2007

TOP 10

GLOBAL ECONOMIC CHALLENGES

AN ASSESSMENT OF GLOBAL RISKS AND PRIORITIES

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BROOKINGS GLOBAL EXPERTS

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The beginning of 2007 offers a conflicting picture of the global economy for those trying to discern trends, challenges and opportunities. Concerns about energy security and climate sustainability are converging—finally bringing consensus in sight on the need for action in the United States. But prospects for breaking the global stalemate are still years away. Though some developing countries are succeeding in bringing hundreds of millions out of poverty, too many are still mired in a doom spiral of conflict, poverty and disease—despite the entry of new philanthropists, advocates and global corporations into the field of development. China's projected 9.6 percent growth rate is sending ripples to the farthest reaches of the planet—creating opportunities but also significant risks. The United States remains in the "goldilocks" zone, but this is premised on continued borrowing from abroad at historically unprecedented rates while many Americans fret about widening inequality and narrowing opportunity. While the United States concentrates on civil war in the Middle East, most leaders in the region are preoccupied with putting an outsized cohort of young people to work and on the road to becoming productive citizens.

What are the most important challenges we face and what are the potential solutions? In Washington, where short-term political wrangling too often crowds out the harder and more important long-term challenges, this inaugural publication of Brookings Global Economy and Development seeks to put the spotlight squarely back on the most consequential issues demanding action. It seeks to size these issues, offering policymakers and leaders a clear view of the critical challenges as viewed by leading experts in the field. From the economic exclusion of youth in the Middle East to a pragmatic approach to energy and environmental security, these "top 10" challenges are intended to mark core issues and shed light on opportunities with a broader and longer-term perspective.

When we gather a year from now, we would expect many of these challenges to remain front and central, but we would hope that this publication would elevate their visibility and help sustain a dialogue on their resolution.

THE 2007 TOP 10 GLOBAL ECONOMIC CHALLENGES

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10. GLOBAL POVERTY: NEW ACTORS, NEW APPROACHES

1 ENERGY AND ENVIRONMENTAL SECURITY

BROOKINGS GLOBAL EXPERTS

- WARWICK McKIBBIN
- PETER WILCOXEN

Energy and environmental security has emerged as the primary issue on the global agenda for 2007. Consensus has recently been forged on the potential for long-term economic, national security and societal damage from insecure energy supplies and environmental catastrophe, as well as the intense need for technological advances that can provide low-polluting and secure energy sources. Yet despite growing global momentum, there is still little agreement on the best set of actions required to reduce global dependency on fossil fuels and greenhouse gas emissions. Confounding the international policy challenge is the disproportionate impact of high oil prices and global warming across nations, insulating some countries from immediate concern while forcing others to press for more rapid change.

THE GLOBAL CONTEXT

These challenges will only grow greater in the year ahead as the rising economies, specifically China and India, expand and consume at remarkable rates. According to the United States Energy Information Administration (EIA), China's oil consumption increased by almost half a million barrels per day in 2006, or 38 percent of total growth in world oil demand. India's electricity consumption is estimated to grow from 519 billion kilowatt-hours in 2003 to 845 billion kilowatt-hours in 2010. Overall, the EIA forecasts that worldwide oil consumption will rise from 80 million barrels per day in 2003 to 98 in 2015 and 118 million in 2030.

Although energy and environmental security are frequently argued about as separate and distinct issues, policymakers in the United States and abroad would be well advised to focus on mitigating climate change as the most effective means to the energy security end. Establishing a credible, practical and effective framework for cooperation on climate change should be the primary means of making an immediate impact by addressing energy and environmental security in a coherent policy.

Furthermore, policy would be greatly strengthened by institutionalizing market-based mechanisms for pricing carbon emissions, which would spur the development of new technologies that will decrease emissions at the same time as they decrease reliance on crude oil. Carbon taxation approaches would have a similar effect by increasing the competitiveness of biofuels, which can be produced widely and enhance the capability of home-grown supply. In this way, an effective climate change policy has the potential to make a more immediate impact on our long-term energy dependence than singular policies that attempt to reduce reliance on supplies from particular countries.

THE CHALLENGE

To address the fundamental issues of uncertainty and paralysis that surround climate policy, we must move beyond the current set of policy recommendations that have been proposed and debated by the international community. Though the Kyoto Protocol process and other policy discussions have been helpful in proposing systems for addressing climate change and in focusing attention on the severity of the problem, such efforts have failed to obtain international cooperation on carbon emission reductions from the largest emitter—the United States—and the fastest-growing emitters—China and India. International environmental treaties must overcome the political reality that leaders will find it exceedingly difficult to swap economic growth, flexibility and sovereignty for ambiguous benefits that are shared by nations unequally and are limited in their domestic impact.

For a climate policy to be effective, therefore, it must satisfy three broad requirements: it must be widely adopted; it must remain in force indefinitely; and it must provide credible incentives for individuals and firms to make the investments necessary to reduce emissions. The third point is particularly important: Creating a solid foundation for large, long-term investments by the private sector will create a national constituency with a strong financial interest in perpetuating the policy and avoiding any backsliding by future governments.

RECOMMENDATIONS FOR ACTION

The way forward lies in a variant of the cap-and-trade market-based proposals that are generally recognized to be the most efficient and least-cost method for reducing emissions of greenhouse gases. The original cap-and-trade approach was successfully applied to reduce sulfur dioxide emissions that are quite different from those of the carbon dioxide emissions in the northeastern United States. Thus there needs to be a longer term approach and great care in reducing carbon emissions where possible at low cost.

One approach that meets these criteria is the blueprint for climate change developed by Warwick McKibbin and Peter Wilcoxen—a hybrid system of long- and short-term emissions permits that would be coordinated across countries but managed and traded within national borders. The blueprint would combine a fixed supply of long-term (“perpetual”) permits with a flexible supply of short-term (“annual”) permits that would be valid only for emissions in a specific year.

> **Perpetual permits for carbon reduction.** A country adopting the hybrid policy would distribute perpetual permits that would account for less than its current emissions by the amount of its commitment to reduce total emissions. The permits could be bought, sold or leased without restriction and each would allow the holder to emit one ton of carbon per year. When initially distributed, the permits could be given away, auctioned or distributed by the government in any way it deems appropriate. After that, the permits could be traded among firms or bought and retired by environmental groups. The permits would be highly valuable because 1) there would be fewer available than needed for current emissions and 2) each permit would allow one ton of emissions for every year in perpetuity. As a consequence, the owners of the perpetual permits would form a private sector interest group, which would be needed for long-term support of the policy as they would have a clear financial interest in keeping the policy in place.

> **Annual permits for efficiency.** The other component of the policy—annual emissions permits—would be sold by the government for a specified fee. There would be no restriction on the number of annual permits sold but each permit would be good only in the year it is issued. In this way, the annual permits would provide the advantages of a carbon tax by instilling clear financial incentives for emissions reductions without committing the government to achieve a particular emissions target regardless of cost.

