ababa Declaration and Action Agenda on Financing for Development. (AAAA, 2015).

One of the key features of good development banks, especially at a national, but also at a regional and multilateral level is promoting and helping fund structural transformation, key to dynamic, inclusive and sustainable economic growth. Indeed, national development banks are increasingly seen as a valuable instrument to help implement national development strategies. This was reflected in the Addis Declaration, where governments agreed: “*We stress that development banks should update and develop their policies in support of the post-2015 development agenda, including the sustainable development goals...*” (AAAA, op cit).

## INSTRUMENTS FOR LONG-TERM STRATEGIES

The greater need for instruments to implement more long-term national development strategies for structural transformation has been increasingly recognized. This coincides with a renewed and growing recognition of the value of a modern “industrial policy” and the importance of an “entrepreneurial and development State”, that encourages and leads, providing the vision and the dynamic push for private innovation and structural transformation (Chang 2002, Wade 2003). This builds on the success stories of the past, for example in East Asia, as well as more recently in China and India; Mazzucato (2013) also shows that much key innovation in the United States, the most free-market of economies, was spear-headed by public funding for innovation, though implemented by the private sector.

However, there is an important new element. There is an urgent need for a major structural transformation in the development model, to make inclusive and human centred growth compatible with the needs of the planet. This implies the urgency of major investment in green development, for example renewable energy, with public development banks as a key instrument for this.

In a complementary perspective, Stiglitz and Greenwald (2014) add the very important dimension that inclusive and sustainable growth requires the creation of a learning society and a knowledge economy—public development banks can be important institutional vehicles for supporting this. Indeed, development banks can help overcome market failures in both financial and knowledge markets simultaneously, as well as supporting structural transformation.

## A KEY ROLE FOR DEVELOPMENT BANKS

Public development banks can and do play a key role in catalysing additional long term private finance and thus leveraging public resources for inclusive and sustainable development. This is particularly valuable at times when Governments are relatively resource constrained, though useful in all times.

Indeed, though development banks, have paid-in capital provided by Governments, they mostly raise their funds for financing their lending on the international and national private capital markets. Typically, their loans are also co-financed by private lending and investing and mobilize broader financial resources by leveraging public resources. To illustrate this leverage, we take the example of the European Investment Bank (EIB), the EU regional public development bank. The EU governments agreed in 2012, to double the paid-in capital of the EIB by Euro 10 billion. This has allowed the EIB to increase its' own lending by around Euro 80 billion, funding this lending on the long-term international and national capital markets, willing to lend to EIB at low cost, given its AAA rating; as the EIB typically requires co-financing of at least 50%, mainly by private lenders or investors, this leads to additional funding of projects of around Euro 160 billion; the leverage for public resources implied here is sixteen, particularly valuable, as pointed out above, when fiscal resources are scarce.

Furthermore, techniques are used so the resulting loans will be attractive to private lenders and investors, whilst being able to provide finance of sufficient maturity and sufficiently low cost to borrowers. Indeed, where the borrowers are in very poor countries and/or are funding investment in global public goods, like limiting climate change, the finance provided by development banks can be blended with grants, to provide concessional finance.

Indeed, development banks can help catalyse and co-finance with private finance, in ways that prolong maturities, which is key for funding development. It is important to stress that national development banks, in particular, only lend for specific previously evaluated projects and companies. This is an important difference with private banks that do much of their lending to other financial actors, including for non-productive, and even speculative, activities.

## COUNTER-CYCLICAL ROLE IN PROVIDING LONG-TERM FINANCING FOR DEVELOPMENT INVESTMENT, WHEN PRIVATE FINANCE FALLS

The positive counter-cyclical role many development banks played during the crisis and its aftermath has been accepted, both in emerging and low-income countries, but also increasingly in developed economies.

This is particularly crucial to help maintain long term investment, including in infrastructure, such as social infrastructure, thus ensuring continuity of existing projects and helping new ones start, valuable both for short term growth and long term development.

There is a growing body of detailed empirical evidence that national public banks provide counter-cyclical finance. For example, Brei and Schclarek (2012a) and (2012b), compare the lending responses across national public and private banks to financial crises using balance sheet information for about 560 major banks from 52 countries during the period 1994 to 2009. They find evidence that the growth rate of lending during normal times is higher for the average private bank compared to the average public bank. During financial crises, however, private banks' growth rate of lending decreases while that of public banks increases. These results indicate that public banks have played a counter-cyclical role in their banking systems, while private banks behaved pro-cyclically.

