



Dialogue on
Globalization

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**Growth with Responsibility
in a Globalized World –
Findings of the Shadow G-8**

Dialogue on Globalization

Dialogue on Globalization contributes to the international debate on globalization – through conferences, workshops and publications – as part of the international work of the Friedrich-Ebert-Stiftung (FES). *Dialogue on Globalization* is based on the premise that globalization can be shaped into a direction that promotes peace, democracy and social justice. *Dialogue on Globalization* addresses “movers and shakers” both in developing countries and in the industrialized parts of the world, i.e. politicians, trade unionists, government officials, businesspeople, and journalists as well as representatives from NGOs, international organizations, and academia.

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1. Preface

On June 6–8, 2007, heads of governments and states will meet in Heiligendamm, Germany, for the next G-8 summit, arguably the most influential and prestigious forum for world leaders to shape the global policy agenda. As the previous thirty-two summits did, the gathering of the G-8 in Heiligendamm is likely to provoke intense debate not only on the summit's results and gaps but also on the scope and limits of the G-8 as a political forum itself.

With this publication, the Initiative for Policy Dialogue, the Friedrich-Ebert-Stiftung, and Erlassjahr contribute to this discussion. It is based on a joint project called the "Shadow G-8," a meeting of a diverse group of concerned citizens from around the world, including former government officials, G-8 alumni, and leading economists, which was initiated and chaired by Nobel laureate economist Joseph E. Stiglitz. The group met on February 9, 2007, at Columbia University in New York. A second event took place at the United Nations in New York on April 17, 2007, where the findings of the first meeting were discussed with the German Federal Minister for Economic Development and Cooperation, Heidemarie Wieczorek-Zeul.

The Shadow G-8 followed a straightforward format: first the group considered the major issues facing the world today, and then discussed how the leaders meeting in Heiligendamm might most effectively make progress on those issues. The announced agenda of this year's G-8, Growth and Responsibility, served as the point of departure. Participants discussed what might or should be included on that agenda, as well as what should be the G-8's minimum aspirations: the bar that the leaders should set for themselves in advancing this important agenda.

The results are presented in two parts: in the Chairman's Summary, Professor Stiglitz succinctly conveys the Shadow G-8's key findings and recommendations, which reflect the remarkable degree of consensus that existed among the group. The rapporteur's report, written by Professor Stephany Griffith-Jones, elaborates on the recommendations and provides further background information.

While this publication is an honest attempt to summarize the main points of concern and consensus that emerged from the Shadow G-8, it cannot reflect all the views of every participant. The contents therefore remain the responsibility of the cosponsoring organizations.

I offer my profound thanks to the two authors of this report, as well as to all those who participated in and contributed to this project.

Jürgen Stetten
 Director, New York Office
 Friedrich-Ebert-Stiftung

2 Shadow G-8 Chairman's Summary

Joseph E. Stiglitz

There is an in-built bias against continuity. Each leader is more interested in creating a new agenda and leaving his or her mark.

The discussion of the Shadow G-8 meeting centered on four themes: climate change, global imbalances, promoting growth and reducing poverty in the developing world (especially in Africa), and global governance. Two themes ran through much of the discussion. First, many of the actions of the advanced industrial countries have had, and continue to have, adverse consequences on developing countries—countries that make up some 80% of the world's population. These actions often impose unacceptably high levels of risk on developing countries. We must address these issues if we want to achieve long-term sustainable global growth with responsibility, but addressing these issues is also a moral imperative. And if we are to effectively address these issues, we need to reform our systems of global governance. Second, the effectiveness of the G-8 process (or the reformed process described below) requires more continuity over time, including monitoring the extent to which commitments are lived up to. While the strength of the G-8 process lies in its informality, this aspect may have to be institutionalized. There is an in-built bias against continuity: each leader is more interested in creating a new agenda and leaving his or her mark than in seeing the fulfillment of an agenda that was set at a prior meeting. It is this personal involvement that provides some of the vitality of the G-8, but the problems of the world are too complex to be resolved in one-year efforts.

The Role of the G-8 and the Creation of a G-N

The attempt to forge a consensus, articulated through an agreed communiqué, may be counterproductive.

The G-8 can, and on occasions has, played an important role in addressing issues of global concern. Indeed its actual and potential influence is why so much attention is focused on these annual meetings of the world's economically most powerful countries. The informal discussions allow the leaders to develop a better understanding of each others' perceptions of these problems and the constraints they face, and to break bottlenecks that may have hindered progress. The attempt to forge a consensus, articulated through an agreed communiqué, may, however, be counterproductive. In diverse democracies, sometimes progress can be more effectively achieved by striving for large elements of common ground, but recognizing and respecting the existence of divergences in viewpoints.

Furthermore, in today's globalized world, many of the most important problems can only be addressed by more global participation: this is obvious in several of the issues that are at the center of discussion today—global warming and global imbalances. The G-8 is no longer the appropriate forum for these issues. Indeed, the discussions may be counterproductive: their positions can be seen as the stances of the wealthiest industrial countries to advance their interests at the expense of others. While inviting (even on a regular basis) some other countries to participate in some of the discussion might be seen as a step in the right direction, it too may actually be counterproductive—it can become a two tier system that reflects global inequities of the past and imposes responsibilities on the new semi-members of the club for decisions and positions in which they did not fully participate.

There needs to be a new forum, a G-N, in which leaders of the advanced industrial countries, middle income countries, and developing countries can gather together, to discuss informally the major issues facing the world. This should be a small enough gathering that there can be meaningful exchange, yet a large enough gathering that discussions can adequately reflect the diversity of circumstances and perspectives that exist in today's world.¹ This group would help identify key issues on which global action was required and help set in motion initiatives involving informal groupings of variable size and membership.² The G-8 meeting should set in motion plans for the first G-N meeting in the summer of 2008.

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Climate Change

With the issuance of the 4th Intergovernmental Panel on Climate Change (IPCC) assessment, it would be irresponsible for the G-8 not to take action on global warming. There is perhaps no issue of greater importance than saving the atmosphere of our planet, and the G-8 needs to recognize that for the foreseeable future, assessing progress on how the world deals with global warming will have to be an agenda item at every meeting. At this critical juncture, more rhetoric about taking more aggressive actions towards global warming will not suffice. The G-8 should focus on what the member countries themselves can do and how they most effectively can help developing countries reduce their carbon emissions.

The G-8 should agree to:

- a. A set of principles, recognizing the importance of global warming, and recognizing that it can only be addressed by giving countries a portfolio of options, including incentives, standards, regulations, and research. Key decisions today (such as those concerning power plants, transportation, and land usage) will affect carbon emissions for decades to come. There are a variety of ways that countries can achieve the objective of emission reductions. The G-8 should lay out a portfolio of choices, but these choices are about means, not results.
- b. Monitoring results—progress in emission reductions and increases in energy efficiency—should be an annual feature of every G-8 meeting.
- c. The agreed upon “principles” should include:
 - I. Appropriate incentive structures that require increasing prices for carbon. Incentive structures should be set up to provide adequate incentives for installing, say, low emission power plants, which firms should know today. How these increasing carbon prices are achieved is a matter that can be left to countries, e.g. whether cap and trade or carbon taxes are established.³
 - II. An assessment of the carbon impact of various public measures, such as alternative transportation systems and land usage rules.