> **Private sector investments in carbon reduction technologies.** Although the policy would be more complex than an emissions tax or conventional permit system, it would provide a stronger foundation for the large private sector investments in capital and research required to fundamentally address climate change. It would also address the core issue many democratic governments face in adopting climate change policies by establishing a set of stakeholders that have a strong incentive to maintain the policy.

> **National action now.** This type of policy would be simplest to implement on a national basis with permits valid in the country of issue and not internationally tradable. With permits managed by each country according to

its domestic legal system and regulations, there would be no need to establish complex international trading rules or the creation of a powerful new international institution before meaningful action on climate could be taken. International accession to such a protocol would be easy: A country would simply need to agree to establish a hybrid permit system and to charge a specified price for annual permits. There would be no loss of sovereignty to an outside authority, no lengthy political ratification process of the accord and no need to extensively monitor international activities.

> **Carbon sinks.** Although the proposed hybrid scheme does not contain cross-border carbon permit trading, additional carbon reduction could be achieved by creating permits that could be allocated for projects that remove carbon from the atmosphere. These carbon "sinks" or "offsets" would be established by individual country regulations that would qualify, measure and verify emissions offsets, and award short- or long-term permits for the equivalent tonnage reduction.

OTHER BROOKINGS EXPERTS:

- DAVID SANDALOW

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2 CONFLICT AND POVERTY

BROOKINGS GLOBAL EXPERTS

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In a world where boundaries and borders have blurred, and where seemingly distant threats can metastasize into immediate problems, the fight against global poverty has become a fight for global security. American policymakers, who traditionally have viewed security threats as involving bullets and bombs, are increasingly focused on the link between poverty and conflict; for instance, the Pentagon's 2006 Quadrennial Defense Review focuses on fighting the "long war," declaring that the U.S. military has a humanitarian role in "alleviating suffering, … [helping] prevent disorder from spiraling into wider conflict or crisis."

Such assertions have a compelling logic. Extreme poverty literally kills: Hunger, malnutrition, and disease claim the lives of millions each year. Poverty exhausts governing institutions, depletes resources, weakens leaders, and crushes hope—fueling a volatile mix of desperation and instability. Poor, fragile states can explode into violence or implode into collapse, imperiling their citizens, neighbors and the wider world as livelihoods are crushed, investors flee and ungoverned territories become a spawning ground for terrorism, trafficking, environmental devastation and disease. Yet if poverty leads to insecurity, it is also true that the destabilizing effects of conflict make it harder for leaders, institutions and outsiders to promote human development. Civil wars may result in as many as 30 percent more people living in poverty—and as many as one-third of civil wars ultimately reignite.

THE GLOBAL CONTEXT

Contrary to the conventional wisdom that civil conflict stems from ancient ethnic hatreds or political rivalries, compelling evidence now suggests that the most powerful predictors of civil conflict are in fact weak economic growth and volatile low incomes. According to the U.K. Department for International Development, a country with $250 per capita income has a 15 percent likelihood of internal conflict over five years—many times greater than the 1 percent risk for an economy with $5,000 per capita income. In 2002, more than two-thirds of the poorest countries of the world were in conflict.

Tragically, poverty and insecurity are mutually reinforcing, leading to what Brookings scholar Susan Rice evocatively calls a "doom spiral." Conflict increases infant mortality, creates refugees, fuels trafficking in drugs and weapons, and wipes out infrastructure. It also makes it harder for outside players to deliver assistance and less attractive for the global private sector to invest. Thus, once a country has fallen into the vortex, it is difficult for it to climb out—as the world has witnessed with the ongoing catastrophe in Democratic Republic of Congo, a crisis that has claimed nearly 4 million lives and sparked a massive humanitarian emergency, where most people today are killed not by weapons but by easily preventable and treatable diseases. Violent conflict also produces considerable economic spillover for neighboring countries, as refugees flow in, investment pulls out and supply chains and trade routes are disrupted.

Resources and Conflict. A powerful driver of extreme poverty is scarcity—typically of such renewable resources as water, timber and arable land that are fundamental for daily survival. When demand for resources outweighs supply and when the distribution is perceived to be grossly unfair, public frustration can spark civil strife. Resource scarcity challenges will only intensify over time; during the next 20 years, more than 90 percent of the world's projected growth will take place in countries where the majority of the population is dependent on local renewable resources. Already today, more than 40 percent of the planet's population use wood, charcoal, straw or cow dung as their main source of energy, and more than 1.2 billion people lack access to clean drinking water.

Abundance no less than scarcity can fuel conflict and poverty —generally of nonrenewable and more easily "lootable" mineral wealth like oil, gas, gold or diamonds. More than 50 developing countries, home to 3.5 billion people, depend on natural resource revenues as an important source of government income. Too many of these suffer from a resource curse—pathologies of corrupt regimes, led by elites who have few incentives to invest in social development.

Demographics and Poverty. Demographics is another critical driver. Nearly half the people on the planet are under 25 years old. The disproportionately large share of young people in the population—the so-called youth bulge—is in absolute and relative terms the largest cohort ever to transition into adulthood, and it will remain so over the next two decades. Nearly 17 million of the world's youth are refugees or internally displaced persons; 130 million are illiterate; as many as 300,000 fight as child soldiers; and, collectively, young people make up almost 60 percent of the world's poor. There is strong historical evidence linking youth bulges to instability and conflict. But this need not be the case. A youthful population can be a country's blessing instead of its curse, providing a "demographic dividend" of energetic workers to jump-start productivity and growth.

THE CHALLENGE

Tackling the poverty-insecurity nexus demands sustained commitment to building long-term local capacity. Assistance is most effective not in the immediate aftermath of a conflict, when donor interest is typically greatest, but as a preventive measure before conflict erupts and in the middle of the first postconflict decade, when the recipient country's absorptive capacity has improved. Unless policies and programs shift from reactive to proactive and from responsive to preventive, breaking out of the poverty-insecurity trap will remain elusive.

Unfortunately, U.S. foreign assistance does not have a good track record on staying the course in combating poverty and improving governance in fragile states. Proactively addressing weak states is all the more vital with U.S. "hard power" assets, such as the military, stretched thin and ill-equipped to undertake development missions. The challenges of the new century—global poverty, insecurity, and pandemics—require the United States to strengthen its "soft power" capabilities. It is surprisingly badly suited to do so—employing an outdated Cold War structure designed for the 20th century to address the challenges of the 21st. A recent analysis by the Brookings Institution in cooperation with the Center for Strategic and International Studies counted more than 50 separate offices addressing more than 50 separate aid objectives—a laundry list that is not ranked in any consistent hierarchy.