Other previous papers reached similar conclusions. Micco and Panizza (2006), for example used bank-level data for 119 countries for the period 1995-2002 and find that lending by government-owned banks is less sensitive to business cycle fluctuations than that of (domestic and foreign-owned) private banks. They find that this differential behaviour is due to an explicit objective to stabilize credit.

The 2007/2008 crisis showed that multilateral and regional development banks of the developed and developing world also significantly increased their total lending to developing countries in the years when these were most affected by the North Atlantic crisis.

It is encouraging, that the MDBs and RDBs collectively increased their lending commitments to emerging and developing economies by 72 percent between 2008 and 2009, the year when private capital flows to these countries fell most sharply as a result of the global financial crisis. (Griffith Jones and Gottschalk, 2012). Their disbursements also grew significantly in the same year by 40 percent, though the increase was slower than commitments. This represented a major counter-cyclical response, which helped sustain investment in those countries, including in the social sectors, above levels they would have otherwise had.

However, the counter-cyclical response of MDBs could be further improved, as it was proportionally far smaller for low income countries than for middle income countries, and it was also often slower for disbursements than for commitments (for more details see Griffith-Jones and Gottschalk 2012, op cit).

## POLICY AND INSTITUTIONAL PROPOSALS

Given the important roles that public development banks can and have played, it seems clearly desirable that their roles are expanded, multilaterally, regionally and in countries where they already exist. Indeed, one of the key lessons that can be drawn from development banks' experience is that their scale is important. If a development bank has sufficient scale and represent/s a significant proportion of the financial sector in a country, its impact in fulfilling their roles, can be more

meaningful, especially in helping support structural transformation, providing counter-cyclical financing in crises and downturns, and supporting greater inclusion.

Furthermore, in countries where such development banks do not exist at present, and very much including low-income countries, it seems very desirable to set them up. Collaboration by existing development banks, whether multilateral, regional or national, can be very valuable, so that good experiences can be transferred, as well as errors not repeated.

Last but not least, a very important point needs to be emphasized. This is the need for “good” development banks. It is important to stress it is key to have as “good” development banks as possible, that is those, that are well run, and well governed, so they can fulfil their functions well. An important aspect is that we should always be aware that the correct comparator for a public development bank is not some “ideal” non-existent financial institution, but the equivalent private financial institution, and that the main aim is to maximize development impact, whilst assuring minimal commercial returns. Furthermore, it is important to stress that “good” national development banks need to collaborate effectively, both with private financial institutions and investors, as well as with regional and multilateral development banks.

The need for “good” development banks needs to be placed also in a broader context, considering also that in the past development banks have had problems in their functioning, that undermined, at least partly their valuable potential contribution to sustainable and inclusive development. Clearly further research is required on this topic of what makes a “good” development bank. In a preliminary way, it would seem that important features would need to include: a) clear targets for the development bank, in the context of a clear national development framework, b) good governance, to avoid influence of special interests, avoid corruption and promote alignment with national development strategies c) correct incentives for bank staff and for borrowers, to ensure loans are made in ways that both maximize development impact, and ensure a minimum commercial return d) transparency of operations of the development bank; independent evaluation of their performance; accountability to national Parliaments and civil society e) provision of technical assistance to borrowers, when required

Besides expanding and improving existing development banks, as well creating as new ones where they do not exist, there is greater need for coordination amongst development banks, so that they can carry out important national, regional and international challenges. Indeed, there is much talk about joint public –private development finance. This is indeed important. But equally important is the need for more rigorous coordination between the World Bank and Regional Development Banks, as well as between them and the national development banks. Indeed, the best way of thinking about development banks is as a system, where valuable synergies are created by the collaboration between these different categories of development banks. For example, a national development bank may fulfil

its' development functions better, if its loans and other activities are coordinated with loans from regional and/or multilateral development banks. In the same way, the effectiveness of the activities of multilateral and regional development banks can be enhanced if they operate in countries with good and effective national development banks, that have local knowledge (and therefore less information asymmetries) of the projects or sectors being funded.

Coordination can have different degrees. A first one is to lead to complementing activities, rather than competing ones, (though some element healthy competition, e.g., a “race to the top”, to deliver the best projects, which maximize development impacts, the most speedily, at lowest cost of loans can be positive).

