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Making the Global Financial System Work for All

A Contribution by individual Members of the G20 Eminent Persons Group on Global Financial Governance*, other thought-leaders and the London School of Economics and Political Science.

*The proposals of the 16-member EPG, submitted in Oct 2018, are being deliberated on within the G20.

LSE Institute of Global Affairs

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Why Reform?

Tharman Shanmugaratnam

Deputy Prime Minister and Coordinating Minister for Economic and Social Policies, Singapore*

We are in a new global era. It presents an unprecedented challenge. But it also carries real opportunity for reforms and innovations that can enhance growth, build social inclusion, and tackle the urgent challenges in the global commons that affect us all.

The G20 Eminent Persons Group of Global Financial Governance (EPG) has made specific proposals to achieve these objectives. The reforms needed are within our reach. They involve new ways of spurring development finance, and ensuring greater and more lasting development impact. There is large untapped potential for joint action by the MDBs, bilateral institutions and the private sector, to work with countries to de-risk not only individual projects but whole investment environments. There is also significant opportunity to diversify risks across countries and build a standardized, large scale asset class to attract institutional investors, who to date have had minimal participation in developing country infrastructure.

We must also deepen domestic financial markets, and enable countries to benefit from capital flows and run sustainable current account deficits, where they are fundamentally needed at their stage of development, without the recurring bouts of instability that set back growth. It is critical too, that we build a more reliable global financial safety net – by ensuring an adequately-resourced global layer in the IMF, and stitching together the decentralised structure of global, regional and bilateral arrangements that have evolved over the last decade. We must also put in place a more integrated system of global risk surveillance, to avert the next crisis.

At the heart of the EPG's proposals is the need for a new, cooperative international order for a world that has changed irreversibly: one that is more multipolar and decentralised in decisions, yet more interconnected. And a world with challenges that are more pressing than we have seen in decades – especially in securing jobs, and addressing the grave threats to the environment and global health. The reforms do not require new international bodies. They require that we take bold and defined steps to ensure today's institutions, multilateral and bilateral, work together as a system, and leverage the full potential of markets.

At the heart of the EPG's proposals is the need for a new, cooperative international order for a world that has changed irreversibly... and with challenges more pressing than in decades.

The recommendations within the EPG's Report have received support from a broad range of stakeholders. Most of the reforms are achievable within a few years, with collective resolve and focused effort. The ambition is in the doing. As a key partner, the B20 will play a key role in shaping this cooperative international order - one that enables nations everywhere to meet the aspirations of their citizens, and serves the global good. ◆

*Tharman Shanmugaratnam chaired the G20 Eminent Persons Group on Global Financial Governance which submitted its reform proposals in Oct 2018.

Tharman Shanmugaratnam is Deputy Prime Minister and Coordinating Minister for Economic and Social Policies in the Singapore Cabinet. He is also Chairman of the Monetary Authority of Singapore (MAS), Singapore's central bank and financial regulator.

Tharman chairs the Group of Thirty, an independent global council of leading economic and financial policy-makers. He earlier led the International Monetary and Financial Committee (IMFC), the key policy forum of the IMF, from 2011-2014; he was its first Asian chair.

Tharman has spent his working life in public service, in roles related to education and economic policies. He served as Minister for Finance for eight years (until 2015), and as Minister for Education for five years prior to that. In addition to his current responsibilities in government, he is a board member of the Government of Singapore Investment Corporation (GIC) and chairs its Investment Strategies Committee.

Engaging the B20

Erik Berglof

Professor, Director, Institute of Global Affairs,
London School of Economics and Political Science

Do we have a global financial system that works for all and are we having the critical impact required to address the global challenges to create a sustainable future for our children and grandchildren? Do our multilateral financial institutions really function as a system? Do the shareholders, and ultimately the taxpayers, get value for money? The G20 Eminent Persons Group on Global Financial Governance (EPG) was a G20 initiative under the German Presidency in 2017 to review the efficiency and effectiveness of the global financial architecture.

The urgent transformation needed to achieve the UN Sustainable Development Goals in 2030 requires global investments on a scale far beyond what we have seen to date, particularly in emerging and developing economies. Much of it will have to come from the private sector, but the international financial institutions will play an important part in supporting the efforts of countries to enhance the investment climate, particularly through improved governance and human capital, and in facilitating private investment by bringing down and sometimes sharing risk.

