Shadow G-8 Meeting Report

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Introduction

A group of senior former politicians and UN officials, as well as leading academics met at Columbia University in New York on February 9th, 2007, under the Chairmanship of Professor Joe Stiglitz (for a list of participants see Annex 1; for the outline of the meeting see Annex 2).

This detailed Report of the discussions held complements and expands on the Chairman's Summary. It finishes with a list of specific recommendations that came out of the shadow G-8 meeting.

The meeting considered the most urgent global challenges facing the world (climate change, global imbalances, the promotion of development and poverty reduction in poorer countries). It then made suggestions for how the G-8 leaders (meeting in Germany in early June 2007) could best make progress on these major issues. Both concrete measures to be taken immediately and more long term agendas were suggested.

The meeting attached great importance to significantly enhancing the legitimacy and effectiveness of the G-8 process; it was suggested that an expansion of the G-8 may be a pre-requisite for this by including, as full members, a number of emerging economies. The meeting therefore started with a discussion of the G-8 process and how it could be improved.

The role of the G-8 and the creation of a G-N

The current process of G-8 leaders' summits has made a contribution to global governance; it is useful for the leaders of the large developed countries to meet and discuss – as well as try to build consensus amongst themselves – about the world's great challenges and how best they can deal with them. As the Chairman's Summary points out, "the G-8 can, and on occasions has, played an important role in addressing issues of global concern".

The G-8 summits seem to be most effective when leaders discussed subjects on which there has been great in-depth previous preparation; a very good example were discussions and – above all – commitments on Africa at Gleneagles in 2005, building on the work of the Blair Commission for Africa. Furthermore, particularly productive are informal discussions between leaders alone, where they are free to debate differences and try to deal with them rather than papering over them mainly for the purpose of agreeing a communiqué[1]. Such communiqués often have somewhat limited substance and lack sufficiently specific plans of action. A further problem is that there is no clear mechanism for follow-up, nor is there a system of institutional monitoring of the achievement of goals set, as well as evaluating the gap between goals and actual achievements.

However, the main limitation of the current G-8 is that it is a forum of the eight industrialised countries that ***were*** the dominant powers of the mid-twentieth century. By excluding the increasingly important emerging economic powers of the twenty first century, it has become unrepresentative. Indeed, developing economies today have not only a majority of the world's population, but represent at least half the world's GDP (measured at purchasing power parity) and hold two thirds of the world's foreign exchange reserves. This significantly limits the G-8s legitimacy and its' effectiveness. As a result, all participants agreed that the G-8 process had to be improved.

A proposal emerged from the New York meeting - supported by a large majority of the participants – that an expanded body be formed that adds to the existing G-8 leaders as full members the leaders of the emerging economies; this would include countries such as China and India, as well as strong regional leading countries of all continents. Other meetings and groups have made similar proposals which seems to imply that widening the G-8 ***is an idea whose time has come***. Indeed, some global leaders, including British Prime Minister Tony Blair in 2006, suggested the G-8 should be amplified.

Several participants in the New York meeting suggested that the G-8 leaders summit should be expanded to create a new forum, a G-N, representing both leaders of the advanced industrial countries and those of developing countries, both middle and low-income. A working structure and precedent for this G-N already exists in the rather effective forum of G20 Finance Ministers. It is interesting that the latter more representative body was formed during the East Asian and Russian financial crises, as it

[1] Indeed, it was proposed that a more appropriate outcome would be a Chairman's Statement, rather than a joint communiqué.

became urgent to have a body that could help form the consensus required to deal rapidly with critical economic issues that had global repercussions. The then G-7 Finance Ministers could not do it on their own. A similar case exists today for a body (G-N) of leaders representing key countries to deal at the highest level with broad global issues, such as climate change, global imbalances and development challenges. Current attempts at inviting ***some*** developing countries on an ad-hoc basis to a small part of G-8 summits was widely seen as ***deeply unsatisfactory***. Amongst the criteria that could be adopted for choosing countries for the L-20 would be:

i. Scale of their economy, with the largest economies in the world clearly needing to be represented, as well as
ii. Income per capita and population (where a range could be adopted, with both countries with high and low income per capita, as well as with small and large populations).

This new forum, the G-N, would discuss informally the major issues facing the world. As regards size, as the Chairman's Report points out, it should be a small enough group to facilitate meaningful exchange, yet large enough to reflect the diversity of countries and their perspectives.

There was a detailed discussion on how the G-N might be selected, building on the G-8 membership. Clearly the major players in the developing world (such as China, India, Brazil and Mexico) whose participation is essential for any meaningful consensus-building and basis for future action would need to be included. Regional leaders like South Africa and Nigeria in Sub-Saharan Africa would also clearly need to be included. Naturally, the Middle East should be represented. However, a large proportion of the world's population lives in small countries; thus, to maximise legitimacy, the voice of small countries would need to be included. This could, for example, be addressed in Africa by the Head of the Organisation of African States attending, to represent smaller economies; similar solutions could be addressed for Latin America and Asia. Similarly, just as the G-8 represents the countries with the highest income per capita in the world, some of the poorest countries in the world should also be represented.