Thus it is not surprising that the bulk of U.S. assistance does not fund the things the government claims to care about. The United States spends barely more than a dollar per person in the world's 50 poorest nation-states. Strategic and diplomatic demands mean that the lion's share of U.S. assistance flows to countries based on their strategic importance, with the net result that U.S. assistance on a per capita basis actually declines as governance improves. The United States wants to encourage good governance, but the Middle East Partnership Initiative—the flagship democracy promotion program in that region—represented only 2 percent of overall U.S. economic assistance to the Middle East in 2005; meanwhile, strategically important Egypt received an assistance package amounting to $24 per capita, poor governance notwithstanding.

RECOMMENDATIONS FOR ACTION

The world faces immense challenges brought on by local insecurities and conflicts that morph, seemingly overnight, into transnational threats and sustained challenges. Only by addressing the root causes of these issues can we hope to foster sustained growth and a more secure future:

> **Overhaul U.S. foreign assistance.** As the world's most generous donor, the United States must refine its foreign assistance focus from 50 objectives to no more than 5, and from more than 50 agencies to one preeminent organization. Long overdue for comprehensive reform, U.S. foreign assistance would have greater impact if it were streamlined to achieve coordination among key actors and coherence among the full set of development tools, a unified framework integrating the national security and developmental agendas, and customization of aid approaches based on the capacities and need of the recipient.

> **Take a comprehensive approach to weak states.** The United States and other bilateral and multilateral donors should place a much higher priority on addressing countries at risk of conflict and state failure. This will require an integrated set of policies that enables leaders of newly democratic countries to deliver concrete results to their people: further debt relief; increased market access; the elimination of agricultural subsidies; improved incentives for private sector development; sustained support for civil society, the free press, women's rights and democratic institution-building; and concerted efforts to prevent and terminate conflict and to rebuild postconflict states.

> **Reduce resource risks.** States and outside actors should proactively seek to attenuate the risks that resource scarcity and abundance pose to human security, through measures to promote economic diversification, capacity building, equitable distribution, enforceable property rights, demographic sustainability and public health. Government, nongovernmental organizations (NGOs) and private actors should be creative in devising tailored, targeted, emergency assistance for states facing sudden economic and environmental catastrophes. For example, foreign assistance could be quickly and routinely deployed to states that suffer a drought or commodity price collapse *before* violence has a chance to break out. In addition, crop insurance programs and other forms of protection could be created for individuals whose livelihoods may be destroyed. Just as critical, especially in cases of natural resource abundance, are efforts to promote transparency—not only on the budget side of the ledger but the expenditure side as well. Publicizing how much money is flowing in for natural resources, and how it is being allocated, makes it harder for governments to skim from the top, and for rebels to benefit from plunder.

> **Focus on youth.** Innovative private sector players and NGOs are working to engage and empower youth in underprivileged areas. The private sector has a critical role to play in providing employment opportunities for young people in poor countries—especially by ensuring that training and skill development are linked to market demands—and by supporting entrepreneurship. NGOs are pursuing grassroots efforts to make youth an integral part of community safety and well-being. Because poor youth, especially those in conflict situations, too often find themselves marginalized from political discussions and processes, leaders and activists working to provide opportunities for youth must think not only in economic terms but political terms as well. Youth should be encouraged and trusted to organize, lead and govern programs as much as possible.

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3 COMPETING IN A NEW ERA OF GLOBALIZATION

BROOKINGS GLOBAL EXPERTS

- LAEL BRAINARD
- ROBERT LITAN
- WING THYE WOO

Is the new episode of globalization just another wave or a seismic shift? Though individual elements feel familiar, the combined contours are unprecedented in scale, speed and scope.

THE GLOBAL CONTEXT

China is the single biggest—and to many the single—issue on the U.S. trade and competitiveness agenda today. When a U.S. lawmaker talks about unfair trade or exchange rates, it is a good bet that China is on their mind. Any discussion on the state of U.S. manufacturing quickly finds its way to China's growing prowess.

Because China is successfully pursuing—at a scale never seen before—a growth strategy that is export led and foreign direct investment fed, its rise is sending tsunami-like waves to the farthest reaches of the global economy, posing tough challenges to some and enticing opportunities to others. China's enormous appetite for energy and raw materials has strengthened commodity prices and put many resource-rich countries back on the map. But in manufacturing, where China is now deeply embedded in global supply chains, the story is more complicated. Higher wage economies competing in the same manufacturing export segments where China has established an edge are faced with the difficult choice of moving up the value chain or lowering costs.

India's concurrent economic emergence has multiplied the challenges and opportunities manifold. Integration of the combined low-wage labor forces of India and China into global labor markets means an expansion of roughly 70 percent—highly concentrated at the lower end of the wage scale. Just about any economic model would predict a squeeze on wage earners until capital and technology investments adjust. Indeed, the data suggests that inequality is once again on the rise in many of the world's richer economies. In the United States, profits are capturing a much larger share of national income, while wages command a lower share than at any time in the last 50 years.

Though India is pursuing a growth strategy more reliant on domestic consumption and investment than China, nonetheless its success in building export strength in higher skilled "knowledge" industries such as software programming has elicited concern among U.S. white-collar workers facing the prospect of low-wage foreign competition for the first time, as well as causing excitement among similarly placed developing countries looking to move up the value chain.

THE CHALLENGE

Although American multinationals and consumers are benefiting from new global opportunities, some American workers now face challenges in both manufacturing, where productivity is outpacing wage growth, and services, where offshoring is on the rise. Concern runs across political and demographic lines, with discussion of the "anxious middle" who seek safe harbor from the forces of globalization. How effectively the United States responds to this new competition will help to determine future living standards for the American middle class. It will also influence America's capacity to reassert leadership in the international arena and to address the needs of the world's poorest people.

To respond successfully will require that political leaders reject both the hollow cheerleading for a benign globalization that spreads benefits evenly, as well as the false comfort that they can shield their constituents from the forces of globalization and technological advance. It will require a proactive and sustained strategy that not only addresses trade rules but also vigorously implements the requisite domestic policies to ensure that a large majority of Americans thrive in the global economy.

RECOMMENDATIONS FOR ACTION

Though there is no single panacea to keep the United States or other nations competitive, a powerful set of policies can be employed to help navigate the new wave of globalization:

> **Invest in the foundations of future prosperity.** Critics of U.S. trade policy are right to protest that successive rounds of trade liberalization have been pursued with much greater vigor than critical domestic programs to equip a larger number of Americans to benefit and protect those who pay the greatest price. The key is to strengthen our comparative advantage in high-value-added, innovation-intensive industries and empower our citizenry through appropriate training and incentives to take on new high-skill jobs. This will require expanding the quality and accessibility of education and training, strengthening science and technology, and investing in infrastructure.

> **Provide social insurance to support mobility.** With globalization and innovation accelerating the pace at which workers' job specific skills lose value, it is critical to update a social insurance system that has not fundamentally changed since the introduction of Trade Adjustment Assistance in the 1960s. Such a program should aim to ease the economic dislocations and potential loss of health insurance and other benefits associated with permanent displacement in both the manufacturing and service sectors while helping affected workers to find new employment opportunities quickly.