The G-8 should agree to a set of principles, recognizing the importance of global warming.

1 The group discussed a number of possibilities for how the G-N members might be selected. See the summary by Professor Griffith-Jones.

2 The formation of recent groupings within the WTO to address the multiple issues on the agenda is an example of this “variable geometry.” For instance, a grouping to address the variety of issues in aid should include not only the G-8 but the large donors in Northern Europe, the only countries that have lived up to their aid commitments.

3 The group noted the increasing political support for the idea that it makes more sense to tax bad things, like pollution, than good things, like work and savings; and that accordingly, a revenue neutral switch from income or value-added taxes to carbon taxes would seem increasingly politically attractive. Combining this with public support for public transportation would help ensure that such a switch was not regressive in its distributional consequences.

- d. Some actions and commitments that can be taken or made now (even if the implementation may take some time). Among these are the following:
 - I. The elimination of subsidies for fossil fuels and distortionary taxes on alternative fuels.
 - II. The creation of a set of standards for power-generating plants, electrical appliances, housing, automobiles, airplanes, and other major sources of pollution. Such standards should prohibit coal-fired plants in advanced developed countries, unless there is some provision for carbon storage. While there are many complexities in dealing with the problems of global warming, we are fortunate that a large fraction of emissions is related to a limited number of sources, e.g. power plants, so that appropriate standard setting can make a major difference.
- e. The promotion of a broad research program (conservation, alternative technologies, bio-fuels, etc.), including
 - I. The establishment of a Global Research Fund.⁴
 - II. Ensuring that the benefits of the fruits of that research are made as widely available as possible. Concern was expressed that intellectual property protections might inhibit the full utilization of this knowledge, especially in developing countries.⁵ The Global Research Fund might be empowered to buy patents.
- f. Provide more assistance to developing countries (e.g. through the Global Environment Fund or through continued development of the Clean Development Mechanism) to adopt low emissions technologies, but such assistance should not be treated as part of G-8 country aid commitments. This assistance merely offsets the incremental costs associated with providing a global public good; it does not directly enhance developing country growth.
- g. Most importantly, the leaders of the G-8 need to help break the impasse that is developing in designing the post 2012 agenda.
 - I. They can begin by agreeing on a set of principles:
 - 1. Any successful approach to global warming has to be global.
 - 2. Any global system has to be both efficient and fair, which will require common but differentiated responsibilities;
 - 3. Fairness does not mean that because a country has polluted more in the past it should be entitled to pollute more in the future. Indeed, fairness, and the principle of the “polluter pays”, means that those who have contributed to the increase in carbon concentration in the atmosphere over the past 200 years should have, in some sense, entitlement to less pollution going forward; or that they should compensate the rest of the global community, e.g. through support of emissions efficient technologies in developing countries.
 - II. The leaders need to explore, from a variety of perspectives, what a fair system might look like (equal emission targets per dollar, per capita) and what it might entail, e.g. in transfer payments. There needs to be a discussion of alternative approaches (e.g. commitments to rates of increase in energy or emission efficiency or pollution taxes).

Any global system has to be both efficient and fair, which will require common but differentiated responsibilities.

⁴ Knowledge is a global public good, and knowledge that helps the world deal with the worldwide problem of global warming is “doubly” a global public good, requiring public support at the global level.

⁵ The issues are parallel to issues discussed below on access to generic medicines.

- III. G-8 leaders need to set in motion a process of continuing dialogue in an attempt to reach an agreed-upon set of principles. Given the magnitude of what is at stake and current divergences in viewpoints, there is a serious risk of failure in reaching an agreement about the 2012 world.
- h. While the G-8 is largely responsible for the increases in the atmospheric concentration of greenhouse gases, the developing countries are those that are most vulnerable to climate change. They are most likely to suffer the most and, at the same time, least able to bear the consequences.

Global Imbalances

Global imbalances represent a threat to global stability. There is a non-insignificant probability that there will, in the foreseeable future, be a disorderly and costly global economic adjustment. The costs of such a disorderly adjustment are likely to be borne disproportionately by poor countries, through large increases in interest rates (risk premia), changes in commodity prices, and a possible fall in export sales. The G-8 has repeatedly and rightly called attention to these imbalances. But there will be little benefit if the leaders simply repeat the standard rhetoric (calling for reduced budget and trade deficits in the U.S., more exchange rate flexibility by China, and structural reforms [“flexibility”] in Europe), in an attempt to paint a picture of shared blame and shared action. These by now tired, worn prescriptions—which have not led to any action—should not be repeated again at the G-8. Moreover, such rhetoric does not apportion blame appropriately: the U.S. deficits are an order of magnitude greater than the imbalances originating from Europe and China. And indeed, were China to appreciate its currency, it might exacerbate current global problems, by making it more difficult for the U.S. trade deficit to be financed. Furthermore, were China to float its exchange rate, and simultaneously loosen restrictions on those in China investing abroad, it is conceivable that its exchange rate would actually fall.

While there was some disagreement among the group that met at Columbia University about the role of structural impediments in Europe (and the possibility of adverse short-run consequences), there was a consensus on the following: there are serious deflationary biases in the global economy. The deflationary biases are a result of: the Growth and Stability Pact, which limits deficit spending in Europe, even in periods of high unemployment; excessive fiscal and monetary stringency, which are sometimes, but not always—as in the case of Brazil—a result of IMF pressure; and a precautionary build-up of huge amounts of reserves. Currently, tightening of monetary policy by the European Central Bank threatens the fragile recovery of Europe, and thus overall global prosperity.

Given that it is unlikely that governments will take forceful action to forestall a disorderly adjustment of imbalances, it is important that the G-8 take actions to mitigate the risks, especially as they are confronted by developing countries. This includes expanding contingent lending facilities (without imposing conditionality) in the IMF, the issuance of SDR’s to developing countries in the event of a crisis; accelerating the development of credit markets in which developing countries could borrow in their own currencies and/or the issuance of other risk-sharing instruments such as GDP-linked bonds, and providing more scope for developing

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countries to impose prudent actions to dampen pro-cyclical movements of short term capital, e.g. Chilean style capital interventions.

Over the longer term, there will have to be reforms to the global reserve system. The current system, which arguably is already fraying, contributes to global instability and inequity. It makes little sense for developing countries to be lending trillions of dollars to the United States (in the form of reserves), while borrowing back a fraction of the amount at much higher interest rates. The current direction of reform, in which the Euro joins the dollar as a reserve currency, will not rectify the inequities and is likely to enhance global stability only slightly.

The G-8 should initiate a working group to study reforms to the global reserve system.

While the IMF might naturally provide the institutional forum for further study of the problem of global imbalances, governance problems within the IMF—where the major source of imbalances holds the veto power—makes its role questionable. The G-8 should initiate a working group to study reforms to the global reserve system. This is an example where “variable geometry” in the structure of global governance should come into play: the Asian countries hold disproportionate shares of global reserves and contribute disproportionately to global savings, and they should perhaps have greater representation in this study group.

Promoting Development

The performance of many Asian countries over recent decades has provided new confidence that development is possible. Yet the gap between the richest and the poorest countries has increased, and the numbers in poverty in Sub-Saharan Africa are set to increase to 336 million by 2015⁶. While much of the responsibility for successful development rests with the developing countries themselves, there is much that the G-8, and more generally the more advanced industrial countries, can do. The group discussed a comprehensive agenda of aid, debt relief, trade, health and education, and attacking corruption. The group highlighted several actions that should be taken now, and several initiatives aimed at longer run reforms.