Some participants emphasised that the process could be improved by the G-8 focussing on G-8 matters (such as labour reform, technological innovation and its impact both domestically and on the rest of the world) and on global issues to be discussed and dealt with through strengthened international and multilateral institutions, which have most legitimacy as they represent all countries.

A synthesis position was presented that the broad agenda would be set by legitimate international institutions like the United Nations. The G-N, a fairly small group of leaders but representing a variety of countries including all the major nations would help agree on how to take that agenda on key issues forward. Implementation would then take place in the appropriate institutional contexts, either international, regional or national. In some areas, a "variable geometry" of formal groupings becomes fruitful; for example, discussions of debt forgiveness should involve all major creditors; discussions on aid should include not just the G-8, but the small European countries that meet (or even surpass) the UN target for aid.

A more inclusive summit of leaders, the G-N (involving both developed and developing countries), would thus clearly increase legitimacy and effectiveness of dealing with global challenges, if it was part of a broader process.

The Agenda

During its launch of the prospective agenda for the upcoming G8 Summit in Heiligendamm, the German G8 presidency emphasized that leaders should focus more tightly on global economic matters, not least the issue of global imbalances. This was reiterated by German Chancellor Angela Merkel when ***she criticized that the G8 agenda has become too broad in recent years***. Therefore, it would be necessary to "get back to the roots" of the 1970s[2].

Subsequently, the host country introduced the overall summit theme ***"Growth and Responsibility"*** and identified as main objectives the issues of economic growth, stability and employment. There was a great deal of concern that the tightened focus in the proposed G8 agenda might lead to a marginalization of developing countries' concerns such as world poverty and missed the opportunity to address climate change, the German presidency has ***shown certain flexibility over the last months and fine-tuned the list of agenda items***. The original summit plan to focus exclusively on

[2] The section on the agenda draws on Frank Schroeder "Same old wine in new bottles? The agenda for the 2007 G8 Summit in Heiligendaam" http://www0.gsb.columbia.edu/ipd/pub/Frank.Schroeder.pdf ; on the same IPD website, other background papers prepared for the New York Meeting can be found.

intellectual property protection, energy and global imbalances was modified and expanded to the issues of economic development and climate change. Furthermore, important consultations have taken place, for example, between the German Development Minister and African civil society.

A closer look into the proposed direction by the German presidency shows that Heiligendamm might lead in some areas to a reformulation of earlier G8 commitments.

The German government set the tone for the core economic agenda in Heiligendamm with the item ***"Investment, Innovation and Sustainability".*** According to the German presidency the main objective in the summit will be to ***develop a stable and predictable framework for the international trade and financial system***.

The German agenda highlights the need to identify the dimension of global imbalances and to determine policy solutions. The agenda does not give particular emphasis on how to rebalance the global patterns of growth, savings and investment, ***the focus remains rather on single countries or regions***. These are defined in similar terms as previous G-8 meetings.

With respect to the systemic stability of the international financial system the proposed G8 agenda appears rather vague. ***The only important exception in this area is the German proposal to discuss policy options that could improve transparency*** of hedge funds.

The proposed G8 agenda emphasizes the importance of freedom of investment in the world economy.

While the proposed agenda for Heiligendamm acknowledges the importance of innovation its positive impact on economic growth, ***the main focus will be directed at improved protection of intellectual property rights***.

The German Presidency underscored the need to make progress in counteracting climate change and increasing energy efficiency. This would include attempts to achieve progress a successor agreement to the Kyoto Protocol. Furthermore, the agenda proposes the G8 set verifiable and attainable goals to ***increase the use of alternative fuels, particularly biofuels***.

In comparison to the development commitments made by the G8 in Gleneagles in 2005 on debt relief, trade and Official Development Assistance (ODA), ***the proposed agenda implies a retreat from earlier priorities***.

The suggested program for Heiligendamm, at the time of writing this Report, ***does not acknowledge the need to evaluate progress in the implementation of the Gleneagles commitments in the area of debt relief, trade and ODA***. Germany proposes to develop a "reform partnership" with the African continent in order to establish "a new and stable framework for private investment". Moreover, this new proposal should give priority to African countries that are pursuing good governance, fighting against corruption and are using raw materials responsibly.

As in previous G8 meetings, the agenda for Heiligendamm acknowledges the need for the strengthening of health care systems and the fight against HIV/AIDS in Africa. However, it seems to be uncertain that this might lead to any new initiatives or resources in this area.

While senior officials of the German government have announced that Germany will introduce the proposal to invite leaders from Africa, Asia and Latin America to all future G8 meetings, the German presidency has stated at the same time that this would not lead to an enlargement of the group. It is rather envisioned to start "a new form of dialogue" with emerging countries such as Brazil, China, India, Mexico and South Africa.