However, coordination can be also deeper. Should different development banks, e.g., regional and multilateral, as well as national, coordinate to see how best they can collaborate to meet certain key public goods in different sectors and regions? A good example is the need to expand funding on a large scale for investment in renewable energy, to help countries meet their targets for climate change mitigation and providing electricity for all. This is a major task, where the needs are being increasingly clarified, but where the means for funding them, and the projects through which they will be implemented, as well as the complementary policies to make them happen need to be systematically evaluated, and then carried out. Important divisions of labour and specific forms of collaboration could be defined between different development banks. Such a collaboration could be done more extensively at an informal level, as it often happens already; however, such coordination could be done more formally, for example through the G-20, the Bretton Woods Institutions and/or the United Nations.

Such coordination could be very valuable to meet targets in several SDGs, especially in areas of public goods, both regional and global, such as mitigating climate change, and helping fund more infrastructure, including for social development, such as educational establishments and hospitals.

A final point needs to be made on such cooperation and coordination. As mentioned above, two major new institutions have recently been created, the AIIB and the NDB.

Both are not just important additions to the development bank family, and bring important additional financial resources and expertise to development finance. They also have a new important characteristic in that their capital is mainly (AIIB) or exclusively (NDB) funded by emerging economies. This reflects an important shift towards a greater role of Southern institutions in development finance, with a number of potentially important implications for global governance of development finance, including more diverse sources of finance for developing and emerging country borrowers, as well as probably less conditionality or conditions more appropriate for their level of development. In the context of our recently above proposal of closer coordination, to meet key SDG

challenges, it seems important that any such coordination effort includes these new development banks from the start.

## Impact of developed economies fiscal and monetary policy on developing and emerging economies

There is increased consensus that large economies' (and especially though not only developed ones, on which we will focus here) policies have an important effect on the rest of the world, and especially on developing and emerging economies growth and human based development prospects.

Here we will examine mainly fiscal policies, though we will also refer briefly to monetary policy. In both cases, there are important externalities from decisions taken in large developed economies on other economies, -externalities that have and still are often ignored. An important difference pointed out by the Chair of the US Council of Economic Advisors, Jason Furman (2016) is that whilst expansionary fiscal policies in a major or major group of developed economies are most likely to have positive externalities on other, especially developing and emerging economies (DEEs), expansionary monetary policy, for example by the US, may have had negative externalities for the rest of the world, and especially for the DEEs. Indeed, looser monetary policy, starting with near-zero capital costs, is likely to generate demand primarily through increases in competitiveness. This is a zero-sum game, since currency movements switch demand from one country to another rather than increase it globally.

Fiscal expansions, in contrast, raise demand on a global basis. International coordination seems necessary to avoid an excessive and self-defeating reliance on monetary policy and achieve a mutually rewarding reliance on fiscal policy to address problems.

The issues of the need for coordinated international responses were recognized clearly at the successful G-20 summit in London in April 2009, given the seriousness of the financial crisis (although the problems were misdiagnosed as cyclical and temporary rather than more secular and enduring, as Summers, 2016, points out). The common commitments undertaken there to engage in fiscal expansion and enhance the capacity of international financial institutions to respond to problems in emerging markets, such as expanding the capacity of the IMF to lend by a large quota increase and by a significant Issue of SDRs, were effective in halting the collapse of the global economy, as well as helping maintain growth and employment in the DEEs, well above what it would have been without such measures.

Unfortunately, subsequent G-20 summits took limited action and had a misguided preoccupation with fiscal austerity, thus missing opportunities to accelerate global recovery.

Going forward, the key priority of G-20 summits—as it was in London in 2009—should be increasing global demand and making sure that it picks up particularly in those countries where there is the most economic space, especially in countries with large current account surplus. As we discuss below, one area where there is ample space for a more expansionary fiscal policy is the European Union.

Illustrating clearly both the need for greater international coordination, and—especially—the need for a more expansionary fiscal policy is the case of the Eurozone, where monetary policy has in recent years been used very significantly, but where fiscal policy has been severely constrained; this has been true not just for countries with large debt and with a history of large current account deficits, like Greece, Spain and Portugal, (which clearly need more fiscal space than they have been given by the European Commission and the International Monetary Fund), but also, and even more, by countries like Germany and Holland, which—in spite of their very large current account surpluses, and large fiscal space—have also pursued very tight fiscal policies; in the case of Germany the current account surplus was 8.5 % of GDP in 2015, (Eurostat, 2016) and fiscal policy continued having what is termed a black zero target, that is aiming at zero public sector deficit. Indeed, there is a Eurozone rule that countries having current account surpluses above 6% of GDP should be fined; however, this rule has not been implemented for countries like Germany and Holland. This raises the issue of selective implementation of rules, leading to asymmetric and deflationary bias for adjustment.