> **Negotiate and enforce favorable rules.** U.S. interests in favorably shaping the rules governing international trade—and in vigorously pursuing enforcement of those rules—are greater than ever before. With other countries vigorously pursuing bilateral and regional trade agreements that may raise barriers against U.S. competitors, this is no time to sit on the sidelines. Though foreign policy has dominated U.S. trade policy for the past several years, it is time to once again focus on advancing and enforcing those rules that have the greatest consequences for American competitiveness—for instance, intellectual property theft in China and China's comprehensive subsidization of its exports.

> **Do no harm.** While economists can argue whether the nation as a whole benefits from the current episode of globalization, most would predict that some workers pay the costs disproportionately. Indeed, current data suggests that gains are increasingly concentrated at the upper end of the income spectrum with earnings at the middle falling behind. Politicians can hardly expect support for a policy of continued openness if they insist on pursuing tax cut policies that exacerbate these distributive trends and providing health and other benefits through the tax system in a manner that favors the already advantaged.

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4 GLOBAL IMBALANCES

BROOKINGS GLOBAL EXPERTS

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Today's interconnected world is in uncharted territory. The world's sole hegemonic power, the United States, nurses an addiction to foreign capital, while up-and-coming powers such as China and oil exporters sustain surpluses of increasing magnitudes. Some worry that the world is at a tipping point, where only a dramatic shift in economic policy can alter the looming trajectory. Others see underlying structural factors perpetuating gross imbalances for a sustained period.

Which view is correct matters greatly. Global current account imbalances are true to their name: Though a small number of leading actors such as the United States, Europe, Japan and China have an outsized influence on the size and composition of imbalances, disorderly adjustment would pose risks to all players in the global economy.

THE GLOBAL CONTEXT

Current account imbalances reflect the amount a country borrows from or lends to foreigners each year, equivalent to the gap between what a country invests and what it saves domestically. Although current imbalances are the culmination of investment and saving decisions of a myriad of players around the globe, it is striking that the United States alone absorbed 75 percent of the combined current account surpluses of Germany, Japan, China and other surplus countries in 2004.

It is no coincidence that in the last several years, U.S. consumption and investment have remained strong and borrowing has remained relatively cheap despite a sharp deterioration in the fiscal balance and high energy prices. Indeed, it is precisely the availability of large and growing lending from foreigners that has enabled Americans to have their cake and eat it too. The United States is now running the largest trade and current account deficits in its history—almost twice as great as the highs in the mid-1980s. In 2006, the nation borrowed $890 billion from foreigners—borrowing at a rate of nearly 7 percent of national income. Not surprisingly, foreigners now hold roughly half of all Treasury securities.

It is true America has borrowed heavily in earlier periods—notably in the 1980s. But at that time, the United States was a net creditor internationally. Today, the United States is a large net debtor, and the national savings picture is projected to deteriorate further with the retirement of the baby boom generation. Between 2000 and 2005, foreign debt went from 14 to 25 percent of U.S. GDP—right in line with the indebtedness of Brazil and Argentina on the eve of their financial crises in 2001 (with debt-to-GDP ratios of 18 and 33 percent, respectively).

Although other rich countries have reached high levels of borrowing relative to income, these have been relatively small economies. There appears to be no historical precedent for the largest economy borrowing at these magnitudes on a sustained basis.

THE CHALLENGE

Some financial markets experts are sanguine, believing current large global imbalances reflect underlying structural factors that will persist for some time. China's poor social insurance is reflected in savings rates in excess of 40 percent, which in turn contribute to (although do not fully explain) foreign exchange reserves on the order of $1 trillion. Oil exporters—awash with liquidity—have flooded into the global capital markets. During the same three-year period when U.S. oil imports rose from $104 billion to $252 billion, Saudi Arabia's external surplus rose from 6 percent of GDP to 30 percent.

But others warn of the all-too-familiar risks of growing global imbalances. In a hard landing scenario, there could be a sudden rush to the exits, where investors dump dollar assets, the Federal Reserve would be forced to sharply raise interest rates, housing and equity markets would be adversely affected, and growth could be curtailed.

Even with smooth adjustment, the later corrective action is taken, the more costly it becomes. The cost of servicing foreign obligations will absorb a growing share of U.S. export earnings, so that it will require an even greater turnaround in the trade balance and compression in domestic growth to stabilize the debt-to-GDP ratio.

These debt dynamics make a compelling case for taking corrective action sooner rather than later. Instead, the approach so far has been to leave it to the market to work though the global imbalances. But this approach begs the difficult question of global burden-sharing in the adjustment process. So far, those countries with market rates—Europe, Canada, Australia and Latin America—have taken a disproportionate share of the burden, while China and Japan have essentially taken a free ride. Moreover, it misses the opportunity to diminish the cost by encouraging markets and currencies to adjust sooner rather than later.

RECOMMENDATIONS FOR ACTION

Given the potential collateral damage if global imbalances continue to spiral out of control, it is essential to consider a range of policies that could gradually reduce global imbalances now rather than later. Most economists agree that a mid range strengthening of the Chinese yuan would unlock a broader move toward currency adjustment by China's neighbors, take some of the pricing pressure off U.S. manufacturers and improve the macroeconomic climate in China. However, although it is a critical component of a broader package, a mid range revaluation of the yuan would not by itself ameliorate the overall U.S. current account balance. Though China may run surpluses similar in size relative to GDP as Germany and Japan, China commands a much smaller share of global surpluses in absolute terms.

The best path to facilitate an orderly decline in global imbalances while supporting continued growth is through a combination of mutually reinforcing actions—continued improvement in the U.S. fiscal balance along with encouragement for increased private saving, a significant strengthening of the Chinese yuan accompanied by further appreciation of other Asian currencies, and measures to strengthen growth in Europe and Japan. Both the IMF and an expanded Group of Seven (G7) could be used to advance these goals far more effectively than they have to date.

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5 RISE OF NEW POWERS

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- BARRY BOSWORTH
- DAVID DE FERRANTI
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The rise of "emerging powers"—a group that usually includes the so-called BRICs (Brazil, Russia, India, and China) but which sometimes is applied more broadly to include South Africa, Mexico and other nations—is reshaping the global economy and, more gradually, international politics. Growing much faster than the rest of the world, these economies are changing the structure of international production and trade, the nature and direction of capital flows, and the patterns of natural resource consumption. At the same time, the growth of these countries is beginning to shift the global distribution of power, forcing the great powers to come to terms with the reality that they will need to share management of international rules and systems in the coming decades.