Climate Change

There was a very strong consensus in the group on the urgency of action on global warming. This consensus is increasingly spreading throughout the world; the evidence is clearly on the table that humans are causing climate change, with the IPCC – the Inter-governmental Panel on Climate Change – saying that there is a 9 in 10 probability that humans are causing climate change. This is a major factor increasing the probability that the G-8 must and will act.

It is also becoming very clear that any slack available in the system has gone. Thus continuing with current trends of production and consumption – without major changes – would lead to extreme consequences. A difficulty that needs tackling is the inherent inertia of the energy system. For example, power plants have a life time of up to 50 years; current plans to install many conventional coal power plants – if implemented – could cast a huge emission shadow over the future.

As the Chairman's Report clearly points out, the G-8 should focus first on acting to change their own economies, and secondly develop technology cooperation – and grant additional resources – to help developing countries reduce their carbon emissions.

It is important that resources transferred to developing countries be additional to existing aid and do not come out of current ODA, so that the aim of meeting the Millennium Development Goals are not underestimated. For this reason, it was argued it should be developed countries' environment ministries that should provide the additional funding. Indeed, this overlaps with the issue of global social justice; there is a currently a huge injustice in that there is no overlap between those who have been the largest polluters and those who are mainly bearing the cost of the pollution. Therefore, the issue of environment is not just one of efficiency, but also of global justice.

A. Proposed specific actions and commitments for G-8

Focussing on energy use per GDP (energy efficiency) and carbon emissions per unit of energy (carbon intensity), the G-8 should, at their June 2007 meeting agree to specific actions, in their own economies, such as:

a. All commit to double the historical rate of energy efficiency improvements. This should be done at a specific level in building, transportation and the industrial sector. It should be possible to achieve 20-40% efficiency gains in all these sectors at no cost. This would not just reduce emissions, but would also slow growth in energy demand; this would slow down the rate of installation in some really bad technologies, such as pulverised coal power plants. It was suggested that an annual technical summit could discuss progress in different sectors and countries. Furthermore, a body like the IEA could play a role in receiving national plans on increases in energy efficiency and emission reductions that could be discussed at these annual meetings. It would be very appropriate to do this in the context of a G-N leaders' summit, as discussed above, or of their Environment Ministers.

b. ***Only*** build new coal-fired power plants in developed countries with retro fits for capture and sequestration of their carbon emissions. Given limited available experience with such plants, increased funding is required urgently for important research, development and demonstration of capture and sequestration technology. Because an estimated 40% of emissions come from power plants, such a measure could be very effective.

c. Agree and set standards, for example, on cars' fuel efficiency (minimum miles a gallon), airplanes, housing and other major sources of pollution. The ***commitment*** to these standards ***should be immediate at the G-8 meeting*** this June, even if implementation could be phased in.

d. Given that natural gas has both low carbon content and also helps reduce local pollution, it is important to encourage reduction of distribution leakage and improve metering to reduce theft (see also Moss, 2006). Such measures could double the effective supply of natural gas coming from Russia. This would be beneficial for climate change and generate additional revenue for Russia.

e. Bio-energy development offers interesting opportunities and should be actively encouraged. This is not so much with crops such as corn and sugar in developed countries – as price increases make them less economical, except in Brazil, as well as generating environmental problems themselves – however, other crops, such as switchgrass, have more desirable characteristics. This could also be very valuable for developing countries that could save foreign exchange; furthermore, bio-fuels integrate energy and agriculture markets in developing countries in Africa and Latin America.

   Increased demand for agricultural products, due to bio-energy, could reduce the need for subsidies and other measures to protect farm incomes in developed countries. This could facilitate agreement on the Doha Round.

   Concrete action and commitments that can be made now in this field is the elimination of subsidies on fossil fuels and elimination of large tariffs against Brazilian sugar-based ethanol in developed economies. Subsidies on fossil fuels – and on corn ethanol – seem particularly high in the United States, as are tariffs against sugar based ethanol.

B. <u>Research Programme</u>

The G-8 should also agree the promotion of a major and broad research programme by:

a. Creating a ***Global Research Fund*** that would both develop new technologies and disseminate existing technologies that would both favour environment conservation and growth. Indeed, the development of these new green technologies could even lead to higher, as well as more sustainable, growth. This fund could be financed by rich countries but its results should be freely available for poor countries so as to maximise positive impacts on the environment globally and on growth.
b. It was suggested that an important component of the research should be in the public sector so it can be disseminated as widely as possible. Indeed, knowledge is a public good and the global environment is a global public good. As the Chairman, Joseph Stiglitz, eloquently said: ***knowledge about how to preserve the environment is a double public good.***

   Concern was expressed that if intellectual property rights were the major vehicle for producing innovation that would reduce pollution it would reduce the dissemination of this knowledge. To overcome this danger, an important component of the research should be publicly funded; where research was private, the Global Research Fund could be given resources to buy patents and make it available to others at cost. This avoids restricting knowledge dissemination with very high social cost. One of the mechanisms that could work well to encourage relevant research is the creation of an innovation prize fund.

