Global Economy and Development at BROOKINGS

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THE G-20 CANNES SUMMIT 2011: IS THE GLOBAL RECOVERY NOW IN DANGER?

OCTOBER 2011

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FORWARD

Kemal Derviş

The November 2011 Group of Twenty (G-20) meeting in Cannes has unfortunately acquired a sense of drama similar to that of the first two G-20 meetings: the Washington November 2008 meeting and the London April 2009 meeting. At that time, the world economy and the global financial sector were facing a real emergency. For the next meetings, the sense of urgency had diminished, as the massive Keynesian support policies prevented a global depression and allowed the beginnings of a recovery. It is that recovery that now is in danger by the mounting sovereign debt worries in the advanced economies, the persistent high unemployment, and the threatening dimensions assumed by the debt crisis in Europe. As has become tradition, the Brookings Global Economy and Development Program has asked some of our scholars to provide their thoughts on the challenges faced by world leaders as they gather in Cannes on November 3–4.

As usual, the essays are brief and tackle different aspects of the overall challenge facing the G-20. I hope they will provide useful input into the debate that will take place and on what the summit can achieve.

Skidding Off the Road to Recovery: New Risks for the Advanced and Emerging Markets of the G-20

Eswar Prasad discusses the continued poor economic recovery of industrial nations and how their economic problems are creating tensions in emerging markets as they try to maintain high rates of growth.

The Euro Area Crisis: A Crucial Opportunity for European Leaders at the G-20

Domenico Lombardi proposes increasing the European Financial Stability Facility as a safety net against further sovereign debt defaults and argues that unless European nations come to Cannes with serious policy changes to implement, the eurozone's financial institutions will continue to weaken.

The G-20 and the Global Food Crisis

Homi Kharas argues that the G-20's proposal to tackle food volatility does not go far enough to address the three major food policy issues—an unstable food market, domestic impediments to foreign food trade, and a lack of social safety nets in developing countries.

The Economic Imperatives of the Arab Spring

Raj Desai identifies four economic challenges in post-Arab Spring countries and what the G-20 can do to help. His policy recommendations include better state building, reducing the social and economic burden on Arab youth, broadening the economic base in Arab economies, and ending the region's economic isolation.

Averting the Threat of a New Global Crisis

Johannes Linn and Colin Bradford explain the unique opportunity that emerging markets have at this G-20 meeting to become major players in global governance.

Strategic Approaches for the G-20 to Support Africa's Infrastructure Deficit

As a major agenda item of this G-20 gathering, Mwangi Kimenyi and Vera Songwe discuss how infrastructure in Africa could be dramatically improved by bettering project implementation and preparation mechanisms.

SKIDDING OFF THE ROAD TO RECOVERY: New Risks for the Advanced and Emerging Markets of the G-20

Eswar S. Prasad

Framing the Issue

Advanced economies as a group are skidding off the road to recovery; emerging markets are dealing with domestic policy tensions related to maintaining strong growth while keeping inflation under control.

Leaders of the major advanced economies face dire economic circumstances and have little room for domestic policy maneuver. A series of adverse shocks, coupled with political wrangling that has stymied effective policymaking and added to uncertainty, has crippled growth in advanced economies. Emerging markets have kept up their end of the bargain by maintaining strong growth so far, but the battle against domestic inflation and weaknesses in major export markets are beginning to affect their growth as well.

Policy Considerations

Debt crises, weak employment growth and policy dithering in the major advanced economies have exacerbated global economic uncertainty. The perception of rising risk and inadequate policy responses has shaken financial markets and dented confidence around the world. Reflecting widespread anxiety and fear about global economic prospects and the lack of obvious policy solutions, global financial markets remain on edge.

The recovery in the United States has been hurt by a withdrawal of fiscal stimulus in the short run and little decisive action in tackling the long-term debt problem, exactly the opposite of what is needed. Political wrangling and weak employment growth have contributed to declines in business and consumer confidence, with these factors feeding off one another and stunting the recovery. Japan is still reeling from the aftermath of the earthquake and tsunami, with political instability contributing to a lethargic economy that is unable to shake off its torpor. Most macroeconomic indicators—including GDP, employment and exports—are weak and show little sign of recovering anytime soon. The German economy remains relatively bright but overall short-term macroeconomic prospects for European economies are grim as they deal with fiscal austerity programs and banking systems under considerable stress.