There is disappointing progress in living up to the commitments made at Gleneagles. To achieve the commitment of doubling aid to Africa a further \$5 billion dollars is required annually.

There is disappointing progress in living up to the commitments made at Gleneagles. To achieve the commitment of doubling aid to Africa and providing 0.7% of GDP in aid overall, a further \$5 billion dollars is required annually.⁷ Some of the recent increases in recorded aid have been in the form of debt relief (money that might not in any case have been collected).⁸ This means that going forward, there may have to be substantial increases in real aid flows. The group highlighted that fulfilling commitments is an area where better follow-through and monitoring is particularly important.

6 The World Bank, 2006, “Global Economic Prospects: Economic Implications of Remittances and Migration”, Washington, D.C.: International Bank for Reconstruction and Development.

7 The G-8 countries pledged to give an extra \$50 billion of aid worldwide by 2010, half of which would go to Africa. Patrick Watt and Tom Sharman, July 2006, The G8 Summit in 2006 (ActionAid), p. 6. http://www.actionaid.org.uk/doc_lib/g8_2006_briefing.pdf.

8 Some countries have paid a high price for their debt relief. Nigeria, for example, has had to turn over \$12 billion of its recent oil revenues in return for debt relief. Watt and Sharman, July 2006, p. 6.

A Development Trade Agenda: Beyond the Doha Round

Whether or not the Doha round is completed will make little difference for most developing countries. Whatever the outcome, it is clear that the developed countries have not lived up to the commitments made at Doha – and to the hopes of those that looked forward to a global trade regime that would promote development. The danger is that, should the round be completed, it be viewed as a development round. It is not.

There are a host of possible development oriented reforms that should be implemented, beyond the agriculture issues that have received so much attention. For instance, escalating tariffs are effectively designed to impede developing countries' ability to move up the value chain, to higher value added manufactured goods. Before turning over this next round of negotiations to trade ministers, the leaders should lay out a set of principles and criteria by which to evaluate the development impact of any trade measures.

Recent trends towards the proliferation of a spaghetti bowl of bilateral and regional trade agreements represent a threat to the global trade regime that was created with so much hard work over the past sixty years. The most important principle in that regime was that of non-discrimination, embedded in the most favored nation principle. Fears of a loss of advantages gained by new preferential treatments are creating impediments towards further global liberalization. Moreover, with bargaining power in these bilateral arrangements even more skewed than at the multinational level, there is a real danger that these agreements will be even more disadvantageous to developing countries. The G-8 should call a moratorium on bilateral agreements, until an assessment of their impacts on the global trading regimes and on developing countries can be conducted.

Health and Intellectual Property

Africa particularly has been badly hit by AIDS, a disease that is undoing so much of the progress that has been made in extending life expectancy. There have been laudable contributions from the advanced industrial countries and private foundations. With generic medicines selling at prices that are only 3% or less of the prices of brand name drugs, intellectual property protections have meant that, in some cases, the drug companies have been as much the beneficiary of this assistance as the developing countries; and even with this assistance, scarce money is still being diverted from other essential uses.

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) recognized the need for access to generic medicines, making provisions for "flexibilities" through compulsory licensing. Yet there appear to be significant impediments to taking full advantage of these flexibilities, and there is evidence that pressure is being put on developing countries not to issue compulsory licenses. Some way forward, through which those in developing countries can have access to generic medicines for all diseases (not just those associated with epidemics like AIDS), must be found. This may necessitate revisiting TRIPs (as suggested by the World Commission on the Social Dimension of Globalization, i.e. a TRIPs minus), or by an agreement within the current TRIPs framework on an expedited administrative procedure.⁹

⁹ For instance, a list of drugs (perhaps like hair-loss drugs) that would not be eligible for compulsory licenses would be established. Countries would be allowed to issue a compulsory license for all other drugs.

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The G-8 should call a moratorium on bilateral trade agreements.

Furthermore, the World Health Organization (WHO), and increasingly even pharmaceutical companies, have recognized that the current intellectual property system is not providing adequate incentives for innovation to combat the diseases afflicting developing countries. There must be a commitment to ensure that there is more research for the diseases that are widespread in developing countries, e.g. through the creation of a global health research fund.

One needs a balanced intellectual property regime, one that balances interests of users and producers, of academic researchers and of researchers in the private sector, of those in the developing world and in the developed.

What is clear is that the simple slogan “strengthen intellectual property rights” is not the right answer. It frames the question the wrong way, and as such, could move policy in the wrong direction. Intellectual property is complex, and there are a host of specific design features that determine whether an intellectual property regime promotes or retards innovation. One needs a balanced intellectual property regime, one that balances interests of users and producers, of academic researchers and of researchers in the private sector, of those in the developing world and in the developed. The issue is of particular importance because what separates developed from developing countries is not just a gap in resources, but a gap in knowledge; and TRIPs may have reduced access to knowledge by developing countries. Just as there was a need for a development oriented trade regime, so too is there a need for a development oriented intellectual property regime. In addition, TRIPs pays too little attention to the protection of Traditional Knowledge. Therefore, the G-8 should set up a working group to define what such an intellectual property regime might look like and how it might be implemented.

This group should also look at how open sourcing can be used to promote development; and to ensure that intellectual property laws do not work to the disadvantage of the open source movement. This group, or a separate group, should offer a portfolio of options to encourage research (including government supported research and prize funds¹⁰), and the role of intellectual property within that portfolio.

The most important input in the production of knowledge is knowledge, and there is a global imperative to accelerate the production of knowledge in areas of health.

There are, however, also immediate actions that the G-8 could undertake. They might encourage the spread of the practice, initiated by Yale and some other American universities, of not patenting life-saving medicines in developing countries, and of demanding “carve outs” for developing countries in any licensing agreements made with pharmaceutical companies. They could insist on such practices for any government funded research. They can insist that the results of any government-funded research be made available to any country for purposes of drug approval, and that such research can be used by researchers anyway in the world as part of their own research. The most important input in the production of knowledge is knowledge, and there is a global imperative to accelerate the production of knowledge in areas of health, especially in the diseases affecting developing countries.

¹⁰ A medical prize fund would, for instance, reward those who come up with cures and vaccines for the diseases that are prevalent in developing countries. Such a fund could be financed by contributions from the advanced industrial countries, for example, a commitment of 0.05% of GDP. A committee of experts could determine the size of the prize for different diseases, related to their prevalence and impacts. Once the cure is discovered, the competitive marketplace would help ensure low-cost production of generics. Other proposals, such as a guarantee purchase fund, can also be considered. A major criticism of guarantee purchase funds is that they leave in place the monopoly distortions of the marketplace, which are particularly costly to those not having access to the fund.

Africa

Addressing the legacy of Africa is one of the most important moral issues of our times. Dealing effectively with the issues of aid, trade, health, and intellectual property already discussed is essential.