THE GLOBAL CONTEXT

Of the emerging powers, the BRICs have the most potential to affect the global economy. This group is set apart from many other developing countries in having very large populations (ranging from 140 million to 1.3 billion), significant land mass, and economies that are both diversified and anchored in potentially large internal markets. Each of the BRICs has or will soon have market power in particular sectors—from soybeans and dollar-denominated securities to ethanol and natural gas, enjoying sufficient scale to move prices of these goods single-handedly. The BRICs are also the political and economic centers of gravity in their respective regions, and all four countries have strongly held aspirations to play a global role.

With India and China as manufacturing and service-producing powerhouses, respectively, and with Russia and Brazil as their main suppliers of food, energy and raw materials, the BRICS are projected to reach the ranks of the top 10 economies by 2040 and to surpass the economies of the Group of Six, in dollar terms, within 40 years. Even if these projections turn out to be overly optimistic, the sheer weight of demographics and the emerging division of global labor suggest that, barring some major reversal, at least some of the BRICs will rank among the leading players in the international economy.

THE CHALLENGE

The BRICs themselves face complex challenges in managing their own growth and political evolution while maintaining stability, finding their place in the global marketplace among other larger emerging economies and navigating both regional and global political complexities:

> **Maintaining political and social stability.** Policymakers in the BRICs face the challenge of balancing rapid economic development and political modernization while preserving social stability. The specific challenges for each country are different, but all will have to cope with growing inequality and internal migration, facilitate continued high rates of employment growth, promote the development of internal demand and manage rapid demographic change.

> **Environmental sustainability.** The environmental costs of rapid growth are clearly evident in the destruction of Brazilian forests and the rapidly deteriorating air quality in Chinese cities. If their growth is to be sustainable, the BRICs will have to change their energy mix away from coal and toward cleaner fuels, manage natural resources more efficiently, secure stable supplies of fuels and raw materials, and improve environmental regulation and enforcement. Eventually, the BRICs—and particularly India and China—must become fully engaged in global efforts to tackle climate change.

> **Building institutions to deal with shocks.** All four BRICs need to develop stronger institutions to cope with ecological and economic shocks. Given the size and population of these countries, shocks can quickly take on unmanageable proportions, so effective crisis control and containment institutions must be in place. The BRICs must institute more effective regulation and supervision of financial systems, better social safety nets to insure those dislocated by breathtaking economic change, and stronger public health systems to monitor, contain and control pandemics.

RECOMMENDATIONS FOR ACTION

The economic and political rise of the BRICs also present complex challenges to the G7 economies that have been dominant for the past several decades. How effectively they respond to the rise of these new powers will have major implications for global and regional stability and institutions. Several recommendations could help shape this evolution favorably:

> **Look at the BRICs through new lenses.** Knowledge of the internal politics and economic and social trends inside the BRICs remains remarkably thin in most G7 capitals. In U.S. policy circles, knowledge of India and Brazil is especially weak. G7 decision makers need to enhance not only their understanding of individual countries but also of the evolving relations among the BRICs themselves and their neighbors. The G7 should engage the BRICs not only at the government-to-government level but also promote business and civil society links. These links can help build more resilient bilateral ties and strengthen democratic and internationalist voices within the BRICs. This will be especially valuable in China and Russia.

> **Promote the balanced and sustainable growth of the BRICs.** Today's leading industrialized nations have a large stake in the continued stability and growth of the BRICs. Given their growing weight in international markets, economic collapse in one or more of the BRICs would have serious repercussions for Europe, Japan and the United States and threaten regional stability. In addition, the G7 has a compelling interest in encouraging the BRICs to choose development strategies that minimize environmental degradation and resource depletion and respect human rights and good working conditions.

> **Give the BRICs a real stake in existing institutions.** The current rhetoric about pressing China and other BRICs into behaving like "responsible stakeholders" will not achieve the desired end unless these countries have a voice and decision-making power in international organizations commensurate with their weight in the global economy. Until the BRICs are included as "responsible stewards" of organizations such as the IMF, the World Bank, the International Energy Agency, and the G7, the BRICs' preferred strategy will be to pursue thicker regional and bilateral links rather than to engage fully in—and share the costs of—global governance institutions.

> **Encourage sustainable growth.** The G7 should encourage the BRICs to adopt growth strategies that minimize negative spillovers. The G7 should aggressively pursue the BRICs' participation in multilateral initiatives to reduce carbon gas emissions and help them adopt cleaner and more efficient technology, energy and infrastructure. At the same time, the G7 should provide incentives for and increase pressure on the BRICs to follow international human rights norms and social responsibility standards when conducting business in other developing countries.

> **Undertake policies that promote competitiveness while providing insurance.** The emergence of the

BRICS is sending ripples to the farthest reaches of the world economy—posing challenges to some and opportunities to others. Political leaders in higher wage economies will need to proactively develop policies that facilitate mobility into new growth sectors while providing social insurance to those displaced by the new wave of globalization.

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6

ECONOMIC EXCLUSION IN THE MIDDLE EAST

BROOKINGS GLOBAL EXPERTS

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- CAROLINE MOSER
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The Middle East has before it what could be one of the greatest demographic gifts in modern history: a potential economic windfall arising from a young and economically active workforce. Today, young people age 15 to 24 years account for 22 percent of the region's total population, the highest regional average worldwide. With the right mix of policies, this demographic opportunity could be tapped to spur economic growth and promote stability.

Yet millions of young people are currently growing up in the Middle East without significant economic prospects. This prolongs their transition to adulthood due to delayed movements between education and employment and household formation through marriage and family. In many Middle Eastern countries, unemployment is at its heart a youth problem. In Syria, for example, youth account for 80 percent of the unemployed. How the Middle East tackles this challenge will offer valuable lessons far beyond its borders.

THE GLOBAL CONTEXT

Current youth unemployment levels in the Middle East are reaching approximately 32 percent. First-time job seekers, mostly between 15 and 24 years of age, make up more than 50 percent of the unemployed. For women, the unemployment rate is nearly 50 percent greater than for men. Finally, youth in the Middle East are 3.5 times more likely to be jobless compared with adults. Youth exclusion leads to both income and non-income dimensions of deprivation, with implications on the individual and society.

Though many Middle Eastern youth enjoy superior levels of education and health compared with their peers in South Asia or Africa, the majority of them are unable to effectively participate in economic, social and political life. This situation has prevented many youth in the Middle East from becoming full-fledged members of society, leading to a situation that can depress wages and limit economic integration during the adolescent years.

THE CHALLENGE

Similar to world averages, the Middle East's informal sector is estimated at 25 percent of regional GNP. This sector plays a major and increasing role in providing first-time jobs in Middle Eastern economies to low-skilled workers. However, the informal sector offers little satisfaction to educated youth and is often spurned. Youth who opt for informal sector employment enjoy a source of income yet encounter low wages, poor working conditions and job insecurity. This impedes their transition to adulthood; an informal sector wage may mean living with parents and not being able to afford housing and marriage, especially if there is restricted mobility from the informal to the formal sector.