Emerging markets continue to perform well but remain under pressure, with concerns about persistently high inflation and, in some cases, frothy asset markets. The challenge for these economies is to maintain high growth while tamping down inflation, a difficult proposition even in good times and particularly so when the advanced economies are dragging down global growth and adding to emerging markets' policy complications. Capital flows to emerging markets have shrunk as global investors retreat to safe havens, taking some of the pressure off these economies.

China's economy continues to forge ahead, with GDP and industrial production still growing strongly and robust domestic demand offsetting a decline in export demand. There are signs of increasing domestic policy tensions as concerns about high inflation square off against the desire to maintain strong domestic growth. The odds are about evenly balanced between a soft and hard landing, with global economic conditions being the wildcard. Continued weakness in China's major export markets, Europe and the U.S., has already affected its export growth and there is a prospect of new domestic demand stimulus measures to offset this external drag on growth.

India's financial markets have cooled off and GDP growth has slowed slightly, but foreign trade and industrial output continue to grow strongly. In Brazil, GDP and industrial production growth have both weakened. In these and many other emerging markets, continued strong credit growth even as confidence indexes are weakening indicates a major challenge for policymakers in maintaining strong growth while keeping inflation bottled up.

Emerging markets may find it difficult to continue being the drivers of global growth for much longer if the policies in advance economies fail to restore their own economic growth and, instead, just add to global financial instability.

The European debt crisis is adding to global uncertainty, which is one of the factors adding to the fragility of the global recovery. Continued political wrangling is worsening the European debt crisis by the day. There are encouraging signs on the policy front in Europe in recent days, but there remain serious concerns about the measures being too little and too late.

Currency wars have broken out into the open, with even many advanced economies getting drawn in. Japan and Switzerland have intervened extensively in foreign exchange markets to prevent rapid appreciation of their currencies. The currency spat between China and the U.S. has heated up and could turn ugly as both sides attempt to flex their muscles. The world economy can ill afford heightened trade tensions that would add to global economic uncertainty and further affect prospects for a sustained recovery.

The global financial turmoil and the search for safe havens have temporarily moved other emerging markets to the sidelines of the currency wars as they no longer face pressures for currency appreciation. But there is a general awareness in these economies that they may have won at best a temporary respite from capital inflow surges.

Action Items for the G-20

Policy options for the advanced economies are being hemmed in by economic and political circumstances. Fiscal policy is constrained by crushing debt burdens and monetary policy is reaching its limits, with further unconventional monetary easing likely to yield a low ratio of reward to risk. Advanced economy central banks already have expanded their balance sheets massively in ways that carry many economic and political risks. For the foreseeable future, these central banks will continue to face the twin burden of supporting growth and preventing financial panics.

In advanced economies, the lack of political consensus is a key constraint in fashioning effective and credible policy measures. Domestic political tensions in the major economies and cross-border policy tensions are adding to economic uncertainty and hindering effective policy responses to the faltering recovery.

For its own sake and that of the world economy, Europe must act quickly to implement concerted and forceful measures to forestall a financial and economic meltdown that could have global repercussions. In the U.S., the fragile state of the recovery calls for more aggressive short-term fiscal measures, despite all the risks that rising deficits entail, and a more balanced approach to long-term fiscal discipline that includes revenue measures rather than just spending cuts.

The world economy is entering a difficult and dangerous phase, where there are no easy or costless policy solutions but policy paralysis also carries enormous risks of unraveling the feeble recovery.

THE EURO AREA CRISIS: A Crucial Opportunity for European Leaders at the G-20

Domenico Lombardi

Framing the Issue

In Europe, the market turmoil that started as a fiscal and banking crisis in a few peripheral countries, has now spread to larger sovereigns, such as Italy and Spain, through increasing spreads in their government bonds vis-à-vis the German Bund and a steady deterioration in the balance sheets of their financial institutions. This has triggered a wave of downgrades that are likely to feed into still higher spreads and a further weakening of financial institutions in Europe.

Policy Considerations

It has become exceedingly clear that the piecemeal approach of European policymakers trying to deal with one distressed country at a time has not worked. Yet, when European finance ministers and central bank governors left Washington in late September after attending the annual meetings of the International Monetary Fund, they left with the commitment to work out a comprehensive approach to resolve what has now turned into a systemic crisis of the euro area. Meanwhile, financial markets have bought into this by exhibiting a "honeymoon behavior" as the previous turbulence has temporarily stabilized. Should European leaders come to Cannes with little in their hands, we are likely to see a further escalation of the crisis with Italy probably being hit the hardest.