In conducting its review, the EPG engaged intensely with the private sector. After it delivered its final report, Making the Global Financial System

Work for All, to the G20 Finance Ministers and Central Bank Governors in October last year, the group also organised a series of panels at the Bali meeting of the Institute of International Finance. Yet, the EPG has never worked directly with the B20.

This collection of material from the report and opinion pieces is meant to bring the messages of the EPG to the B20 delegates but also to the wider global business community. The LSE Institute of Global Affairs and its Global Policy Lab have taken on the role of facilitating this engagement. We believe strongly in the systemic approach of the EPG and plan to contribute research and policy engagement to further develop the ideas in its final report.

The Global Policy Lab was set up to support connecting policymakers and thinking environments within and across emerging economies, and ultimately to help them increase their impact on global decision-making. The EPG embodies the mission of our Global Policy Lab. Its 16 members include eight from advanced economies and eight from emerging economies, with the EPG Chair, Tharman Shanmugaratnam, Deputy Prime Minister of Singapore, representing the growing leadership of the emerging world. Throughout the work of the EPG, peer-to-peer exchange was critical to progress.

We begin with a statement from the EPG Chair, Tharman Shanmugaratnam, and sum up the report and its proposals. Five members of the EPG will then provide their views on why the group's work is vitally important for the business community. We have also included four additional contributions from policymakers and policy thinkers close to the group's work. We hope that you will continue to engage with us and the Friends of EPG network set up to follow up on the EPG report and its proposals towards a new multilateralism. ◆

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Making the Global Financial System Work for All

In April 2017, the G20 Eminent Persons Group on Global Financial Governance was asked by the G20 Finance Ministers and Central Bank Governors to recommend reforms to the global financial architecture and governance of the system of International Financial Institutions (IFIs) so as to promote economic stability and sustainable growth in a new global era; and to consider how the G20 could better provide continued leadership and support for these goals. The result was the first of its kind global report titled "Making the Financial System Work for All."

At the heart of the report is the future of the open and competitive world order that has brought a large part of humanity out of poverty, raised living standards across nations, and provided the foundation for unprecedented global peace over the last 70 years. That open order remains critical to every nation's future. But the system of international governance and cooperation that underpins it is fraying. Left on its own, there is a real risk of drift into a fragmented world, with policies in different parts of the world working at odds with rather than reinforcing each other, and with all nations ending up losing.

We cannot return to the past. The central challenge is to create a cooperative international order for a world that has changed irreversibly: one that is more multipolar and decentralized in decisions, yet more interconnected, and with challenges ahead that are much larger and more pressing than we have seen in decades

Getting national policies right is at the core of achieving inclusive societies and mutual prosperity. But international and national initiatives should reinforce each other in a way that creates a stronger future for all. An open, competitive and well-coordinated international order will enable win-win outcomes for nations. Its weakening will lead to lose-lose outcomes, as global growth and opportunities for new jobs are eroded over time, and as financial stability and the global commons become more fragile. Equally, cooperative internationalism will survive only if it helps the broad base of nations achieve inclusive growth.

At the heart of the report is the future of the open and competitive world order that has brought a large part of humanity out of poverty, raised living standards across nations, and provided the foundation for unprecedented global peace over the last 70 years.

The reforms that we propose in our report strengthen and add resilience to global financial governance for this new, cooperative international order. The present system lacks the coherence, joint capacity and effectiveness to support its most fundamental goals in global development and financial stability. It must be brought up to date with the realities of a new era.

We can achieve this by implementing decisive reforms to make the system work as a system. These reforms are within our reach.

They do not require new international bodies. They instead require that we take bold and defined steps to ensure that today's institutions – global, regional and bilateral – work together as a system. They require that we build

trust and transparency among these different institutions, and leverage their combined strengths, so that the system as a whole delivers greater and more lasting development impact and reduces the frequency and damage of crises.

Our proposals build on various reforms that had been underway among the IFIs, and seek to take them further. But they also require a much greater sense of urgency and recognition among their shareholders of the need for consistency and joined-up efforts among the IFIs and all other stakeholders so we raise our whole game.