While the group that met at Columbia recognized the importance of accountability—of ensuring that aid money is well spent—conditionality often goes well beyond that. While there have been important steps in reducing conditionality, they have not gone far enough. More worrisome is the possibility of non-transparent conditionality entering through the backdoor, in the use, for instance of Country Policy and Institutional Assessment (CPIA) indicators for the allocation of IDA money. It is regrettable that what went into these indicators only became transparent recently (implying that they could not even be used to encourage countries to take appropriate actions to improve their governance indicators); but as information has become more public, questions are being raised about their reliability and/or their relationship to aid effectiveness. Conditionality may impair aid effectiveness and undermine democratic processes, and this is true either for up-front or hidden conditionality.

The G-8 should commit itself to promoting democratic processes, reforming conditionality, and ensuring that conditionality is not brought in by the back door. It should initiate an aid working group (another example of the variable geometry referred to earlier), with participation by both aid donors (including those donors, such as small European countries that are not part of the G-8) and recipients, on the impact and extent of implicit and explicit conditionality.

Corruption has been at the center of the World Bank's recent agenda. Fighting corruption is, of course, important. Nonetheless, objections have been raised to this agenda. There is worry about the possibility of corruption in the corruption agenda: that standards will not be applied in a consistent way or that basic safeguards (due process) will not be followed in taking actions (like denying loans to a party accused of corruption). There is also concern that the single-minded focus on corruption has distracted attention from other problems. Aid can be ineffective not just because of corruption but also incompetence or lack of administrative capacities.

There is worry about the possibility of corruption in the corruption agenda: that standards will not be applied in a consistent way.

Nonetheless, there are concrete actions that the G-8 can and should undertake to deal with corruption:

- a. Every act of corruption involves both a briber and a bribee—and often the source of the bribe is from a multinational corporation. The OECD Convention on Combating Bribery should be expanded to all countries and more rigorously enforced. Developed countries have been slower in ratifying the UN Convention against Corruption than developing countries.
- b. Secret bank accounts facilitate this corruption, just as they helped finance terrorism. Their use for terrorism has been stopped; but their use for other purposes has not.¹¹ The G-8 could do this quickly, simply by not allowing their banks to deal with any bank in any country that does not subscribe to certain basic principles of transparency.

¹¹ This includes tax evasion.

- c. In previous G-8 meetings, attention was directed toward the importance of transparency in resource-rich countries, to avoid the resource curse. The Extractive Industries Resource Initiative focused particularly on “publishing what you pay.” But it is time to go beyond lip service to action. Until a few years ago, some in the G-8 allowed tax deductions for bribes. Now they don’t. Now is the time to no longer allow deductions for any payments that are not published. Overnight, this would change the extent of transparency.

Many African countries and other developing countries still face an unbearable burden of debt, in spite of the progress that has been made in debt relief.

Many African countries (and other developing countries) still face an unbearable burden of debt, in spite of the progress that has been made in debt relief. Going forward, however, the challenge is to prevent the recurrence of these debt burdens. The most important step in this direction would be to ensure that more risk is shifted from developing countries to developed, e.g. by devising ways that developing countries can borrow in their own currencies. The international financial institutions in particular should lend in local currencies¹² and should be instructed to look for new instruments to shift more of the risk away from developing countries, e.g. GDP indexed bonds, which would help align interests between creditors and borrowing countries.¹³ But even with the best designed risk sharing arrangements, circumstances will occur in which countries will be unable to repay what they owe. The discussions which began in the aftermath of Argentina’s collapse on developing more systematic procedures for the restructuring of sovereign and cross border debt, should be restarted.

The G-8 discussion in Heiligendamm will almost certainly turn to the key question of how to promote investment in Africa. It is important that this discussion be framed by the realities of the situation.

The G-8 discussion in Heiligendamm will almost certainly turn to the key question of how to promote investment in Africa. It is important that this discussion be framed by the realities of the situation: even those countries in Africa which have achieved macroeconomic stability and reduced corruption—performed by all accounts and by most measures well—have not been very successful in recruiting foreign investment. (To be sure, the constant refrain of corruption has not provided particularly constructive advertising.) Part of the reason is the absence of infrastructure. Reducing manmade trade barriers has only limited impact if there are no roads to bring goods to market or ports to ship them abroad. That is why a strong aid-for-trade initiative is so important. The African Development Bank (ADB) can also play a role here. A shortage of human skills—compounded by a weak legacy of educational institutions and a brain-drain—can only be corrected by more investment in education.

In Africa, as elsewhere, the World Bank and other international economic institutions have and can continue to play an important role in development. But the effectiveness of their role, especially when it comes to discussions on questions of governance, is threatened by deficiencies in their own governance. The IMF’s recognition of the problem, and its first steps in reform, were noted. And while deeper reforms in these institutions may take time, there are some steps that can be taken immediately by the G-8 countries themselves. Most importantly, there needs to be an agreement that the heads of the institutions should be chosen differently: they should be chosen in a transparent manner, in procedures that look for the most qualified candidate regardless of country of origin.

¹² Or in market baskets of correlated currencies.

¹³ Both the creditor and the borrowing country would be better off when the borrowing country performs better.

Moreover, the G-8 should recognize the principle of competitive pluralism, that there is not a single way forward for developing countries. Different countries have taken different paths. There are many different forms of a market economy and different development institutions may advance different perspectives, so allowing developing countries to make their own choices will strengthen democracy. By contrast, the current system of linkage, where availability of loans, say at the World Bank, are contingent on the approval of an IMF program, goes in exactly the opposite direction, and whatever one thinks of the particular orthodoxy, it is wrong to impose any orthodoxy on all countries.¹⁴ Delinkage is a simple step that could do as much for promoting democratic development as almost any other that the G-8 could undertake at its meeting in Heiligendamm.

The G-8, the most important annual meeting of the advanced industrialized countries, has stirred growing dissatisfaction with the global governance system, process, and outcomes. The need for multilateralism and solving problems collectively has never been greater, yet the institutions are not in place. We hope that the Shadow G-8 will lead to a better diagnosis of the global architecture and a productive debate on reforms, with a particular emphasis on the well-being of developing countries.

Moreover, the G-8 should recognize the principle of competitive pluralism, that there is not a single way forward for developing countries. Different countries have taken different paths.

¹⁴ It is perhaps noteworthy that many of the most successful developing countries have followed strategies that are markedly different from those advocated by the IMF.

3 Shadow G-8 Meeting Report

Stephany Griffith-Jones

This meeting report complements and expands on the Chairman's Summary, it details the official G-8 agenda, as well as the debates of the Shadow G-8 on global governance issues, climate change, global imbalances, and issues relating to developing countries, such as aid and debt. It concludes with a list of specific recommendations that came out of the Shadow G-8 meeting.

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 together, to discuss the world's great challenges and how best they can deal with them, and to try to build consensus among themselves. As the Chairman's Summary points out above, "The G-8 can play, and on occasions has already played, an important role in addressing issues of global concern."

The G-8 summits seem to be most effective when leaders discuss subjects on which there is great, in-depth preparation in advance. Very good examples were the discussions and, above all, commitments on Africa at Gleneagles in 2005, which built 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 genuinely to address them rather than papering over them mainly for the purpose of generating a communiqué.¹⁵ Such communiqués tend to lack substance and sufficiently specific plans of action. A further problem is that there is no clear mechanism for follow-up at either the G-8 or national level; likewise, there is neither a system of institutional monitoring of the achievement of goals set nor an evaluation of the gap between goals and actual achievements.