The forthcoming G-20 Summit in Cannes is going to test the European resolve to handle their sovereign debt crisis through a systemic response. On the one hand, the financial firepower of the European Financial Stability Facility (EFSF), the European rescue fund, should be increased to make it a credible backstop against the scenario that larger sovereigns may be temporarily cut-off from the market should their borrowing costs further escalate. After more than three months since euro area leaders approved relevant amendments to the EFSF to widen the scope of its interventions, national legislatures in Europe have now finally ratified these amendments. However, these amendments, while helpful in themselves, do not foresee a step up in resources for the EFSF. Therefore, the facility is unlikely to have more bite in tackling Europe's debt woes.

To understand why a beefed-up EFSF is needed to curb further contagion in Europe, one can look at the example of Italy. Currently, the Italian Treasury has to borrow on average some euro 250 billion each year in order to roll-over its public debt. This amount is nearly equivalent to the current residual EFSF financial capacity, netting out for the commitments already taken vis-à-vis the peripheral European economies. In other words, a one-year hypothetical "stand-by" arrangement with Italy would deplete the entire European rescue fund.

The urgency of realigning the EFSF's size also reflects the need to provide a safety net to the weakening euro area financial system. It is plausible that countries already under stress may be unable to recapitalize their financial sectors and consequently the EFSF would serve as the last line of defense. Estimates circulating in the private and official sectors range in the euro 50 to 200 billion. The recapitalization of the euro area financial system has become a high priority for senior policymakers outside of Europe as they recognize the huge potential for global contagion that could come from a distressed European financial sector. This is even more relevant given that Greece looks like it will in fact go through a default—ideally in an orderly manner arranged in cooperation with the private sector.

Action Items for the G-20

Clearly, these are all steps that the Europeans will have to work out at their own European Union Summit that will precede the G-20 gathering by a few days. The G-20 Cannes Summit, however, will provide an opportunity for a collegial assessment of the European response by non-European leaders and for escalating pressure on euro area leaders. Non-euro area G-20 leaders will be able to leverage on the terms of their support for further IMF engagement in the European crisis, including a follow-up aid program for Greece, and a much-needed expansion of the IMF's financial capacity to underpin its financial safety nets.

More specifically, emerging economies—which are expected to contribute to a revamped IMF war chest through bilateral lines of credit—will want to see a sustainable strategy in place before committing their own resources. For the United States, a credible fix in Europe will help to contain a large source of vulnerability of its still fragile economic recovery. However, among U.S. officials and leaders, there is an awareness that they have little ammunition in helping the Europeans solve their debt crisis besides peer pressure and persuasion.

The Cannes Summit will provide yet another opportunity for European heads of state and government to address this ongoing situation. If they squander it, the euro area will most likely be hit by escalating pressures from financial markets through a progressive weakening of larger sovereigns as well as the entire euro area financial sector.

THE G-20 AND THE GLOBAL FOOD CRISIS

Homi Kharas

Framing the Issue

Food prices have reached peak levels not seen since the 1970s. Maize, wheat and sugar prices have doubled or tripled over the last year. Food prices are different from other prices since food is a necessity. The impact of high food prices is acutely felt by all households, especially those that are poor. There are also indirect economic costs. For example, as food prices increase, the discretionary income of households for spending on other items falls, which adds to the contractionary pressures of an already weak economy. In many developing countries, high food prices directly contribute to hunger and poverty. When governments try to shield their populations from the impact of high food prices through subsidies, it can lead to soaring fiscal deficits.

If food prices simply trended higher, one would expect more investment in food production and a significant supply response, which would bring prices back down. Yet, food prices have been very volatile in the last three years. For instance, the price of maize in July 2008 reached $287 per metric ton, fell to $158 in December 2008, remained at these levels through the 2009 recovery, but started to rise again in the second half of 2010. Maize prices peaked at $319 in April 2011, but have since fallen by about 10 percent. Managing food price volatility, as distinct from the price level, has become a serious problem for policymakers. When prices were low, there were high levels of suicides in India among farmers too indebted to provide for their families and sometimes violent protests in rural China against low government procurement prices. But, within a few months, prices spiked and the world saw demonstrations by urban consumers against high prices that may have contributed to the fall of some governments.

