A Needed G-20 Consensus: A New Structural Reform Agenda for Developing Countries

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What a wonderful world we lived in before the 2008 collapse of Lehman Brothers and the global financial crisis that followed. Economists and financial market analysts had coined many phrases to describe the period of prosperity before the crisis. Some of these include: the Goldilocks economy, the new economy, the Great Moderation and the second wave of globalization. During this period, the developing world as a whole also enjoyed significant growth acceleration and poverty reduction. Also during this period, international policymakers built up an elegant macroeconomic policy framework, comprised of inflation targeting, the fiscal rules of the Maastricht Treaty for fiscal sustainability and a flexible exchange rate regime. This global economic framework also encouraged regional and international economic integration and private finance initiatives for infrastructure investment. It seemed as if this prevailing global economic framework would ensure the continuation of prosperity in the world economy well into the future.

However, all this was shattered by the global financial crisis and the Great Recession that followed. We are probably still in the process of learning all the lessons from the 2008-09 crisis, but it is becoming clear now that we have to leave the prevailing macroeconomic policy framework behind. We must wade into uncharted waters, where familiar macroeconomic policy tools are no longer sufficient in ensuring global economic stability and growth. We may have to use unconventional or unorthodox structural policy tools and mix these with the conventional macroeconomic policies. The International Monetary Fund under the leadership of its former Managing Director Dominique Strauss-Kahn had ventured into this area, when it began discussing the resuscitation of Keynesian fiscal policy, once regarded as defunct, the controlling of volatile international capital movements, once regarded as a taboo, and the creation of “fiscal space”. But we need to go further if we are going to maintain the growth dynamics of developing economies in the medium term.

It would be highly useful to economic policymakers as well as politicians around the world if we could come up with a new G-20 Consensus, with a view of focusing their minds on the much needed policy reforms. This consensus should not be a one-size-fits-all formula, like the much maligned Washington Consensus, but should be flexible and helpful to economic and development policymakers in the developing world, who are struggling to formulate policies appropriate for their countries and their circumstances.

The IMF and World Bank, as well as regional development banks should be called upon to initiate the formulation of a G-20 Consensus for the group's consideration. This work will surely require quite a bit of rethinking in terms of the traditional policy positions that have been promoted by these international institutions in the past. While a new G-20 Consensus should be up for discussion, its ultimate framework should include the following elements:

First, there is enormous underinvestment in infrastructure, including energy supply. Infrastructure deficits are not only limited to sub-Saharan Africa. In fact, they are also prevalent in Asia and Latin America. From a decade's experience of working toward fulfilling the Millennium Development Goals, we have learned that a most effective method
of achieving the MDGs is economic growth and yet we have not focused on necessary infrastructure for promoting economic growth. How can we build manufacturing industries if we are to suffer all kinds of power shedding, brownouts and blackouts almost on a daily basis? We have been discussing global climate change with a particular focus on emissions mitigation. But we have hardly begun planning adaptation measures against high waters, typhoons and other climate-related natural disasters that would require substantial infrastructure investment. Many developing country governments have attempted to co-opt the private sector into infrastructure investment in the form of private finance initiatives with rather meager successes. The World Bank and regional development banks often have hid behind the concepts of private sector development and private investment initiatives, and avoided the difficult task of assisting large-scale infrastructure investment—no doubt out of fear of possible environmental damages and corruptive practices. There needs to be a wholesale rethinking of how to do infrastructure investment in the developing countries, which should be part of the structural reform agenda for the G-20.

Second, the recent experience shows that we need to strengthen fiscal institutions in more purposeful ways. Fiscal policy is the crucial nexus between macro and microeconomic policy. While we all recognize the need for improving governance, it seems that many of the efforts to improve governance are too diffuse to yield concrete results. The improvement of what we now call public financial management would go a long way in suppressing corruptive practices in the public sector. It would also help the governments of natural resource rich countries deal with the "natural resource curse", not only in terms of fighting corruption but also in responding to demand and price volatility.

Third, thanks to globalization and the integration of the world economy, small, open economies have, for all practical purposes, lost “tax sovereignty” in setting tax rates. They often have to follow their larger neighboring country in harmonizing their tax environment to keep multinational corporations and investors from leaving. For this reason, the revenue functions of governments are becoming increasingly important.

Fourth, as more countries move to become middle-income countries, social security systems, national health care systems and pension programs must be expanded. Fiscal institutions, both in the form of revenue functions as well as resource transfer mechanisms, will be essential and crucially important foundations for these systems.

Fifth, in the medium-run, an expansion of fiscal space is an imperative. The national budgets of many developing country governments still include a variety of subsidies which are the vestiges of previous policies. While we have learned that direct subsidies to the poor and needy are more effective and preferable to subsidies to inputs or outputs across the board, many national budgets still include substantial subsidies for energy, food and agricultural inputs. Although this is a politically sensitive area, the G-20 Consensus may suggest subsidy rationalization as a first step of fiscal reform.

Lastly, as part of the G-20 Consensus, there should be a rebuilding of policy planning functions for developing country governments. In the past quarter century or so, with few exceptions (e.g. China’s Development and Reform Commission and India’s National Planning Commission), policy planning functions of these governments had gradually lost their power and leadership in policy formulation and resource allocation. However, most of the structural reform agenda suggested above requires long-term planning, be it infrastructure investment or the expansion of social security institutions and social safety-nets. The rebuilding of planning functions should be made on the basis of a thorough review of their past performance, as there must have been good reasons for their waning power, authority and effectiveness.