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However, the main limitation of the current G-8 is that it is a forum for the eight industrial 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-8's legitimacy and its effectiveness. As a result, all participants of the Shadow G-8 agreed that the G-8 composition must be widened and its process 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 body the leaders of the emerging economies as full members. This should

¹⁵ Indeed, the participants in the Shadow G-8 proposed that a more appropriate outcome would be a chairman's statement rather than a joint communiqué.

include countries such as China and India, as well as strong regional representatives from all continents. That other meetings and groups have made similar proposals seems to imply that widening the G-8 is an idea whose time has come. Indeed, some global leaders, including in 2006 British Prime Minister Tony Blair, suggested that the composition of the G-8 should be expanded.

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 leaders of the advanced industrial countries, as well as those of developing countries, both middle and low income. A working structure and precedent for a G-N already exist in the forum of the G-20 Finance Ministers. This latter, more representative, body was formed during the East Asian and Russian financial crises, when the need for a consensus-building institution that could deal rapidly with critical global economic issues became urgent. The then G-7 finance ministers could not do it on their own. A similar case exists today for a body of leaders representing key countries to address broad, global issues at the highest level, such as climate change, global imbalances, and development challenges. Recent attempts at inviting some developing countries on an ad hoc basis to a small number of the G-8 summits have been widely seen as deeply unsatisfactory. Among the criteria that could be adopted for choosing countries for the G-N are:

- I. Scale of their economies, with the largest in the world clearly needing to be represented.
- 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).

There was detailed discussion about how the G-N might be selected, building on the G-8 membership. It is important to include the major players in the developing world, such as China, India, Brazil, and Mexico, whose participation is essential for any meaningful consensus building and as a basis for future action. Regional leaders like South Africa and Nigeria in sub-Saharan Africa would also need to be included, and the Middle East should be represented. Further, as a large proportion of the world's population lives in small countries, their voices would need to be included as well to maximize legitimacy. This could, for example, be addressed in Africa by the attending head of the Organization of African States; similar solutions could be arrived at for Latin America and Asia.

The new forum, the G-N, would discuss informally the major issues facing the world. As the Chairman's Summary 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.

Some participants of the Shadow G-8 meeting emphasized that the broad agenda should be set by a legitimate international institution, such as the UN. 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 may become fruitful. For example, discussions of

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debt forgiveness should involve all major creditors and debtors; discussions on aid should include not just the G-8, but the smaller European countries that meet (or even surpass) the UN target for aid, as well as representatives from recipient countries. The G-N, as a more inclusive summit of leaders, and as part of a broader process involving both developed and developing countries, could thus increase legitimacy and effectiveness in global economic decision-making processes.

The Heiligendamm Agenda¹⁶

The German G-8 presidency emphasized that leaders should focus more tightly on global economic matters, not least the issue of global imbalances.

During its launch of the prospective agenda for the upcoming G-8 Summit in Heiligendamm, the German 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 the G-8 for the expansion of its agenda in recent years. She stated that it would be necessary to “get back to the roots” of the 1970s.

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. Some critics argued that the narrower focus in the initial G-8 agenda might lead to a marginalization of developing countries’ concerns, such as world poverty, and misses the opportunity to address climate change. In response, the German presidency has shown certain flexibility over recent months and has fine-tuned the list of agenda items.¹⁷ The original summit plan to focus exclusively on intellectual property protection, energy, and global imbalances was modified and expanded to include the issues of economic development and climate change. Nevertheless, a closer look into the proposed direction by the German presidency shows that Heiligendamm might lead in some areas to a reformulation of earlier G-8 commitments.

The German government set the tone for the core economic agenda in Heiligendamm with the agenda item “investment, innovation, and sustainability.” According to the German presidency, the main objective at 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 dimensions of global imbalances and to determine policy solutions. The agenda does not give particular emphasis to rebalancing global patterns of growth, savings, and investment. The focus remains rather on single countries and regions. These are defined in terms similar to those of previous G-8 meetings.

¹⁶ This section is based on the background paper “Same Old Wine in New Bottles: The Agenda for the 2007 G8 Summit in Heiligendamm,” which can be downloaded at: http://www0.gsb.columbia.edu/ipd/pub/Frank_Schroeder.pdf.

¹⁷ In this context it should be mentioned that for the first time the G-8 development ministers met, in March 2007, with representatives from developing countries to discuss key policy issues on the agenda of the G-8. The chair’s summary can be downloaded at: http://www.bmz.de/de/zentrales_downloadarchiv/eu_und_g8/chairs_summary_final_2.pdf.

With respect to the systemic stability of the international financial system, the proposed G-8 agenda appears vague. The only important exception in this area is the German proposal to discuss policy options that could improve the transparency of hedge funds.

While the proposed agenda for Heiligendamm acknowledges the importance of innovation and its positive impact on economic growth, its main focus will be on improved protection of intellectual property rights. The German presidency proposed initiating a structured dialogue with developing countries on this issue at the G-8 summit. However, it remains uncertain if this will allow for debate on how the current intellectual property regime can be changed towards a more development-oriented paradigm.

The German presidency underscored the need to make progress in counteracting climate change and increasing energy efficiency. The agenda proposes that the G-8 set verifiable and attainable goals to increase the use of alternative fuels, particularly biofuel, and to make progress on drawing up a successor agreement to the Kyoto Protocol on climate protection. Against this background, the U.S. has already announced its intention to weaken any G-8 statement on climate change, which will likely hinder any progress in this area at the Heiligendamm summit.¹⁸

The suggested agenda for Heiligendamm, at this point, does not acknowledge the need to evaluate progress in the implementation of the Gleneagles commitments on debt relief, trade, and Official Development Assistance (ODA). Instead, Germany has proposed the development of a “reform partnership” with the African continent in order to establish “a new and stable framework for private investment.” This new proposal by the German presidency targets African countries that are pursuing good governance, fighting against corruption, and using raw materials responsibly.

As in previous G-8 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 is uncertain whether this will lead to any new initiatives or mobilization of new resources in this area.

While senior officials of the German government have announced that Germany will introduce a proposal to institutionalize the invitation to leaders from emerging countries such as Brazil, China, India, Mexico, and South Africa, the German presidency has stated that this should not lead to an enlargement of the G-8. It is rather envisioned to start “a new permanent form of dialogue” with leaders from Africa, Asia, and Latin America; however, this would not give these nations any true avenue to impact policy decisions of the G-8.

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18 Juliet Eilperin, May 13, 2007, “U.S. Aims to Weaken G-8 Climate Change Statement,” Washington Post, http://www.washingtonpost.com/wp-dyn/content/article/2007/05/12/AR2007051201445_pf.html.

Climate Change

There was a very strong consensus among the Shadow G-8 about the urgency of action on global warming. The evidence is clearly on the table that humans are causing climate change, an argument supported by the IPCC. This is a major factor in shaping public opinion, which in turn puts pressure on the G-8 to take action.

To avoid dangerous climate change, we cannot continue with current patterns of production and consumption, which will lead to atmospheric concentrations of greenhouse gases and will pose increasingly high risks of extreme consequences.

It is also becoming very clear that much of the carbon storage capacity available in the atmospheric system has been used up. To avoid dangerous climate change, we cannot continue with current patterns of production and consumption, which will lead to atmospheric concentrations of greenhouse gases and will pose increasingly high risks of extreme consequences. A difficulty that needs tackling is the inherent inertia of the energy system. For example, power plants have a lifetime of up to fifty years; implementation of current plans to install many more conventional coal power plants could cast a huge emission shadow over the future.