C. <u>Broad Principles</u>

Concrete actions such as outlined above are essential. However, it is very important to define broad principles for such actions; these will also be useful for defining the agenda beyond Kyoto.

a. An essential principle is that households and firms should be clear that they will face rising prices of emissions into the future, for example, for the next 30 or 40 years. This could be achieved by a variety of mechanisms (e.g. carbon taxes, cap on trade), which could be decided individually by countries. This could be complemented by setting a floor on domestic prices of energy, which would be like a price-based standard, implying a minimal condition of not lowering energy prices below a certain level.

Such a policy would influence long term decisions on structures and scales of cities, nature of housing, transport systems, etc, with very large impacts on energy consumption. Emerging economies could do something different in these crucial aspects, which could be better than what industrial countries have done.

b. Another principle is the "polluter pays", which implies accepting that polluting is a real cost of production. The principle is clear for the present and future. Somewhat more controversial – but quite fair – is whether those who polluted in the past should make some additional payment for this, as major emerging economies have argued. An alternative path could be – as the Chairman's Report suggests – to lower entitlement of pollution by those countries that have polluted more in the past in the future and/or compensation through support of emissions efficient technologies in developing counties.

D. Building on Kyoto

A very important challenge for G-8 leaders is to start moving forward on the difficult – but crucial task of designing a post 2012 agenda. It was seen as important that any post-Kyoto agreement must be very long term as investment decisions in this field are so long term.

It would seem more feasible to agree on principles and targets of overall reduction of carbon emissions and then different countries could implement in different ways through a menu of options. This could, for example, be achieved by each country imposing a carbon tax (this would imply taxing public bads – like emissions – instead of public goods, such as jobs or savings). However, a carbon tax would be complicated to implement politically in some countries as public opinion has not reached that point. So another, possibly easier, approach could imply, for example, increasing energy efficiency and agreeing efficiency targets. However, what is politically feasible or not can change very dramatically through time. Another framework would be a bargaining one, whereby, based on principles and criteria, the levels of emissions allowed for each country would be determined; then countries would be allowed to trade these rights; developing countries would receive a large gift of the emission allowance. A third framework, actually used in Kyoto, implied reductions from a particular year (in the case of Kyoto, 1996), with some bargaining around individual circumstances. However, such a framework cannot be used to bring in China and India – involving China and India in a post 2012 agreement is, of course, essential. Indeed, it seems important to seek solutions that would be attractive for different categories of countries. For example, OPEC countries – with whom agreement on many aspects will be very difficult – are open to the idea that they have to contribute towards improved technology for fossil fuels – an area that is important as fossil fuels will be a major source of generating energy. Furthermore, it will be crucial to secure commitment from developing countries; indeed, a way forward for agreement to include developing countries is that they may well agree on energy efficiency targets as this could make less pollution consistent with growth; they would find it extremely difficult to agree on emissions targets, unless these were expressed in terms seen as fair to them, such as equal per capita or equal per gallon emissions, which might probably not be acceptable to developed countries.

Two final important points were made. Firstly, it is important that there is no free rider. This is a global problem and all countries should assume responsibility. An enforcement system may need to be designed for this purpose. This could, for example, put import tariffs on energy intensive goods or on emissions intensive goods.

Secondly, because of the magnitude of the challenge, it is essential to make progress on all fronts simultaneously, as any one area will – with present technologies – clearly not be sufficient to avoid dangerous climate change.

Global Imbalances

Global imbalances represent a threat to global stability. As the Chairman's Summary stresses: "There is a not-insignificant probability that there will, in the foreseeable future, be a disorderly and costly global economic adjustment". Of particular concern is that the impact of such an abrupt adjustment would be particularly painful for poor countries that would be affected by declining commodity prices, lower export volumes and higher costs in servicing their debt. A first step to deal with global imbalances is an accurate diagnosis. The international discussion on imbalances has been somewhat biased. Thus, for example, Chinese current account surpluses are far smaller than US current account deficits; therefore, excessive emphasis is placed on adjustment by China and not enough on the US. Therefore, a large role in diminishing global imbalances needs to be played by the United States, especially via a lower fiscal deficit. Similarly, there is very little discussion of the very weak Yen – which results, to an important extent, from a massive carry trade that benefits from large interest rate differentials with other countries. This destabilising speculation – by financial markets – implies a very weak Japanese currency, contributing to a massive current account surplus.

The discussion on Europe's role in the global imbalances rightly emphasises the need for Europe to accelerate its growth. However, the almost exclusive focus on structural reforms seemed excessive to many participants in the group. Indeed, a major problem for growth seen by the group are the deflationary biases of the Growth and Stability Pact, which limits increased fiscal spending even in periods of low growth. Furthermore, some participants saw the structural reforms themselves – by leading to lower wages, and thus lower domestic demand – to be acting as a constraint on European growth. It was pointed out that there was not just traditional beggar my neighbour policies, but also beggar thyself policies in Europe. It was unanimously agreed that under current circumstances, ***any further tightening of monetary policy by the European Central Bank would be very negative*** for Europe and the global economy.