In the face of high unemployment and economic uncertainty, Middle Eastern youth are delaying marriage and the creation of their own families. A generation ago, 63% of Middle Eastern men in their mid to late twenties were married. This trend is reversing, as the Middle East now experiences the lowest rate of marriage among developing regions, with just above 50 percent of men between the ages of 25 to 29 years married. In a culture that sees marriage as the social pinnacle of life, this delay compounds the gravity of exclusion.

This second-generation development challenge—where high levels of poverty are replaced by widespread exclusion from economic, social and political life—confronts almost every country in the region. Therefore, youth inclusion in economic development programs in the Middle East must become a priority.

RECOMMENDATIONS FOR ACTION

To overcome these challenges, it is estimated that more than 100 million jobs must be created during the next two decades in order to employ this young and large population. However, job creation is no easy task. To foster this type of job growth, the Middle East must undertake serious economic reforms that aim to increase the economic inclusion of the young.

The opportunities afforded to prime workers in their earlier years, in terms of skill acquisition and on-the job training, will be critical in determining the quality of their human capital. The youth who today lack access to opportunities to develop their human capital, due to long-unemployment spells or being confined to the informal sector, will need "second chances" to become productive workers in their prime and to fulfill the promise of the "demographic gift."

Rapid progress is needed to reform education, improve gender equality and establish good governance. Though these changes may add to short-term turbulence, they are necessary to increase the prospects for future prosperity and stability. In addition, the divisions between the restricted high-wage public sector and the low-wage informal sector need to be bridged to provide increased employment opportunities for Middle Eastern youth.

Labor market and regional development reforms may be necessary first steps in fostering long-term stability programs. Infrastructure to support the large young population must be improved and created so that youth have the education and social services that they need to be empowered, positive and participatory members of society. Finally, all aspects of society including the family unit, the external community, local institutions and global markets, must be engaged to sustain youth inclusion.

The Brookings Wolfensohn Center for Development recently launched the Middle East Youth Project **(www.brookings.edu/global/wolfensohncenter/me_youth.htm)** focusing on youth exclusion in Egypt, Iran, Syria and Morocco. The initiative spotlights two main youth transitions to adulthood: the transition from education to employment, and the transition to household formation through marriage and family. Through an alliance of academics, policymakers, the private sector and civil society, the Middle East Youth Project will help craft more effective policies to create opportunities for young people in the region.

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7 GLOBAL CORPORATIONS, GLOBAL IMPACT

BROOKINGS GLOBAL EXPERTS

- DAVID CAPRARA
- JANE NELSON

The private sector is becoming a significant player—indeed, some might say the dominant player—in shaping the global economic and development agenda. Multinational corporations with operations spanning the globe, and in some cases capacities and networks that match those of governments, have a particularly important role to play in helping to spread the opportunities of globalization and in mitigating some of its risks.

THE GLOBAL CONTEXT

Multinational corporations are driving the emergence of new markets, industries, technologies and business models as well as unprecedented cross-border financial flows and expanded global value chains. Some are also supporting innovative market-driven approaches and public-private partnerships with the potential to address challenges that have traditionally been the purview of the public sector—most notably in the areas of poverty reduction, economic exclusion, environmental sustainability, humanitarian relief, health and human rights. At the same time, multinational corporations and their leaders are facing heightened public expectations and censure in terms of their negative impact in these areas, corporate governance scandals, and accountability for non financial performance—all in the face of unremitting competitive pressures and investor demands.

Though new market-driven approaches and public-private partnerships offer potential to mobilize untapped private sector resources, networks and problem-solving skills, they also create new risks as well as governance and accountability challenges for both business and government leaders. This is especially the case when corporations are operating under conditions of bad governance, conflict, weak public administration, inadequate infrastructure or other governance gaps and market failures. The challenges of corporate responsibility and good public governance are nearly always intertwined, but they are particularly interconnected under such circumstances.

THE CHALLENGE

New business models, market mechanisms, and governance frameworks are needed to more effectively harness the opportunities and address the risks of growing corporate investment in developing countries and engagement in global issues. New approaches, led by business or where companies partner with others, can play a crucial role in three areas:

- To mobilize, reward and scale up the positive contributions that corporations can make, especially through innovations in their core business operations and investments, and through mobilizing corporate competencies, such as the skills of employees as part of volunteering initiatives and community investment.
- To identify, mitigate and monitor any negative impact and externalities arising from corporate activities, through initiatives such as industry-wide standards and guidelines, integrity pacts and multistakeholder monitoring and dispute resolution mechanisms.
- To enable the private sector to play a legitimate role in improving the broader enabling environment at a national or regional level, in particular through efforts to strengthen public governance and public institutions, not only in the economic sphere but also in areas such as anticorruption and strengthening public health systems.

Designing and implementing these new approaches to engage corporations in an effective and accountable manner is a challenge for business and government leaders alike, as well as leaders of labor and civil society.

This is a leadership challenge that goes far beyond corporate compliance and philanthropy, although both have an important role. It requires the engagement of companies and their leaders at the most strategic level to harness their core competencies and resources along the corporate value chain, and to mobilize business leadership at both the operational and policy levels. It requires regular communication and consultation with key corporate stakeholders, ranging from employees, consumers, investors and business partners to regulators, NGOs, foundations and local community leaders. It requires individual corporations to identify and manage the key development contributions and risks arising from their own operations, while at the same time working with their industry peers and leaders in other sectors to tackle more intractable development challenges that require concerted collective action.

RECOMMENDATIONS FOR ACTION

Encouraging examples in these areas already exist and many more are emerging. There are more and more new individual business models and products, industry-wide efforts, and global multisector alliances and financing mechanisms—to create greater economic opportunity, deliver services to low-income communities, respond to complex emergencies, uphold human rights, tackle global health challenges, manage the risk of pandemics, address climate change and water scarcity, support education reform and overcome corruption.

These examples are in the early days, and much needs to be learned about these innovations in terms of their drivers, their scalability and their impact, both on the companies themselves and on the development challenges they aim to address. Yet they offer potential for helping to transform the development landscape, especially if they can achieve greater scale and incorporate more of the world's leading corporations. Three recommendations for moving in this direction are as follows:

- **Increase collective efforts.** Though it is essential that major corporations get their individual operations in order and focus on what they are best equipped to deliver, there is potential to scale up impact and address more systemic challenges through collective initiatives with other companies, governments and development partners. These initiatives can be focused on a particular country or region, a specific development challenge or policy, or a particular industry sector. Examples include: South Africa's National Business Initiative; Philippines Business for Social Progress; Business Action for Africa; the Global Business Coalition Against HIV/AIDs, TB and Malaria; the Global Alliance for Improved Nutrition; the Extractive Industries Transparency Initiative; the Marine and Forest Stewardship Councils; the Equator Principles; and the Brookings Initiative on International Volunteering and Service.
- **Analyze initiatives that have achieved scale.** A number of individual corporations and collective initiatives can claim to have achieved scale in tackling a specific development challenge or set of challenges at either a national or global level, in some cases reaching millions of people. These require greater analysis in terms of what has worked and what has not, and whether they can either be replicated elsewhere or scaled-up further.
- **Actively engage emerging market multinationals.** There is an urgent need to better understand and partner with the emerging multinational corporations and state-owned enterprises from India, China, elsewhere in Asia, Brazil, Mexico, the Middle East and Africa, especially those that are investing heavily in other developing countries. The growing reach, impact and influence of multinational corporations, both individually and collectively, are unlikely to diminish. The leadership challenge is to develop new business models, market mechanisms and governance frameworks that serve the public interest while making sound business sense and that mobilize corporations with-

out replacing or undermining the role of governments or destroying the ability of the private sector to create long-term value.