As the Chairman's Summary clearly points out, the G-8 members should focus first on changes in their own economies and, secondly, cooperate with developing countries on technology to help them reduce their carbon emissions. This would require additional financial assistance to the Global South to adopt low emissions technologies. Indeed, such an approach overlaps with the issue of global social justice. A huge injustice exists in that there is no overlap between those who have been the largest polluters and those who are mainly bearing the cost of pollution. Therefore, the issue of environment is not just one of efficiency but also of global justice. It is important that resources transferred to developing countries be added to existing aid and do not come out of current ODA budgets, so that the aim of meeting the Millennium Development Goals is not undermined.

Assistance needs to be formulated in such a fashion that it also attracts investment capital from more advanced developing countries. For example, loan guarantee funds targeted to support investments in renewable energy and energy efficiency, which are often perceived as entailing greater risk, hold great promise for encouraging indigenous investments in clean energy technologies.

Proposed Specific Actions and Commitments for the G-8

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

- a. Committing to doubling the historical rate of energy efficiency improvements. It should be possible to achieve 20–40% efficiency gains in the building, transportation, and industrial sector. This would not just reduce emissions but also slow growth in energy demand and reduce the rate of deployment of carbon-intensive energy technologies, such as pulverized coal power plants. An annual technical summit should be convened to provide a forum for monitoring progress and promoting cooperation. Furthermore, a body such as the International Energy Agency could play a role in reviewing national plans and progress.

- b. Only building new coal-fired power plants in developed countries with retrofits for capture and sequestration of carbon emissions. Given the limited available experience with such plants, increased funding is urgently required 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. Setting and upholding standards on fuel efficiency for transportation, buildings, appliances, industrial applications, and other major sources of pollution. The commitment to these standards should be immediate at the G-8 meeting this June, even if implementation is phased in.
- d. Encouraging Russia to reduce distribution leakage of natural gas and to improve metering and thereby reduce theft.¹⁹ Such measures could double the effective supply of natural gas coming from Russia. As natural gas has low carbon content and helps reduce local pollution, this would be beneficial for climate change.
- e. Encouraging bioenergy development. Crop-based biofuels are an initial step in this direction, but cellulosic biofuels produced from nonfood crops, such as switchgrass and jatropha, hold much greater promise because they require fewer inputs, can be produced on marginal lands, and do not compete with human agricultural consumption. Production of these energy crops could also be very valuable for developing countries, saving them money on foreign exchange and creating new export crops. Furthermore, biofuels integrate energy and agricultural markets in developing countries in Africa and Latin America.

Research Program

The G-8 should also agree to the promotion of a broad-based research program by:

- a. Creating a Global Research Fund that would both develop new technologies and disseminate existing technologies favoring environmental conservation and growth. Indeed, the development of these new green technologies could even lead to higher and more sustainable growth. This fund could be financed by industrial countries, but its results should be freely available to poor countries, so as to maximize positive global impacts on the environment and growth.
- b. Supporting publicly funded research, so that the resulting knowledge and technologies can be disseminated as widely as possible. Indeed, knowledge is a public good, and the global environment is a global public good. As Shadow G-8 Chairman Joseph E. Stiglitz eloquently said: "Knowledge about how to preserve the environment is a double public good." Participants of the Shadow G-8 meeting expressed the belief that the major vehicle for producing environmentally friendly innovations to meet human needs should not be covered by intellectual property rights, as the rate of dissemination of that knowledge would be limited. To overcome this, a major component of this research must be publicly funded. In the case of privately conducted research, the Global Research Fund's resources could be used to buy patents in order to make them available to others at lower cost. Creating a prize fund for innovation could encourage relevant research toward this objective.

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¹⁹ See also Richard Moss et al., 2007, *Bringing Energy Efficiency to Scale: A Strategic Plan for Improving Energy Productivity* (Washington, D.C.: United Nations Foundation).

Broad Principles

It is very important to identify broad principles in order to define the agenda beyond Kyoto.

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- a. The G-8 should not only prepare households and firms for rising prices related to emissions into the future, it should also outline a time frame for such a policy shift, for example, for the next thirty or forty years. This approach could be implemented through a variety of mechanisms (for example, carbon taxes and caps on trade). However, countries should be left with the policy space to decide which instruments to choose. Nevertheless, it might be necessary to set a floor on domestic prices of energy, a price-based standard. Such a policy shift would influence long-term decisions on the structure and scale of cities, nature of housing, transport systems, and so on, with very large impacts on energy consumption.
- b. Pollution should be considered a real cost of production, implying the necessity to recognize the principle that the polluter should pay. This principle should be acknowledged in the present and future. Somewhat more controversial, but quite fair, is whether those who polluted in the past should compensate developing countries, as major emerging economies have argued. An alternative path could be—as the Chairman’s Summary suggests—to lower entitlement to pollute in the future for those countries that have polluted more in the past and/or to compensate developing countries through support of emissions-efficient technologies in those nations.

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. Participants in the Shadow G-8 meeting agreed that any post-Kyoto agreement must look far into the future and be predictable in order to insure confidence for public and private investors.

It seems most feasible to agree on principles and targets for overall reduction of carbon emissions, while allowing individual countries to choose the instruments they consider most appropriate and for which they can build public consensus. A case in point is the carbon tax. While this instrument would imply a tax on environmental externalities, such as emissions, instead of on public goods, such as jobs and savings, it would still be difficult to overcome public opposition in some countries. Given the political constraints, an alternative approach could be to meet emissions caps with regulatory policies, such as renewable energy portfolio standards or mandated efficiency standards. Another related framework could be a “cap and trade regime” that allocates emissions rights and allows trading among countries, companies, and other entities.

A variety of “flexibility mechanisms” are employed in the Kyoto Protocol to make the achievement of caps more efficient. These include “joint implementation” and the “clean development mechanism,” which permit flexibility in where emissions are reduced, and the placing of limits via a “basket” of greenhouse gases, so that countries can choose to focus on those with the lowest compliance costs. Any framework should recognize the “common but differentiated responsibilities” of

countries, as called for in the UN Framework Convention on Climate Change. This principle places the onus for early action on developed countries, whose historical emissions are largely responsible for the current buildup of greenhouse gases in the atmosphere. But it does not absolve rapidly industrializing developing countries from eventually acting in ways appropriate to their circumstances. For example, OPEC countries, with whom agreement on many aspects of global warming will be very difficult, could perhaps be induced to contribute to supporting research and development for improved technology for fossil fuels (indeed, they seem open to this), an area that is important because fossil fuels will continue to be a major source of generating energy.

Furthermore, it will be crucial to find common ground between developing and developed countries on emissions and efficiency targets. In general, less pollution could be consistent with economic growth, which might make it easier in this case to gain agreement from developing countries on efficiency targets. However, it could be extremely difficult to obtain their agreement on emissions targets, unless they are expressed in terms perceived to be fair, such as equal per capita or equal per gallon emissions, a method that is highly contested by developed countries.

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Two final important points were made at the Shadow G-8 meeting. First, it is important that there are no free riders in whatever global solution is found. 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 inefficiently produced goods. Secondly, because of the magnitude of the challenge, it is essential to recognize that there is no silver bullet for solving the climate problem. Thus it is crucial to make progress on a diverse portfolio of approaches to addressing the issue.