However, excessive conservatism in monetary and fiscal policy was not restricted to Europe. Brazil, for example, seems to have an excessively tight monetary policy. The need for higher growth in countries like those in Euro-land and Brazil becomes more urgent as the United States slows down its growth.

As regards China, a first point is that the G-8 is the wrong forum to discuss its role in global imbalances, as China is not a member of the G-8. It is therefore essential to involve ***all*** major players. This related very closely to the initial discussion on global governance. Secondly, it is unclear that China's currency is really undervalued. If China eliminated all regulations on capital outflows, at the same time as it floated, the currency might even be devalued. Furthermore, if China were to revalue, its exports to the US may be partly replaced by other countries' exports, and those countries might be less willing to invest in US Treasury Bills.

Going beyond necessary actions by major actors – where there has been much discussion but little relevant action – the possibility of abrupt adjustment is unfortunately likely to continue. Therefore, it is essential to mitigate consequences, especially for the poorer economies. There is a need to build dykes to contain or reduce negative effects.

This can be done though market mechanisms, which developing countries themselves can develop, possibly with the support of institutions like the World Bank or regional development banks acting as market makers or through their own lending. This is the case of local currency debt in which developing countries are increasingly borrowing, thus reducing currency mismatch vulnerability within the economy. Similarly, developing countries could borrow in GDP-linked bonds, whereby countries would service less debt in periods of slower growth and more debt service in periods of more rapid growth. If the world economy slowed down due to an abrupt adjustment, developing countries could temporarily service less debt; this would open space for them to follow more expansionary counter-cyclical fiscal policies that would help both their economies and the world economy grow more. This should be accompanied by providing scope for developing countries to use measures such as market based capital regulations to curb excessive short-term capital inflows.

Secondly, it was seen as important that the G-8 significantly reform the IMF to expand contingent lending against external shocks (such as would be caused by a slowdown of the world economy) and that such lending should have no conditionality given that the external shocks are not at all the responsibility of the developing national government. For low income countries, there should be sufficient, non-conditionality lending to compensate for terms of trade shocks and it should also be simple; existing IMF contingent lending facilities for these countries are complex, high in conditionality and rather small. Similarly, for middle-income countries with good policies as established, for example, in their Article IV consultations, IMF contingent lending could be automatic if they were hit by contagion from other countries.

It is also important that the IMF continues and accelerates the very gradual process of reforming its governance. Changes made recently were seen as positive but far too modest. Several participants described them as baby steps. For example, the increase in basic votes that favours small countries – though welcome – is clearly still insufficient as the proportion allocated to them (4%) is still so much below the proportion allocated at Bretton Woods (11%), even though the number of small country members at the IMF has increased so much.

Naturally, an IMF with adequately reformed governance – that would appropriately represent major players – could potentially provide a valuable institutional forum for helping deal with problems of global imbalances. This would help overcome current ad-hoc-ism, linked to the lack of appropriate institutional mechanisms where all major players are full members.

More broadly, the current international financial system suffers three major long-term challenges that underlie the global imbalances. These need to be discussed in a forum that represents all key players. The G-8 could set up a working group for starting to overcome these challenges.

The first problem is that the international financial system is inherently unstable because it is ultimately a dollar-based system. Somewhat modified, the Triffin dilemma is still valid, which implies that huge US current account deficits – though in the long term apparently unsustainable – seem important to maintain global liquidity and global demand.

The second problem is that the system is very inequitable. Developing countries, where a large part of the population is poor, feel compelled to accumulate large foreign exchange reserves, as a mechanism of “self-insurance” against crisis, given the inadequacies of the “collective insurance mechanisms” provided by institutions like the IMF. At present, they are investing a high proportion of these reserves in developed economies, especially in the United States. This implies a major and very inequitable transfer of resources from developing countries to the United States; the former could be said to be giving “foreign aid” to the latter. This goes against the standard economic neoclassical theories which would expect capital to flow from low growth economies with higher proportions of people who require pensions to high growth economies with younger populations. The system is also inherently unfair. As a result, developing countries are increasingly beginning to challenge the acceptability of current arrangements. To deal with these problems in the long term, it seems crucial to reform the global reserve system. The G-8 should initiate a working group – that includes all the relevant key countries and leading thinkers – to study reforms to the global reserve system.

Thirdly, and in some ways most importantly, levels of exchange rates are increasingly determined by the activities of unregulated financial market actors, such as hedge funds and investment banks, mostly operating from off-shore centres or vehicles which are both un-transparent and unregulated. A typical mechanism through which this is done is the carry trade which, for example, has been weakening the Yen and contributing to strengthen certain developing country currencies. The rapid unwinding of such carry trade, for reasons not necessarily linked to fundamentals, can lead to sharp and destabilising fluctuations in exchange rates, and stock markets, etc, as shown by recent February 2007 events. Perhaps, even more seriously, they can pose major systemic risks, as shown by the impact of LTCM in 1998.