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8 GLOBAL HEALTH CRISES

BROOKINGS GLOBAL EXPERTS

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From responding to the threat of pandemic flu to efforts to controlling the spread of HIV/AIDS, the world has begun to realize that global health issues are relevant for any citizen, regardless of nationality, residence or status. Despite improvements in the world's collective ability to battle disease with advances in medicine and technology, global health needs remain unmet, making the entire world vulnerable to health crises. In particular, poor countries continue to suffer disproportionately from inadequate public health systems and resources, exacerbating their struggle out of poverty.

THE GLOBAL CONTEXT

An estimated 2 billion people worldwide lack access to basic health services. The result is a staggering level of preventable disease. For example, malaria infects more than 500 million people a year and kills more than a million, equating to approximately one death from malaria every 30 seconds. The disease wreaks the most havoc in Africa, where it is a leading killer of children and costs the continent approximately $12 billion a year in lost productivity.

Further, the citizens of poor countries must pay the most out-of-pocket for their health care, because poor governments lack the finance to provide for a functioning, accessible health system. According to Julio Frenk, minister of health for Mexico, an estimated 150 million people and 25 million households are impoverished globally because they are required to make out-of-pocket payments for health care. Of the $3.2 trillion spent on health care worldwide in 2002, only 12 percent was spent in low- and middle-income countries, which house 90 percent of the world's burden of disease.

The financing needs to address global health challenges are daunting; estimates range from an additional $30 to 70 billion a year, or three to eight times the amount of aid for health currently provided by donor countries. Aid for health increased by over 50 percent from 2002 and 2005, reflecting major increases by donor countries, including the United States, and the creation of new financing partnerships like the Global Fund to Fight AIDS, Tuberculosis and Malaria and the Global Alliance for Vaccines and Immunization (GAVI). Even with these notable increases, the level of funding for global health remains significantly below estimated needs. Faced with these tremendous financing challenges, policymakers are turning to innovative solutions to provide more—and more effective—aid for health.

RECOMMENDATIONS FOR ACTION

Innovative solutions for global health financing encompass a variety of mechanisms, tools and methods of providing aid. Recent examples include making an Advance Market Commitment for the future provision of a vaccine against Streptococcus pneumoniae—a proposal developed by Brookings and Harvard scholar Michael Kremer—and an airline tax to raise funds for antiretroviral drugs. Yet while numerous innovative financing proposals have been put forth, little evidence exists for which proposals will be most successful in yielding a sustained health impact.

A focus on health outcomes—with the aim of getting more health for each aid dollar—requires a close look at current problems with health aid and financing: the level of flows, the pattern of flows, the match between flows and country needs and priorities. This is the aim of the Brookings Global Health Financing Initiative **(www.brookings.edu/global/health.htm)**. Innovative financing proposals have a tendency to require new governance structures or tricky financial engineering. GAVI created a new charity to facilitate the flow of front-loaded funding for immunization from the newly launched International Finance Facility for Immunization, while a whole new global health partnership, UNITAID, was created to receive contributions from the airline tax. This additional complexity on the part of the donor community is unnecessary unless it is singularly designed to yield more or better financing for recipient country use.

More and better financing is not an unknown or elusive goal. Regardless of the governance or financing arrangements required, financing that is predictable, long term, untied, coordinated, and in line with recipient needs and priorities allows countries to better invest in the health of their citizens. The innovative tools that are built to provide finance with these characteristics will undoubtedly prove to be worth the investment.

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9 GLOBAL GOVERNANCE STALEMATE

BROOKINGS GLOBAL EXPERTS

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- RALPH BRYANT
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Today's global challenges—nuclear proliferation, the deadlock of global trade negotiations, the threat of pandemic flu, and the fight against global poverty—cannot be solved by yesterday's international institutions. To resolve the world's most pressing problems, which touch all corners of the globe, we must adapt our global governance approaches to be more representative and thus more effective by encouraging and enabling the key affected countries to take an active role in generating solutions.

THE GLOBAL CONTEXT

Global governance is a vast arena, with numerous institutions, structures, processes and players all with their own agendas and missions. Countless reform proposals are on the table for the United Nations, the international financial institutions (such as the World Bank and the International Monetary Fund) and the many summit forums (especially the Group of Eight, or G8). But experience shows that meaningful reform cannot be accomplished by taking action solely within an international organization, because mandates overlap and intersect, there are many entrenched interests and conflicting political forces, and legal and institutional complexities prevent decisive action. So what is the best way to proceed with meaningful reform and break through the current stalemate?

Perhaps the most pragmatic and appropriate path of action is to expand the G8 to make room for and eventually give way to an expanded summit of key leaders as the new forum of global negotiation and decision-making. By bringing other major economies "into the tent," they would be encouraged to contribute constructively to the solution of global issues and share the burdens of challenges that the old industrial countries cannot expect to solve on their own.

The G8 is the best body to focus on to break the global governance stalemate because it offers a summit-level forum for addressing overarching global issues. The G8 could be quickly and effectively transformed by inviting more countries to the table without having to push forward changes to legal foundations, operational mandates and bureaucratic processes bound by treaties and requiring legislative action by member countries, as is the case with governance reforms in the United Nations or the international financial institutions.

RECOMMENDATIONS FOR ACTION

Some global leaders, including British prime minister Tony Blair at the St. Petersburg Summit in 2006, have suggested that the G8 could be amplified to become the G13 by making the major emerging market economies—Brazil, China, India, Mexico and South Africa—permanent members.

Though a G13 would be a start, this proposal leaves out the critical region of the Middle East and would give no voice to Muslim countries, a critical omission given the need for collaboration and coordination on energy security, terrorism and trade. A simple and alternative pragmatic solution was put forward by former Canadian prime minister Paul Martin: to expand the G8 beyond the G13 to a G20. A working structure for the G20 already exists in the example of the successful and effective forum of the G20 finance ministers, which includes representation from Argentina, Australia, Indonesia, Korea, Saudi Arabia and Turkey as well as the BRIC/SAM and the G7.