Global Imbalances

Global imbalances represent a threat to global stability. As the Chairman's Summary stresses, there is a high probability of a disorderly and costly global economic adjustment. Such a disorderly adjustment would be particularly painful for poor countries, which could be affected by declining commodity prices, lower export volumes, and higher costs in servicing their debt.

A first step to deal with global imbalances would be an accurate diagnosis of the current situation. In particular, the international discussion on imbalances has been somewhat biased up to this point. For example, China's current account surpluses are far smaller than U.S. current account deficits; excessive emphasis is therefore being placed on adjustment by China and not enough on the U.S. The U.S. does need to play a large role in diminishing global imbalances, especially via a lower fiscal deficit. Further, there has been little discussion of the very weak yen, which, in large part, results from a massive carry trade stemming from Japan's large interest rate differentials with other countries. The destabilizing speculation by financial markets implies a very weak Japanese currency, which contributes to the massive current account surplus.

A first step to deal with global imbalances would be an accurate diagnosis of the current situation.

The G-8 discussion on Europe's contribution to global imbalances rightly emphasized the need for Europe to accelerate its economic growth. However, the G-8's

almost exclusive focus on structural reforms appeared too narrow to many participants of the Shadow G-8. Indeed, a major problem for growth seen by the group is the deflationary bias of the Growth and Stability Pact, which limits increased fiscal spending even in periods of low growth. Some participants saw the structural reforms themselves—by leading to lower wages and thus lower domestic demand—acting as a constraint on European growth. It was pointed out that Europe has been marked by not just the traditional “beggar my neighbor” policies, but also “beggar thyself” policies. It was unanimously agreed that, under current circumstances, any further tightening of monetary policy by the European Central Bank will have a very negative impact on Europe and the global economy.

Some participants emphasized that excessive conservatism in monetary and fiscal policy is not restricted to Europe. Brazil, for example, appears to have an even tighter monetary policy. The need for higher growth in countries like those in the Euro area and emerging economies like Brazil becomes more urgent as economic growth in the U.S. slows.

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The G-8, in its current composition, is the wrong forum to discuss China’s contribution to global imbalances, as China is not a member of the G-8. It is essential to fully involve all major players. (This argument is very closely related to the initial discussion above on the need for global governance reform.) Further, it is unclear whether China’s currency is really undervalued. If China were to eliminate all regulations on capital outflows, allowing the yuan to float freely, the exchange rate might even depreciate. If China were to revalue, its exports to the U.S. might be partly replaced by other countries’ exports, and those countries might be less willing to invest in U.S. Treasury Bills.

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A concept that has gained increasing popularity is borrowing in local currency in order to reduce currency mismatches in the economy. Countries can do this through their own financial markets or with the support of institutions like the World Bank or regional development banks. Similarly, developing countries can borrow in GDP-linked bonds, whereby countries service less debt in periods of slower growth and more debt in periods of more rapid growth. In the case of an abrupt adjustment, countries holding debt in GDP-linked bonds would have room to follow more expansionary, countercyclical fiscal policies, which would help their economies and contribute to the stability of the world economy. In addition, developing countries should be permitted to use measures such as market-based capital regulations to curb excessive short-term capital inflows.

The participants in the New York meeting believed it important for the G-8 to make efforts to expand the IMF’s contingent lending against external shocks (such as a slowdown of the world economy), and that such lending should have no conditionality attached. For low-income countries, there should be sufficient non-conditionality lending to compensate for terms of trade shocks. Currently, the existing IMF contingent lending facilities for these countries are high in conditionality and rather small in resources. Similarly, it should be ensured that middle

income countries with good policies, according to their Article IV consultations with the IMF, should have automatic access to lending, if hit by contagion from other countries.

More broadly, the current international financial system suffers three major long-term challenges that underlie global imbalances. These should be addressed in a forum that represents all key players in the world economy. The G-8 should initiate a working group to study necessary reforms to the international financial system. As a first step, this working group would address the inherent instability of the global reserve system, because it is ultimately based on the U.S. dollar as a reserve currency. Though somewhat modified, the Triffin dilemma is still valid, implying that huge U.S. current account deficits, though in the long term apparently unsustainable, are important to maintain global liquidity and demand.

The second impediment of the global reserve system is its inequity. Developing countries feel compelled to accumulate large foreign-exchange reserves as a mechanism of self-insurance against crisis, due to the lack of appropriate collective insurance mechanisms from institutions like the IMF. There is a huge opportunity cost associated with holding these reserves, because the funds could instead be put toward much needed investments in such areas as education or infrastructure.

At present, developing countries are investing a high proportion of these reserves in developed economies, especially in the U.S. This suggests a major and inequitable transfer of resources from the South to the North, which goes against the logic of standard neoclassical economic theories that predict capital will flow from low-growth economies, with higher proportions of people who require pensions, to high-growth economies, with younger populations. As a result, developing countries are increasingly beginning to challenge current arrangements in the international reserve system.

Finally, 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 offshore centers, and vehicles that are neither transparent nor regulated. A typical mechanism is the carry trade, which, for example, has been weakening the yen and strengthening certain developing country currencies. The rapid unwinding of the carry trade, for reasons not necessarily linked to economic fundamentals, can lead to sharp and destabilizing fluctuations in exchange rates and stock markets, as seen in the events of February 2007. Perhaps, even more seriously, they can pose major systemic risks, as shown by the impact of Long-Term Capital Management (LTCM) in 1998.

It is encouraging that some G-8 governments, Germany in particular, have raised the issue of improving transparency in hedge funds and their operations. This could be an important first step for regulation and could have implications for other over-the-counter instruments such as derivatives, through which many hedge funds operate. The G-8 leaders have the opportunity to initiate increased transparency and regulation, as most hedge funds are either located in developed countries or in offshore centers linked to them.

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A possible mechanism for regulating hedge funds could be through proper regulation of banks that lend to them and thus facilitate their leverage. This could help monitor risk more precisely. Improved transparency and regulation could 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 focused mainly on global macroeconomic issues. In 1999, at Cologne, Germany, there was a breakthrough on development issues, with the launch of the Heavily Indebted Poor Countries (HIPC) debt relief initiative for low-income countries. Similarly, in later years development initiatives were launched at G-7 and G-8 leaders' meetings, with the global fund to fight major diseases being launched in 1999 and the agreement on a comprehensive G-8 approach on Africa in 2002. This culminated in 2005 at Gleneagles, where development issues dominated the G-8 agenda, in the form of signed commitments to double aid to Africa by 2010, and the pledge for a total increase of development assistance annually of \$50 billion, and to cancel multilateral debt to the poorest countries.

There was concern at the Shadow G-8 meeting that the G-8 at the Heiligendamm summit may retreat somewhat from the prominence given to development issues in previous years. Participants expressed that G-8 commitments are most likely to lead to tangible results if follow-up takes place in institutions where G-8 members are majority shareholders, such as the IFIs. Furthermore, where G-8 members face domestic political roadblocks, communiqués are most likely to be vague and will not lead to concrete results. Finally, the lack of appropriate monitoring mechanisms linked to the G-8 process leads to poor follow-up and makes implementation difficult.