It is encouraging that certain G-8 governments – and Germany in particular – have raised the issue of significantly improving transparency on hedge funds and their operations. Improving transparency of hedge fund and investment banks – as well as in the derivatives market, through which many of them operate, where a large part is over the counter and thus not registered – is an essential first step for regulation. The G-8 leaders should take an important lead on increased transparency and regulation as most hedge funds are either located in developed countries, or in offshore centres linked to them.

A possible mechanism for regulating hedge funds is via property regulation of banks that lend to them and thus facilitate their leverage. This could help monitor risk more precisely. The G-8 should take an important initiative in the field of both increasing transparency and regulation of opaque actors (such as hedge funds) and instruments (derivatives). This would reduce risks to systemic stability, nationally and internationally. It would also facilitate smooth adjustments of exchange rates linked more to fundamentals and less to speculation.

Promoting Development

Up to 1999, the then G-7 focussed mainly on global macro-economic issues. In 1999, at Koln, Germany, there was an important breakthrough on development issues, with an important HIPC debt relief initiative by Germany. Similarly in later years, important development initiatives were launched at G-7/8 leaders' meetings with the global fund to fight major diseases being launched in 1999, with the agreement on the most comprehensive G-8 approach on Africa in 2002. This culminated at Gleneagles in 2005 where development issues dominated the G-8 agenda, including, for example, signed commitments to doubling aid to Africa by 2010, total increases of aid of US$50bn annually, cancellation of multilateral debt to the poorest countries and a comprehensive Africa Plan.

There was a concern at our meeting that for this year – under the German Presidency – the G-8 could retreat somewhat from the prominence given to development issues from Koln to Gleneagles. Lessons learned from past experiences were that the G-8 commitments are most likely to lead to tangible results where follow-up relates to decisions in institutions – like the IFIs – where the G-8 are majority shareholders. Furthermore, where G-8 members have national interests at stake, their commitments are most likely to be vague and not lead to concrete results. A third lesson is that there are no appropriate monitoring mechanisms linked to the G-8 process; there is no follow-up therefore to ensure implementation.

The main development focus this year should, therefore, not be on new initiatives, but on making sure that previous G-8 commitments on the core issues – of aid, trade, debt, TRIPS and HIV/AIDS are actually fully delivered. A crucial institutional aspect therefore, is to significantly ***strengthen monitoring mechanisms***, so as to encourage the G-8 to fulfil their commitments, especially those made at Gleneagles. The importance of involving G-8 Finance Ministers was stressed as they can deliver resources to make commitments happen.

A possible new area for the G-8 is to support the development of internal and regional markets in Africa. In European integration, there were large structural adjustment grants to support this integration. As Africa does not have the capacity to finance this, the G-8 could help by providing some of the necessary funds. This would be very complementary to the important German agenda on promoting investment in Africa.

Aid

This is an area where it is particularly key to have delivery on Gleneagles' commitments, so monitoring is especially crucial. Amongst them, particularly important and easy to quantify, were commitments on increased aid for health and education, where a timetable should be defined.

It was suggested that for the G-8 meeting, a Delivery-matrix be put together, listing ***all*** previous G-8 commitments and listing the status of implementation, including a process to ensure their delivery. It was further suggested that the G-8 should establish a strengthened monitoring mechanism with necessary financing and human resources to monitor: (a) delivery of 2005 aid commitments – both their level and content (true additionality or debt relief funding); (b) delivery of funding gaps related to HIPC (1999) and MDRI (2005), to secure funding of IDA and the ADF; (c) delivery on quality of aid and (d) delivery of universal access to prevention, treatment and care of HIV/AIDS. Some participants stressed that aid should be increased even beyond the Gleneagles commitments, invoking the precedent of the Marshall Plan. It was seen as important to avoid aid fragmentation, and return to a clear focus on development. Furthermore, all major aid donors should coordinate. This links to the need of enlarging the full membership of the G-8, to include countries like China. As regards aid effectiveness, several studies were quoted which showed that aid – once politically directed aid is taken out – does clearly contribute to growth. Nevertheless, there is space to increase aid effectiveness, an area where the G-8 can have an important impact. An important principle is 'do no harm', as was done in the 1980's in Africa with inappropriate conditionalities.

There was particular concern about non-transparent conditionality entering through the back door, for example, through using CPIA governance indicators to allocate IDA money. Initially, CPIA governance indicators were not even revealed, so countries did not know even how to improve their governance performance to get IDA flows. As information has been forthcoming, many questions are being raised whether the indicators used by CPIA are appropriate ones for measuring good governance and its impact on effectiveness of aid. Several participants thought CPIA was so problematic that it should be eliminated, while others thought it should be very significantly improved. An independent review by a think-tank was suggested to evaluate existing criteria and propose better ones for allocating IDA resources. Such a review could then be discussed in a G-N type of forum that included all major donors and – above all – representative recipient developing countries.