Food is one of the most politicized commodities in the global economy. The G-20's decision to address food price volatility is based on the recognition that collaborative solutions are needed to solve this problem. National policies on food and related areas are causing significant spillovers onto other economies, and undermining economic and social stability. Food policies are also a major obstacle in securing international trade agreements. The G-20 must break through the impasse.

Policy Considerations

The G-20 is faced with three big policy issues on food. First, they need to take action to make food markets work better. Second, they should try to limit the damage to food markets that domestic politics are now creating. Third, they need to promote mechanisms to strengthen social stability to give households and farmers better ways of adapting to future price volatility.

Markets

Food markets would probably have volatile prices even under the best of conditions. Both supply and demand are relatively unresponsive to price changes in the short-term, so minor changes in either can lead to big changes in the market equilibrium price. Storage costs are high with significant waste. But food markets are also much more volatile than necessary because of distortionary and discretionary national policies that compartmentalize food markets. Tariffs, non-tariff barriers, government procurement policies, subsidy policies and export restrictions affect local and international food prices. Increasingly, so do biofuel subsidies and other energy-related policies. Food prices today have become linked to energy prices through direct costs (fertilizer, pesticides and transport) and indirect costs (land substitution for non-food uses).

Markets work better when the underlying fundamentals of supply and demand are well known. But information on food is highly imperfect. The level of food stocks is a key variable, but only some countries report this information with any regularity. A proxy can sometimes be the amount of food being purchased by hedge funds for future delivery or even the volume of funds being directed into commodity exchange traded funds. But these funds are unregulated with few disclosure requirements.

When the private sector organizes markets, it puts a high premium on good information. In most countries, commodity exchanges are the places where such information is distilled and risks brokered. Such exchanges are just emerging in some African countries but they need to be linked into a virtual network, underpinned by privately-run warehouse receipt systems.

Most farmers, especially small-holder farmers in the developing world, are not yet integrated into global markets and food supply chains. These are the farmers that could make a substantial contribution to increasing global food supply because their yields are well below those that are attainable with existing technology and agronomic practices. African productivity is only half that of India, one-quarter that of China and one-fifth that of the United States. The technology to increase yields is well-known but requires investments. For example, 90 percent of Africa's agricultural land is rain-fed and subject to the vagaries of weather. Mechanized power to till the soil would do wonders to raise yields. So would the application of fertilizer and better seeds. Several African countries such as Malawi have had spectacular success in increasing production by adopting such policies.

Politics

No progress has been made in dealing with the politics of food. One big issue is how to address biofuel policy. Biofuel could be consuming as much as 6.5 percent of the world's grain output and 8 percent of its vegetable oil, diverting valuable land away from food production. In many countries, biofuel policy is dictated as much by domestic politics toward specific rural constituencies as by technical considerations. Another big political issue is around trade barriers. Most domestic agricultural markets are highly protected, resulting in a fragmentation of markets. That is the opposite of what is required. Food price volatility will come down everywhere if markets are deeper and larger, and better able to smooth weather-related and other shocks more broadly across the globe. The political efforts of some countries to insulate themselves from shocks by imposing ad hoc export restrictions or other means are beggar-thy-neighbor policies that should be shunned.

Social Stability

The third issue has to do with social stability. Here, the G-20 must recognize that hunger has much more to do with conflict, lack of income, inequalities within households in access to food, and lack of nutritional education than it has to do with global food supply. Most G-20 countries have social safety nets that mitigate the impact of high food prices on the poorest households, but most developing countries lack such programs.

Action Items for the G-20

The G-20 proposal, endorsed by agriculture ministers, only tackles a small part of the problem. These include:

implementing a new agriculture management information system, developing norms around land purchases, establishing stocks in select locations and regulating hedge funds investing in commodities. But the big ticket items have not been agreed upon and G-20 leaders should push beyond what their agriculture ministers have agreed to. At Cannes, they should:

- Commit to providing more resources for investment in agriculture or at least to honoring their promises to fund the Global Agriculture and Food Security Program;
- Look to institutional development and assist Africa in the development of privately-held commodity exchanges;
- Discuss the links between biofuel policies and food prices, with a view to mitigating the impact of biofuels on food prices;
- Agree to avoid export restrictions on food;
- Make progress toward liberalizing trade in agriculture and reducing the most distortionary aspects of tariff escalation and non-tariff barriers.