In the same way, the European Commission, in its evaluation of countries' economic policies and performance, carried out twice yearly during the European semester, has in its mandate to evaluate not just variables like fiscal deficit, debt to GDP and other financial macroeconomic variables, but also real economy variables, such as employment. Nevertheless, de facto it is the performance of the financial variables, and especially for deficit countries, that is given top priority in the evaluation and policy prescriptions, and key economic variables, —from a human development perspective—, such as employment are not properly, or not at all, considered.

This raises the difficult issue that it is not just creating an evaluation and monitoring procedure for macro-economic balances which is key, but also for institutions like the European Commission in this case, or the IMF in the case of global imbalances to have the willingness and the power to influence key variables in countries over which these institutions have very little influence, e.g., because they are major creditors (Germany) in the case of the European Commission or global reserve currency (United States) in the case of the IMF .

There is an important debate within Europe on the serious problems and negative spill overs that restrictive policy in surplus countries causes within the Eurozone and the European Union, but there is far less attention to the equally, and possibly more important, issue of the highly negative externalities and effects, which such policies, especially in surplus countries like Germany and Holland

cause on the DEEs. Indeed, the fact that major economies like Germany-and the Eurozone as a whole-have such large current account surpluses and such stringent fiscal policies imposes a deflationary bias on the rest of the world economy, and in particular on the DEEs.

This was important, but less serious in the recent post 2007/8 financial crisis past as the very dynamic growth of China and other DEEs, as well as the fairly positive recovery of the US economy kept the world economy growing at a fairly high rate. But as China slows down quite significantly, though still growing at a very high rate, and as other emerging economies like Brazil have negative growth, whilst commodity prices, especially of oil and minerals fall significantly and capital flows to DEES reverse, the prospects of growth for the DEEs deteriorate significantly. In that context, the negative externalities of a too tight fiscal policy in the Eurozone as a whole, but especially in the large current account surplus countries, becomes particularly damaging for the DEEs.

At the global level, as Ocampo (2016) analyses, there has been a strengthening of IMF surveillance, which is potentially very positive, but again the key issue is lack of enforcement. At the multilateral level, it includes the use of major IMF publications, such as: the *World Economic Outlook* (and associated regional outlooks), and the *Consolidated Multilateral Surveillance Report*. They also include reports that link bilateral and multilateral surveillance, particularly the ‘spill-over reports’ for the ‘systemic 5’ (United States, United Kingdom, Eurozone, Japan, and China), issued annually since 2011, and the pilot External Sector Reports assessing global imbalances. These reports consider a detailed examination of current accounts, reserves, capital flows, and external balance sheets. This supplements bilateral surveillance through the Article IV consultations. Its major changes include, according to Ocampo, 2016, more candid assessments, particularly for major economies.

There has thus been an improvement in the *even-handedness* of the IMF with its different members, since the 2007/8 financial crisis, and in fact the more systemic economies are now a subject of stronger surveillance, which is very positive. The system can be criticized for a number of aspects, including legitimacy, given the still unfinished agenda of IMF reform on voice and participation of DEEs, though some progress has finally been made by the implementation in 2016 of a limited IMF reform approved in January 2010.

The key issue, however, especially from our perspective, as well as more broadly, is whether the IMF has genuine influence over the member countries, and particularly in relation to major economies, on their key policies, which have significant externalities for the rest of the world, and especially the DEEs, as well as for their possibilities of human development.

The multilateral system that has been put in place centred on the IMF continues to rely essentially on a mix of stronger surveillance and peer pressure. However, such forces continue to be weak, as reflected in the limited effect that this cooperation has had in avoiding a new wave of global

imbalances, as well as in guaranteeing a more symmetric adjustment of surplus and deficit Eurozone countries and avoiding the creation of a large Eurozone (and European Union) payments surplus.

As indicated, limited attention has also been given overall to the spill overs generated by expansionary monetary policies in developed countries on DEEs, as well as mitigating the boom–bust cycle of external financing in emerging and developing countries generated since the North Atlantic crisis. It is however encouraging that recent discussions of US monetary policy, as evidenced for example in statements by Federal Reserve Governor, Janet Yellen, who has made clear not only that international developments, influence decisions of US monetary policies, but that there is increasing awareness of the impact of US monetary policy (e.g., of raising interest rates) on the rest of the world (Yellen, 2016). Though this is informal, it seems a very welcome development, especially as it contrasts with the past, when for example the massive increases in US interest rates—done for purely domestic US reasons, to control US inflation—was a major contributing factor to the 1980’s Latin American debt crisis, with major negative effects on human development.