Participants in the Shadow G-8 meeting suggested that the main development focus in Heiligendamm should 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 delivered. It is important to strengthen institutional monitoring mechanisms, so as to encourage the G-8 to fulfill its commitments, especially those made at Gleneagles.

A possible new area for the G-8 to take on is supporting the development of internal and regional markets in Africa. As Africa does not have the capacity to finance the development of internal and regional markets, the G-8 could take the lead on providing some of the necessary funds. This could complement the German agenda on promoting investment in Africa.

Aid

The delivery of aid targets signed on by G-8 member states and the mobilization of additional resources for development remain top priorities in the fight against global poverty. Participants at the Shadow G-8 meeting suggested that it will be necessary to develop a delivery matrix for the Heiligendamm summit listing all previous G-8 commitments and the status of their implementation. It was further suggested that the G-8 should take action to achieve a strengthened monitoring mechanism of these targets, which would be based on ongoing work in this area by the Organization for Economic Cooperation and Development/Development Assistance Committee (OECD-DAC) in cooperation with the World Bank and the UN. That monitoring should lead to more effective delivery of aid. Those attending acknowledged that the monitoring mechanism should be made inclusive in order to allow the participation of new donors, such as China. The mechanism should have the financing and human resources to monitor delivery on:

- Both the level and content of 2005 aid commitments (whether true additionality or debt relief funding).
- Funding gaps related to the HIPC Initiative (1999) and Multilateral Debt Relief Initiative (MDRI, 2005), intended to secure funding from the IDA and the African Development Fund (ADF).
- Quality of aid and follow-up to the Paris Declaration.
- Universal access to prevention of, treatment of, and care in fighting HIV/AIDS and other infectious diseases.

Furthermore, it was suggested at the Shadow G-8 meeting that major aid donors should not only coordinate their efforts but also try to avoid aid fragmentation, while also returning to a clearer focus on development. Participants quoted several effectiveness studies that clearly showed that aid—with politically directed aid removed—does contribute to economic growth.

Certain types of conditionality attached to aid have done more harm than good in the past. There was particular concern among those in attendance about non-transparent conditionality, such as the CPIA governance indicators developed by the World Bank to allocate IDA money. Since the indicators have been made public, critiques are being voiced as to whether they are appropriate for measuring good governance and the CPIA's impact on aid effectiveness. Several participants believed the CPIA is so problematic that it should be eliminated, while others thought it must be significantly improved.

An important broader issue was raised as to how best to find more effective avenues to distribute aid to developing countries. It was suggested that this would require reduced conditionalities and more open policy space, which might best be achieved by channeling aid through national budgets and thus respecting democratic bodies and processes.

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Debt²⁰

In June 2005 at the Gleneagles summit, the G-8 proposed to cancel all debt owed by postcompletion point HIPC countries to the IMF, IDA, and ADB. The deal initially included eighteen countries, for a total write-off of U.S. \$40 billion over forty years. The IMF forgave its portion of the debt in January 2006, and World Bank and ADB 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) was a positive step in relieving the debt burden of some of the poorest and heavily indebted countries. It has made an important difference to countries receiving this debt relief, and has acknowledged that the prior system of debt write-offs did not lead to debt sustainability. But participants in the Shadow G-8 meeting recognized that the MDRI has significant limitations that must 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.

It was emphasized that the MDRI is an ad hoc response to debt relief rather than a solution to the problem of debt overhang.

It was emphasized that the MDRI is an ad hoc response to debt relief rather than a solution to the problem of debt overhang. Therefore, the G-8 should act on developing a comprehensive framework of how to handle sovereign debt restructurings, one that defines how risk should be shared between all debtors and creditors.

In the meeting, the following problems associated with the MDRI were raised:

- a. The IDA and ADB debt relief has replaced the provision of new funds. The IFIs have reduced disbursements for every dollar of debt service relief given.²¹ In essence, the countries have paid for their own debt relief.
- b. The MDRI only encompasses IDA, IMF, and ADB loans (although, in November 2006, the Inter-American Development Bank (IDB) agreed to cancel U.S. \$2.1 billion of the \$3.5 billion 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%. In some cases, debt relief has been de facto funded to an important extent by middle income countries who borrow from the IDB and not by the developed countries. For African countries, this has amounted to debt service savings of 40% on average.
- c. The canceled amounts range from 20% for some countries to 80% for others. The MDRI does not address how much debt cancellation a country "needs" and how it can be achieved. Many countries need additional debt cancellation; some could require less. It is clear that a broader framework is needed that takes into account debt sustainability, as defined by the ability of a country to grow and reach the Millennium Development Goals.²²
- d. Many countries have replaced the loss of new funds with new loans, running up debt levels again. The MDRI obviously does not include new debt contracted, including debt from China and other creditors that are not part of the

²⁰ This section is based on the background paper "Notes for the Shadow G-8 on debt relief," which can be downloaded at: <http://www0.gsb.columbia.edu/ipd/programs/item.cfm?prid=18&iyid=13&itid=1021>

²¹ New funds have been made available to the institutions, but these funds are being reallocated to all IDA and ADB recipient countries based on performance allocation criteria.

²² For debates on how debt sustainability is defined, see the forthcoming Initiative for Policy Dialogue Debt Task Force volume.

- G-8. 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 G-8. 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.
- e. 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 that should be. More importantly, a framework for all heavily indebted countries needs to be developed.
 - f. Debt relief as part of the MDRI is tied to conditionality.

The above limitations of the MDRI also point to the importance of putting the development of a more comprehensive framework for debt restructuring back on the G-8 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 a Sovereign Debt Restructuring Mechanism (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 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. G-8 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 bilateral and multilateral institutions. This is especially true for loans given with conditionality. GDP-linked loans (and 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 has been that the IMF and World Bank cannot take the risk that all debtor countries might have a slowdown in GDP at the same time, depleting the Fund's or Bank's capital. However, this risk is easily hedgeable—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.

In conclusion we can say that 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.

The current system of debt forgiveness is inefficient and does not address the needs of most heavily indebted, low and middle income countries.

4. Key Recommendations

1. A new forum, the G-N, should be created immediately. It would include as full members G-8 leaders and leaders from developing countries, both middle and low income. The G-8 meeting should set in motion plans for the first G-N meeting in the summer of 2008.
2. G-8 countries should commit now to doubling the historical rate of energy efficiency improvements, to agreeing to a set of standards for fuel efficiency in cars, housing, airplanes, and other major sources of pollution, and to eliminating subsidies for fossil fuels and distortionary tariffs on alternative biofuels.
3. The G-8 should pursue “common but differentiated responsibilities” in providing additional sources of assistance (financial, technical, and humanitarian) to developing countries for adaptation and deployment of low-emitting energy technologies.
4. The G-8 should create a Global Research Fund to finance research on conservation and alternative technologies, such as biofuels. Its outcomes should be made as widely available as possible.
5. The risk of an abrupt adjustment to global imbalances implies the need to create mechanisms to mitigate their 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.
6. Mechanisms to increase transparency and to effectively regulate financial actors, such as hedge funds, should be introduced to avoid systemic risk and destabilizing speculation.
7. Clear and detailed monitoring mechanisms for G-8 commitments, in areas such as aid, should be created immediately.
8. The G-8 needs to take on the initiative to develop a comprehensive framework for handling sovereign debt restructurings.

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