THE ECONOMIC IMPERATIVES OF THE ARAB SPRING

Raj M. Desai

Framing the Issue

The Arab Spring constitutes the most important political and economic transitions since the end of communism in Europe. But the world has not found an effective way to channel its support for the reformers in Arab states into economic assistance.

The economic dimension of the transition, moreover, has been all but neglected. While much has been made of the demands for freedom and human rights by protesters, a strong economic rationale is driving Arab citizens to support democracy. A survey of Egyptians conducted this past summer, for example, finds that almost two-thirds of respondents defined the most essential characteristic of democracy as either a low level of inequality or the provision of basic necessities for all citizens. More than 80 percent say that "the economy" is Egypt's greatest challenge. This is the heart of the matter: if the economies fail to deliver, democracy will fail.

The G-20 can play an important role in promoting much-needed engagement between reforming Arab states and the rest of the world. When the reformist mood last spread through the Arab world some four decades ago, it coincided with the emergence of economic protection, planning and redistribution. Today, circumstances have changed. Arab economies—less competitive and productive than other middle-income countries—face the prospects of transition during the worst years for the global economy since the Great Depression. And the Arab economies themselves have failed to deliver in recent decades. They relied too much on economic rents rather than production, and on cronyism rather than inclusion. When they reformed—as they were forced to do in the 1990s—they did so half-heartedly and in ways that enriched a small ruling clique. These failures created deep aversions to economic liberalization that persist today.

Policy Considerations

Despite differences among Arab economies, they face four common economic challenges.

First, the challenge of economic reform in the Arab world is foremost a problem of state building. The public sector has acted as the lynchpin of a political-economic system designed to support redistribution and equity. While these policies improved the health, educational attainment, and living standards of Arab citizens for many years, they also entrenched cronies and enriched a small elite. They have also become increasingly unaffordable. So ingrained in public opinion is the role of the state in the economy, that large percentages of Arab publics prefer government jobs over private sector jobs, despite long waiting lists for public sector employment. Even among Arab youth, large pluralities express preferences for government jobs. Key reforms in the public sector require both fiscal consolidation as well as institutional fixes—increasing access and representation in policymaking, improving the effectiveness of poorly-functioning bureaucracies to deliver public services and controlling corruption.

Second, the disproportionate burdens of adjustment heaped on Arab youth cannot be sustained. Almost two-thirds of the population in the Arab world is under the age of 30. They, unlike older generations whose entitlements are largely protected, face the prospect of longer periods of unemployment or underemployment as well as much greater economic vulnerability, having lost many of subsidies that their elders can still claim. More importantly, the Arab education system is one of the most underperforming in the world. Returns to schooling at primary and lower secondary levels are nearly zero, while they are high at the university level. But for the majority of youth who do not attend university, there is little else. They are left without the requisite skills and training needed to compete in global labor markets.

Third, Arab economies must diversify. Moving beyond an exclusive reliance on oil and gas exports, remittances, and tourism will require gaining the confidence of foreign and domestic investors and entrepreneurs, while creating a favorable environment for all businesses, big and small, to invest, create jobs and expand. Equally important, the business community must regain the confidence of society. The natural advocate of a good government, the merchant class, has not been as a strong voice for change in Arab states. Alliances between rulers and business elites have for too long been part of a mutually-beneficial mechanism for distributing rents rather than an engine of growth. And the organizations that have often prodded reforms in other countries—entrepreneurs' and business associations—are weak, unrepresentative and captured.

Finally, the relative isolation of Arab economies—both from each other and from the world—must end. Much more should be done to take advantage of opportunities offered by both regional and global markets. Unfortunately, cooperation has a poor record in the Arab world. Intra-regional trade among Arab states is barely one-tenth of total trade. In addition to political divisions between Arab states, the impediments consist of uneven levels of import protection, high nontariff barriers, bad trade logistics, and large gaps between bound and applied tariff rates.

Action Items for the G-20

In previous transitions in other parts of the world, the international community has played a valuable role in providing financial resources and anchors to support multi-year reform programs. Such programs help build confidence and shape expectations in a way that crowds in private investments. In the post-Arab Spring, this may be complicated. The resources available from the international community are largely in the form of loans, not grants, and those are less valuable for countries struggling to maintain fiscal discipline.