We return finally to the key issue of fiscal policy, and especially to the case of the Eurozone, though it also has important implications for the DEEs fiscal policies. This impact is both via their effect on world aggregate demand, as discussed above, and via impact on DEEs being influenced in their own fiscal policies by those followed in developed economies.

Though monetary policy has played a positive role in the Eurozone, there is growing consensus, that it is reaching its’ limits, and that it needs support from a fiscal policy, more supportive of sustainable and inclusive growth.

Especially important is to allow an increase of investment (especially public investment, which would also help crowd in private investment) in the Eurozone, both to boost aggregate demand to encourage short term growth and avoid secular stagnation, as well as to enable structural transformation to a more inclusive and more sustainable development model. To achieve this, greater flexibility is needed to implement fiscal rules.

An important role should be played by re-interpreting and/or modifying the so-called Eurozone Growth and Stability pact (GSP); this would imply that limits on budget deficits would focus mainly on restriction on current expenditures (the so-called golden rule) and that certain key categories of productive investment would be exempted.

As the IMF (several World Economic Outlooks, Guergil et al. 2016 and others) have reported, IMF recent empirical analysis, shows clearly that the most effective way of making fiscal policy more counter-cyclical, stabilizing key investment and maintain fiscal sustainability is to have an investment friendly fiscal rule. This could be introduced into the growth and stability pact (GSP), by excluding key

public investments, e.g., in innovation, renewable energy, education, and infrastructure (provided they are efficient, contribute to increases in future productivity and structural transformation), from fiscal deficit targets. This is particularly relevant for the EU, where investment has fallen sharply from 19.0% of GDP in 2007 to 15.3% in 2014; the fall in the South Eurozone investment was even sharper.

Such a change in the Growth and Stability Pact of the Eurozone could, as mentioned lead to higher growth in the Eurozone; this would have positive externalities and spill-over effects for growth in the rest of the world economy, and particularly for the DEEs. If an important part of the additional investment went to transformation to a greener economy in Europe, it would also make an important contribution to sustainable development worldwide.

There would also be an important effect on DEEs, via the precedent established by such a change in Europe. Indeed, implementing more flexible and counter-cyclical fiscal policies, linked to exempting key efficient investments from budget deficit targets, could also be applied in DEEs, leading via national policies there, to higher and more inclusive, as well as more environmentally sustainable growth in them. The combined effects of these national and international policies would be very valuable for giving more space for greater human based development in the developing and emerging world.

There is another way in which higher growth, investment, employment and poverty reduction can be achieved both in Europe, and globally. This relates to enhancing the role of development banks, which we discussed in the first section. Thus, if national governments combine more expansionary fiscal policy-oriented to higher levels of key public investments, with an expanded role for national developments, that fund mainly private investment, they will increase current and future growth, as they will be expanding both current aggregate demand and future aggregate supply. If such actions are coordinated internationally, so that such an expansion of investment takes place in a number of countries simultaneously, the impact will be significantly amplified. In Griffith-Jones and Cozzi, forthcoming, 2016, we have simulated two scenarios, using the Cambridge Alphametrics model; the first, which we call business as usual, implies pursuing current fiscal and other policies; this would yield an average global growth for 2015-2020 of only 2.7%, and a rate of investment of 22.0% globally. On the other hand, with what we call a global investment stimulus, which implies higher levels of public investment and higher lending by public development banks, and thus higher private investment across a range of countries, global growth would be far higher, at 4.8% for 2015-20, and the investment rate for 2020, at 23.8% would also be higher. This would deliver significantly higher employment, and facilitate lower poverty levels.

If we look at the simulated impact for a group of the poorest countries in the world-low income African countries-, the business as usual scenario delivers growth of 3.1 % for the 2015-2020 period, whilst the global Investment stimulus scenario yields significantly more growth, of 4.8% for the same

period; the investment ratio for this group of countries is projected at 14.4% of GDP in 2020 for the former scenario, whilst it rises quite significantly to 17.8% (Griffith-Jones and Cozzi, op cit); this will lead to significantly greater poverty reduction in those countries.

We can therefore see that a more expansionary (or less contractionary) fiscal policy in the Eurozone, focused on higher investment, combined with an expansion of the role of development banks in funding private investment globally can significantly expand investment, growth and employment globally and in different regions. If well coordinated internationally, such an initiative could deliver a far more favourable framework for human development in the coming years. This is one of the main challenges for global governance at present. The time to take it forward is now!

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