An important broader issue was raised as to how best to help poor people in countries with bad governments. Even more generally, ***what are the most effective venues*** for delivering aid in different types of developing countries? This would help maximise the positive effect of aid on development. A good way forward seems to be to reduce conditionalities and open more policy space. This is best done by channelling aid through national budgets and thus respecting democratic bodies and processes. Therefore, it was suggested that monitoring should be done of aid channelled through recipient countries budgets.

It is critical to distinguish between development aid and financing for global public goods. Any funding for global public goods (such as the environment) should be new and additional aid.

Debt

In June 2005 at the Gleneagles summit, the G8 proposed to cancel all debt owed by post-completion point HIPC countries to the IMF, IDA, and African Development Bank. The deal initially included 18 countries, for a total write-off of US $40 billion over 40 years. The IMF forgave its portion of the debt January 2006, and World Bank and African Development Bank began to deliver their portion of debt cancellation in July 2006. In addition, two non-HIPCs, Cambodia and Tajikistan, were included in IMF debt write-downs.

The Multilateral Debt Relief Initiative (MDRI), as the proposal has come to be called, was a positive step in relieving the debt burden of some of the poorest heavily indebted countries making an important difference to countries receiving this debt relief; it was also an acknowledgement that the prior system of debt write-offs had not led to debt sustainability. But the MDRI has significant limitations that need to be addressed. It only covers a limited portion of a country's debt, is only granted to a limited number of countries, and ties debt relief to aid and conditionality.

The MDRI is an ad-hoc response to debt relief, rather than a solution to the problem of debt overhang. The G8 needs to look to a comprehensive framework of how to handle sovereign debt restructurings – one that defines how risk should be shared between all debtors and all creditors.

Problems associated with the MDRI include:

1) The IDA and African Development Bank debt relief replaces new funds. The IFIs have reduced disbursements for every dollar of debt service relief given.[3] In essence, the countries have paid for their own debt relief[4].

2) The MDRI only encompasses IDA, IMF, and AfDB loans (although, in November 2006, the InterAmerican Development Bank agreed to cancel US$2.1bn of the US$3.5bn owed by the five Latin American HIPCs.) Because the debt cancellation only covers a portion of the debt the actual amount of the debt write-off has been significantly under 100%. Furthermore, in some cases debt relief has been de facto funded to an important extent by middle-income countries who borrow from the IADB and not by the developed countries. For African countries this has amounted to debt servicing savings of 40%, on average[5].

3) The cancelled amounts range from 20% for some countries and 80% for others. The MDRI does not address how much debt cancellation a country 'needs' – and how to achieve it. Many countries need additional debt cancellation; some could need less. What is clear is that a broader framework that takes debt sustainability as defined by the ability of a country to grow (and reach the MDGs) post relief into account is needed.[6]

4) Many countries have replaced the loss of new funds with new loans, running up debt numbers again. The MDRI obviously does not include new debt contracted, including debt from China and other creditors that are not part of the G8. This underscores the importance of having a broader group of creditors as part of the process – and, more generally, a broader group of countries as part of the G8.

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[3] New funds have been made available to the institutions, but these funds are being reallocated to all IDA and AfDB recipient countries based on performance allocation criteria.
[4] See Jurgen Kaiser 2005
[5]
[6] For debates on how debt sustainability is defined see the upcoming IPD Debt Task Force Volume.

In addition, some countries have begun to run up domestic debt. While the shift to domestic debt is a positive step in terms of reducing currency risk, countries might soon be facing domestic debt problems.

5) Only post-HIPC countries that have reached their completion point are included in the MDRI, leaving out many low- and middle-income heavily indebted countries that need debt relief. The inclusion of two non-HIPC countries, Cambodia and Tajikistan, in IMF debt relief is an important step in expanding the countries, but many more countries are not included – and more importantly a framework for all heavily indebted countries needs to be developed.

6) Debt relief as part of the MDRI is tied to conditionality.

The above limitations of the MDRI point to the importance of a comprehensive framework for debt restructuring. The issue of some form of a broad framework for debt restructuring should be back on the G8 agenda. This approach could have the further benefit of helping to separate debt relief from the aid allocation process.

As is well-known, however, when the IMF proposed an SDRM in 2001 opposition to the proposal made it impossible to implement. Some of this was due to the specifics of the IMF's SDRM, but much of the opposition was against any statutory approach. This does not mean that it should not be on the agenda, but does mean that we also need to look for intermediate steps that can serve a similar function of better risk sharing between creditors and debtors.

One such proposal is GDP-linked bonds. There has been much discussion of the positive effects of GDP-linked bonds for countries with market access; however, these bonds have not as yet been issued mainly because of the first mover problem. G8 countries could provide a valuable precedent by issuing such bonds themselves. There has been less discussion of how useful this instrument would be for loans to low-income countries from bilaterals and multilateral institutions. This is especially true for loans given with conditionality. GDP-linked loans (or similar instruments, depending on the conditionality) would share the risk that conditionality fails between debtors and creditors. For example, if the IFIs gave a country a loan tied to macroeconomic conditionality, the IFIs would then share the risk that the conditions were not appropriate for the country and would not lead to the expected growth.