More importantly, there is significant resentment against the forces that supported and perpetuated the old regimes—in particular, the international financial institutions and aid agencies that provided the largesse to these Arab states.

Some potential action items for the G-20 include:

- Develop regional assistance tracks to complement the country-specific tracks typically used in development cooperation. A regional approach may be better-suited to addressing the economic and political needs of Arab states.

- Establish a regional development agency that is focused on the issues of transition in the Arab world. The agency should play a leading role on trade and logistics facilitation, regional infrastructure financing and support to the private sector.

- Revive an expanded Barcelona Process and Union-for-the-Mediterranean initiative. These initiatives were designed to build political, economic and social partnerships between the European Union and its southern Mediterranean neighbors, focusing on creating free trade areas, removing most tariff and non-tariff barriers, as well as providing for the elimination of investment obstacles and easier technology flows.

- Better coordinate international assistance efforts, modulated to country circumstances. Reformers in countries such as Morocco and Tunisia, where transitions have thus far been less disruptive, may be able to capitalize on windows of opportunity and move rapidly. But in Egypt, Libya and other countries still engaged in political transitions, the situation facing reformers is less clear.

AVERTING THE THREAT OF A NEW GLOBAL CRISIS: A Critical Opportunity for Emerging Market Economies to Shape the Global Response

Johannes F. Linn and Colin I. Bradford

Framing the Issue

Recent global financial and economic crises have led to reforms in global governance. During this time of extraordinarily difficult domestic economic and political conditions in large industrial economies, a key question for the future is whether the global governance system is now strong enough to cope with the sovereign debt crisis in Europe and whether this crisis will lead to a further strengthening or to a weakening of global governance? In a context of weak economic and political leadership by the industrial countries, the emerging market economies have a special opportunity to help shape a global response to the looming economic crisis.

Since World War II, global crises have spurred reforms to strengthen the global economic and financial governance system. At the end of World War II, the prospects of a major global post-war recession brought about the creation of the International Monetary Fund and the World Bank at Bretton Woods, along with the creation of the United Nations and, subsequently, the General Agreement on Tariffs and Trade, the forerunner of the World Trade Organization. The collapse of the Bretton Woods currency system in the early 1970s, the first global oil crisis of 1973 and the subsequent global economic instability led to the creation of the Group of Seven (G-7) in 1975. In 1999, the G-20 forum of finance ministers was established in the wake of the financial crisis in East Asia in 1999. The first G-20 summit was held in November 2008, in response to the unfolding global financial and economic crisis of 2008–2009. During the early summit meetings, the G-20 agreed on various measures to strengthen the international financial institutions, inter alia, by hastening the governance reform of the IMF and giving it substantially larger financial resources, and by transforming the Financial Stability Forum into the Financial Stability Board. This prompt action, including the coordinated stimulus response and efforts to strengthen the global institutions of financial management, oversight and safety net, helped turn around the global economy after a relatively short and shallow recession, when compared to the calamity of the Great Depression in the 1930s.

Now the sovereign debt crisis in Europe is once again creating great distress in the global economic and financial system. The risks of a sovereign default in Europe and its impact on the global banking system are huge and the ability of the euro to survive as a common currency for much of Europe is at stake. With the U.S. economy already weakened by the continuing fallout of the 2008 crisis—a weak housing market, high unemployment, large government deficits and crushing public sector debt—and Japan's economy immobilized by long-simmering economic difficulties reinforced by natural disasters, the industrial world now faces a serious risk of a new, and perhaps even deeper, economic crisis than in 2008.

Policy Considerations

With the domestic economic realities of the most systemically important countries, the scope for a global policy response—similar to the coordinated stimulus package of 2009—is constrained by their limited fiscal space for further monetary action. This makes it nearly impossible for them to counteract an additional economic downturn.

Furthermore, the difficulties of domestic economic management are reinforced by a fundamental malaise in the political systems of most mature democracies around the world. In the United States, a persistent and acrimonious standoff between the Democratic president of the United States and a Republican House of Representatives is creating economic policy gridlock. In Europe, fractured coalitions, weak leadership and conflicting national interests, combined with cumbersome decision making mechanisms in the eurozone, inhibit a decisive response to Europe's financial crisis. In Japan, the political system has produced a persistent pattern of weak and frequently changing leadership, which has been unable to pursue adequate structural reforms to address the fundamental malaise of Japan's economy.