In addition to being geographically and culturally much more diverse than the G8, the G20 would be more broadly representative, including two-thirds of the global population and approximately 90 percent of the global economy (compared with the current G8 representation of only one-fifth of the world's population and two-thirds of the global economy). As a result, a summit of leaders of the G20 would be a more legitimate forum for global negotiation and decision-making, as well as one that could effectively address the key global issues, because all the major actors would be engaged.

As in the case of reform the UN Security Council, restructuring the G8 will not come easily. Political rivalries and bureaucratic inertia are powerful obstacles. And there are fears that an expanded summit group would no longer be a "club of democracies" and would be too large to enable an effective dialogue. But the purpose of the enlarged summit forum is to resolve urgent global challenges, not solely or even primarily to serve as a club of democracies. Moreover, while it is correct that agreement may be easier to reach in a smaller group, implementation will often fail if key actors are not included in the deliberation and decision-making process.

In the end, the real issue today is not whether a G13 is better than a G20 or vice versa, but whether the leaders of the G8 recognize that their current forum increasingly lacks legitimacy and is headed toward irrelevance, if they are unwilling to expand its membership. An expanded summit would not only in itself represent a more effective forum to address key global challenges; it could also become the instrument to break the stalemate of reform in other international institutions. In this regard, the G20 of finance ministers has been critical for reaching agreement to move ahead with IMF reform. An inclusive summit-level group of decision makers will also be needed to break the stalemate on reforming other key institutions (such as the UN).

Perhaps Germany, which will host the 2008 G8 summit in Heiligendamm, could start the ball rolling by extending an invitation to the leaders of the emerging powers to join the G8, not as second-class guests but as full members of the club. This action would serve U.S., European and Japanese global interests by increasing the inclusiveness and effectiveness of the global steering process as emerging economies join the discussion and are encouraged to contribute constructively to the solution of global challenges.

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10 GLOBAL POVERTY: NEW ACTORS, NEW APPROACHES

BROOKINGS GLOBAL EXPERTS

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The challenge of global poverty is more urgent than ever. More than half the world's population—nearly 3 billion people—lives on less than $2 per day. Nearly 30,000 children die each day—about 11 million per year—because they're too poor to survive. With such a toll, addressing poverty in new and more effective ways must be a priority for the global policy agenda. Fortunately, a variety of new actors are bringing new perspectives, new approaches and new energy to the challenge.

THE GLOBAL CONTEXT

For much of the late 20th century, combating global poverty was primarily the responsibility of bilateral official donors and multilateral development banks (MDBs) as well as the recipient governments themselves. Now there is growing awareness of the shortcomings of official agencies to confront the multifaceted challenges of poverty in the 21st century. Bilateral donors and MDBs principally deal with the governments of poor countries—which themselves can be a principal obstacle to poverty alleviation when corruption or ineptitude prevail. And because they are beholden to their respective constituencies, bilateral donors and the MDBs are politically hamstrung in their ability to exercise the discretion and selectivity that might produce more success stories. Moreover, private flows to developing countries—ranging from philanthropy to corporate partnerships to volunteer service—are now estimated at more than twice the level of public flows.

THE CHALLENGE

The world has recently witnessed a flourishing of new actors taking new approaches to combat global poverty and increasing competition among aid providers. Primarily drawn from the private sector, these visionary individuals are bringing the same spirit of leadership, innovation and initiative that is required for success in the global marketplace to development enterprises. With large financial and organizational resources behind them, these corporate leaders and enterprising individuals are infusing poverty alleviation ventures with creativity, greater flexibility and a general willingness to take large risks.

George Soros was at the vanguard of the foundation movement with his Open Society Institute and network of philanthropic organizations. And since its establishment in 2000, the Bill and Melinda Gates Foundation has committed more than $11 billion in grants to improve global public health, to global development and to increase worldwide access to technology in public libraries—often in partnership with other foundations, the private sector and official donors. And in a growing trend of homegrown philanthropists, Mo Ibrahim, after leading an extraordinarily successful telecommunications enterprise in Africa, is turning his attention and his resources to strengthening African public leadership—providing encouragement for African leaders to improve the welfare of their people while they are in office and to support democratic transitions when their terms are up. The Mo Ibrahim Prize for Achievement in African Leadership will recognize former African heads of state who have demonstrated exemplary governance with a $5 million prize over 10 years and $200,000 annually for life thereafter.

Many new philanthropists—having themselves created enormous value in the private sector—seek to harness business models as a force for alleviating poverty in the developing world. Known as "philanthropreneurs," individuals like eBay founder Pierre Omidyar and America Online cofounder Stephen Case are attempting to make a positive impact in development through for-profit ventures. Undeniably, the vast and multifaceted engine of private sector investing has an important role to play in the development process.

Private sector involvement in economic development is increasing the number of innovative financing vehicles available to entrepreneurs. From mobilizing capital for microfinance and small- and medium-sized enterprises (SMEs) to financing asset accumulation to stimulating entrepreneurship and the transfer of remittances across borders, individuals in the private sector are provoking many to rethink how we approach poverty alleviation.

Microcredit is now a burgeoning business and crowded field with many new actors and initiatives. Reliant upon microfinance loans ranging from as little as $50 to as much as $10,000, microenterprises have enabled millions of poor people worldwide to launch and expand small restaurants, crafts shops and market stands. The fact that microfinance pioneer Muhammad Yunus and his Grameen Bank received the 2006 Nobel Peace Prize will have significant implications for the field by drawing attention to the success of microfinance while more broadly validating the use of financial mechanisms to ease the suffering of poor people.

Firms that grow beyond this micro scale and cross into the realm of SMEs enter a danger zone where the relatively larger infusion of capital they need to thrive is either extremely difficult to obtain or comes at such a high cost that they are at risk of being crushed by daunting repayment obligations. This shortcoming presents a wealth of financing opportunities, because SMEs offer a promising channel for domestic employment, innovation and growth. Investment capital must be directed toward this sector with a tacit acceptance that investors will see lower returns due to high transaction costs. Whether these funds are channeled through long-term loans or equity is still a matter of experimentation.

Financing in support of asset accumulation is also in the vanguard of private sector engagements with development. On a theoretical level, asset accumulation creates a social safety net for those experiencing asset-based shocks by ensuring that they remain above the poverty threshold. By creating opportunities for poor people to accumulate and consolidate their assets in a sustainable way, new actors will stimulate upward mobility within the developing landscape.

RECOMMENDATIONS FOR ACTION

The challenge ahead for those engaged in poverty alleviation and development is how to maximize the returns these disparate players bring to the overarching goal of reducing global poverty. Harnessing the power of these new players and approaches outside the traditional official development assistance framework is still in many instances a matter of experimentation with little analysis of outcomes or best practice, varying degrees of accountability and too little attention to systematic scaling up. New contributors within the development landscape have provided the opportunity to rethink how we approach such endeavors. The task before us is to bring these new players together with the traditional players to pioneer promising new approaches, rigorously and openly evaluate their impact and collaborate to take successful ventures to scale.

WANT TO READ MORE?

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