One response to this proposal is that the IMF and World Bank can not take on the risk that all debtor countries would have a slowdown in GDP at the same time, depleting the Fund or Bank's capital. But, not only is this risk easily hedge-able -- this is precisely the point of GDP linked loans: to transfer the risk of a slowdown from those least able to bear the risk to those more able. More importantly, the IFIs could easily hedge this risk.

The current system of debt forgiveness is inefficient and does not address the needs of most heavily indebted low and middle income countries. The risk is that the MDRI will lead creditor nations to believe that the debt problem has been solved, when what is really needed is a true framework.

Key Recommendations

1. A new forum, the G-N, should be created immediately; it would include as full members G-8 leaders and leaders of the developing countries, both middle and low-income. The G-8 should set in motion plans for the first G-N meeting in the summer of 2008.
2. G-8 countries should commit now to double the historical rate of energy efficiency improvements.
3. G-8 countries should agree a set of standards for fuel efficiency in cars, housing, airplanes and other major sources of pollution.
4. G-8 countries should eliminate both subsidies for fossil fuels and distortionary tariffs on alternative bio-fuels.
5. A Global Research Fund to finance research on conservation, alternative technologies, bio-fuels, etc should be created by the G-8. Its outcomes should be made as widely available as possible.
6. The risk of an abrupt adjustment to global imbalances implies the need to create mechanisms to mitigate its impact on developing economies. These should include helping those countries introduce risk-sharing instruments such as GDP-linked bonds. It should also imply expanding the level and reducing the conditionality of contingent IMF lending against external shocks.

7. The IMF and World Bank should accelerate reform of its governance to ensure adequate representation of developing economies that would enhance these institutions legitimacy.
8. Mechanisms to increase transparency and to regulate effectively actors, such as hedge funds, should be introduced to avoid systemic risk and destabilising speculation.
9. Clear and detailed monitoring mechanisms on G-8 commitments, in areas such as aid, should be immediately created.
10. The G8 needs to study a comprehensive framework of how to handle sovereign debt restructurings.

<u>Annex 1</u>

Person	**Title**	**Affiliation**
Amoako,KY	Executive Director	African Center for Economic Transformation
Chanani,Sheila	Program Coordinator	IGERT
Desai,Lord Meghnad		House of Lords
Fitoussi,Jean-Paul	President	Ecoles de Sciences Politiques & Observatoire Francais des Conjonctures Economiques
Flassbeck,Heiner	Chief Economist	UNCTAD
Gallegati,Mauro	Professor, Economics Department	Universita' Politecnica delle Marche
Griffith-Jones,Stephany	Professor of Economics	University of Sussex, Institute for Development Studies
Gupta,Siddhartha	Program Coordinator	Initiative for Policy Dialogue
Johnson,Hilde F.	Senior Adviser to the President	African Development Bank
Jomo,K.S.	Assistant Secretary-General on Economic Development	UN DESA
Kaul,Inge	Senior Advisor, Office of Development Studies	UNDP (United Nations Development Programme)
Lin,Justin	Director	China Center for Economic Research, Peking University
Linn,Johannes	Executive Director	Wolfensohn Center for Development, The Brookings Institution
Martin,Paul	former Prime Minister	Canada
Montes,Manuel	Program Officer, Governance and Civil Society	UN DESA
Moss,Richard		UN Foundation
Noman,Akbar	Senior Fellow	Initiative for Policy Dialogue, Columbia University
Ocampo,Jose Antonio	Under-Secretary-General for Economic and Social Affairs	United Nations
Reindl,Patricia	Office Manager	FES-NY
Schroeder,Frank		FES NY
Schwartz,Ariel	Program Coordinator	Initiative for Policy Dialogue, Columbia University
Shimada,Go	First Secretary (Economic Section)	Permanent Mission of Japan to the United Nations
Spiegel,Shari	Executive Director and Head of Research	Initiative for Policy Dialogue, Columbia University
Stetten,Juergen		FES-NY
Stiglitz,Joseph	President	Initiative for Policy Dialogue, Columbia University

<u>Annex 2</u>

The Shadow G8

9 February, 2007

Calder Lounge, Uris Hall, Columbia University

AGENDA

9.00am-9.30am	**Introduction and discussion of purpose**
9.30am-10.30am	**Grading the past performance of the G8: accountability**
10.30am-11am	**Presentation of the agenda for the G8 this year**
11am-11.15am	*Coffee break*
11.15am-1.00pm	**Reformulating what's on the table in 2007, including** trade and the Doha Round, climate change and energy, global financial imbalances, global governance, aid, debt, Africa, the social agenda and growing inequality
1.00pm-1.30pm	*Break to get lunch*
1.30pm-3.00pm	**Working Lunch: Reformulating what's on the table in 2007** *cont.*
3.00pm-3.15pm	*Coffee break*
3.15pm-5.00pm	**What's been left out of the upcoming G8 agenda**
5.00pm-6.00pm	**Next steps**
6.00pm-7.00pm	*Concurrent press conference*