As the leaders of the traditional global economic powerhouses—the U.S., Europe and Japan—face huge domestic economic and political challenges, it is clearly their principal responsibility to come quickly and effectively to grips with their economic calamities. Their current weakness, however, has created an opportunity for emerging markets to play a significant role in stabilizing the world economy. Brazil, China and India, among others, have a great stake in preventing another global recession. While they also face domestic economic and political challenges, they have a greater degree of freedom in responding to the current global financial and economic risks.

With their rapidly growing economic and political leverage, the emerging market economies have the opportunity to shape the global response to the current crisis at a time when their partners in the industrial countries are immobilized by their domestic economic and political problems. If they forcefully engage in the global organizations and forums, including the G-20 finance ministers' meetings, the international financial institutions and the WTO, their actions could help not only avert a global economic meltdown, but would also give them a greater opportunity to realize their ambitions to have a greater voice in global governance.

Unfortunately, an alternative scenario cannot be ruled out: Continued poor domestic economic management in the industrial countries might be reinforced by actions in the emerging markets. Growing trade protection, competitive devaluations and capital controls, acrimonious debates in the G-20 and a lack of readiness to support the international financial institutions would hasten a downward global economic spiral and further weaken the global economic institutions. As a result, not only would the world face a global economic collapse, but also the potential collapse of major economic institutions.

Action Items for the G-20

During each global financial and economic crisis in the decades since World War II, the world's leading economies were able to avert the threat of a global depression and to strengthen global international institutions. However, there is no guarantee that this will happen again. Speedy and effective domestic action by the industrial countries, matched by constructive engagement of the emerging market economies in global economic management are required to stem the growing risk of a global economic and institutional disaster. The following steps should be taken:

- Emerging market economies must not backslide into protectionism and they need to pressure their industrial G-20 partners to do the same;

- Emerging markets should further strengthen their role in the IMF by being more proactive, vocal and assertive about governance reforms, and by being willing to provide additional resources for the IMF, which would strengthen its ability to help governments in crisis particularly now in Europe;

- Emerging market countries need to reject pressure to reduce lending and concessional assistance by global development institutions, such as the World Bank, the regional development banks, and the United Nations economic agencies, such as the International Fund for Agriculture and Development. They also need to actively identify ways to increase programs and resources for these agencies by augmenting their own resources to assist the developing world through the crisis; and

- Emerging markets need to vigorously participate in peer reviews of financial system reforms in the Financial Stability Board and the IMF in order to ensure adequate harmonization of best practices in all G-20 countries, as well as be active in establishing more effective regulatory and supervisory capacities for the whole global financial system.

As emerging market economies become more actively engaged in supporting the global financial institutions, the industrial countries need to welcome this engagement, rather than try to suppress or reject it. Although this was the case during the last capital increase of the World Bank, in the recent appointment of the IMF's managing director, industrial countries need to increase engagement with emerging markets, particularly since emerging market governments have offered to provide additional funding for the IMF to help with the rescue of the eurozone.

STRATEGIC APPROACHES FOR THE G-20 TO SUPPORT AFRICA'S INFRASTRUCTURE DEFICIT

Mwangi S. Kimenyi and Vera Songwe

Framing the Issue

Currently, very few issues command the intense and focused attention of governments or require the scale of financing as infrastructure development in Africa. With rapid growth and sound macroeconomic fundamentals over the last decade, many governments on the continent missed an opportunity to invest in transformational infrastructure projects. As a consequence, poor infrastructure is slowing growth and is also among the greatest threats to peace and stability in the region. Recent estimates suggest that Sub-Saharan Africa needs $93 billion a year to upgrade its ailing systems.

The scale of needed investments is daunting and there is a lack of an overall framework to address the issue. The G-20's involvement, therefore, can help governments, donors and the private sector identify and prioritize their projects. Set against a backdrop of a slowing world economy and the need for multiple poles of growth, infrastructure development offers a long-term solution to many of today's challenges. Countries can create jobs, stimulate their economies and provide lucrative investment opportunities for the private sector, while upgrading their insufficient communications, transportation and utility networks.

Given the magnitude of the challenge, success can only be obtained when there is transformative leadership on the continent driving this agenda; however, there is a substantial gap between the G-20 rhetoric and African leadership. The G-20 has already succeeded in raising awareness for creating an attractive environment for private sector investment; now they can help to create the conditions that enable sustainable infrastructure development. This will require both the ability of the G-20 to assess commitment from African leaders and a commitment from the public and private sector.

Policy Considerations

The G-20 faces three main challenges to African infrastructure development that must be addressed in addition to raising resources for feasibility studies. The G-20 has asked the international financial institutions to draw up a list of potentially viable projects which they could support by providing funding for feasibility studies.

First and most importantly, both innovative leadership and predictable market enhancing policies with credible implementation agencies are needed. Countries must have leaders willing to undertake transformational projects such as Kenya's Geothermal KenGen project or Senegal's highly ambitious wind farm power generation project *Parc Eolien Taiba Ndiaye*. These leaders must also be willing to support and build credible institutions that can broker exchanges between the private and public sector, as the nation's economy opens for investment. Successful projects on the continent in the last decade, such as Morupule in Botswana and the West Africa Power Pool, all benefitted from direct and committed leadership. No important infrastructure projects on the continent have been successful without the direct involvement of its leaders. As the private sector knows, a project list developed and propagated by external bodies that lacks strong African leadership will not succeed.

An example of successful leadership and institution building in Africa is in the information and communication technology sector. Across the continent, the availability and quality of service has increased, while the cost has decreased. In just 10 years, mobile network coverage rose from 16 percent to 90 percent of the urban population; by 2009, rural coverage stood at just under 50 percent of the population. Mobile networks cover 90 percent of Africa's urban population and there are 247 million more mobile network users in Sub-Saharan Africa than there were in 2008. Leadership, effective institutions and private sector participation have been critical to this accomplishment.

Second, while the scale of financial resources needed appears enormous, the issue is not the availability of funds but rather their allocation to viable bankable projects. There is a significant amount of capital available for infrastructure funding from the private sector and the international financial institutions. However, these resources are not enough to satisfy the global demand for infrastructure, estimated at $1.3 trillion. As a result, African countries need to compete for these limited resources by creating a strong enabling environment for investment in infrastructure. This includes adequate regulatory regimes, such as appropriate tariff frameworks, as well as predictable government policies implemented by credible agencies. Countries must demonstrate that there is a suitable and competitive market environment in which firms can operate.

The third issue is the capacity within government to access and negotiate projects. Project preparation, feasibility and negotiation skills are costly. Like many developing countries' central banks, the international community should endorse, within government, the creation and development of market-based infrastructure project development teams who are appropriately incentivized and accountable for seeing projects through to completion. While these skills are costly, we know that their absence can be even more detrimental and onerous. For many countries and firms, the delays and reputational risks incurred from lengthy contract renegotiations, project redesign and/or perceived unbalanced contracts is substantial. As a pre-requisite for subsidizing feasibility studies, the G-20 should mandate the creation of an adequately funded infrastructure project unit or multidisciplinary teams, which have comparable international expertise to design and negotiate complex contracts. By utilizing its own resources to establish such an expensive unit, the government will enhance the credibility of its leadership and build confidence within the private sector.

Action Items for the G-20

Development agencies have an important role to play in supporting governments and designing appropriate instruments for project implementation. Several development financial institutions are now working with governments to help provide funds and experienced professionals dedicated to the early stages of infrastructure project development in Sub-Saharan Africa. These multilateral and bilateral institutions are testing different ways to support project preparation and project development in Africa, including through the creation of stand-alone facilities to promote and develop private infrastructure projects.

The G-20 has successfully rallied the development community and the private sector around the infrastructure agenda in Africa, but they can still do more. To reap the full benefits of its efforts, the G-20 must require proportional levels of effort and commitment of African leaders. To continue encouraging African infrastructure development and to ensure high quality project output, the G-20 should require the following:

- There must be clear government and institutional leadership for projects as reflected in government strategy documents and the budget;
- There must be a conducive policy and regulatory environment for infrastructure project implementation including: adequate regulatory regimes; appropriate tariff frameworks; and predictable government policies implemented by credible agencies; and
- The country must demonstrate its commitment to infrastructure development by creating an international caliber project preparation unit.

These pre-requisites will help the G-20 focus and prioritize infrastructure project development and support. In addition, implementation of these measures should not require substantial additional resources and could accelerate infrastructure development on the African continent. In fact, if these issues are addressed, the public resources needed for feasibility studies may be substantially reduced, meaning the funds could be used to address other roadblocks to development.

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