We need a step change in the pace and scale of reforms to enable the growth, job opportunities and sustainability that are critically needed in the next decade. The consequences of failure will not be simply economic. We also need further reforms to avert major, systemic crises; and to make it possible for developing countries to finance sustainable current account deficits, where they are fundamentally needed at their stage of development, without the recurring bouts of instability that set back growth.

As an Eminent Persons Group, our task was to provide an independent assessment of the changes needed. We focused especially on system-wide reforms, rather than those in individual institutions. Our mandate also excluded issues to do with the capital and shareholding structures of the IFIs, which we believe are of central importance but are covered by other ongoing reviews in the G20 and the IFIs.

Importantly, we were guided by the request that our proposals could be acted upon by the G20 and the IFIs in coordination with the other bodies integral to the international monetary and financial system. In this regard, besides drawing on our Group's collective experience in policy-making, our discussions benefited greatly from consultations with a broad range of national authorities, the IFIs, many other thought leaders from civil society, think tanks, academia and philanthropies, and private sector experts. These diverse interactions helped us arrive at proposals which we believe can be implemented within a reasonable time-frame, but which taken together should have a transformational impact.

The ambition is in the doing.

Some of the reforms should be early wins in international coordination. Most are achievable within a few years, with focused effort. Some others go beyond current thinking. We urge that they be considered with an open mind, and developed further or adapted if necessary to enable their implementation.

We have deliberated intensively as a Group, supported by our very able Secretariat under the leadership of Siddharth Tiwari. We thank the G20 for the opportunity to review these important issues. We present our report with sober awareness of the challenges facing the international community, but also with hope for the collective resolve needed to take us into this new era of cooperative internationalism, with benefits for all. ◆

This introduction is adapted from the report: Making the Global Financial System Work for All, published by the G20 Eminent Persons Group on Global Financial Governance. Published with permission.

The EPG: Overview proposals

Proposal 1:
Re-focus on governance capacity and human capital, as foundations for a stronger investment climate.

Proposal 2:
Build effective country platforms to mobilize all development partners to unlock investments, and maximize their contributions as a group, including by convergence around core standards.

Proposal 3:
Implement regional platforms to facilitate transformational cross-border investments and connectivity.

Proposal 4:
Reduce and diversify risk on a system-wide basis to mobilize significantly greater private investment, including portfolio-based infrastructure financing.

Proposal 4a:
Shift the basic business model of the MDBs from direct lending towards risk mitigation aimed at mobilizing private capital.

Proposal 4b:
Develop system-wide political risk insurance and expand use of private reinsurance markets. Proposal

Proposal 4c:
Build a developing country infrastructure asset class with the scale and diversification needed to draw in institutional investors.

Proposal 5:
Right-size' capital requirements for MDBs and other investors in infrastructure, given their default experience.

Proposal 5a:
Establish tailor-made capital and liquidity frameworks for the MDBs.

Proposal 5b:
Review the regulatory treatment of infrastructure investment by institutional investors.

Proposal 6:
Strengthen joint capacity to tackle he challenges of the global commons.

Proposal 6a:
Integrate activities in support of the global commons into the IFIs' core programs, and coordinate them within country platforms.

Proposal 6b:
Create global platforms with the UN guardian agency and the World Bank coordinating and leveraging on the key players in each of the commons.

Proposal 7:
Integrate trust fund activities into MDBs' core operations to avoid fragmentation.

Proposal 8:
Plug shortfalls in data and research that hamper effective policymaking, especially in developing countries.

Proposal 9:
Leverage more systematically on the ideas and operating networks of business alliances, NGOs and philanthropies.

Proposal 10:
The IFI community should strengthen and accelerate efforts to help countries develop deep, resilient and inclusive domestic financial markets.

Proposal 11:
TheIMF's framework of policy guidance should enable countries to move toward the long-run goal of openness to capital flows and to better manage the risks to financial stability.

Proposal 11a:
Develop evidencebased policy options to enable countries to benefit from capital flows while maintaining financial stability, and to provide assurance to the markets that measures taken are appropriate.

Proposal 11b:
Develop an understanding of policy options that enable sending countries to meet domestic objectives while avoiding large adverse international spillovers.

Proposal 12:
Integrate the surveillance efforts of the IMF, FSB and BIS in a coherent global risk map, while preserving the independence of each of the three institutions' perspectives

Proposal 12a:
Incorporate non-official and contrarian views systematically for more robust risk surveillance.

Proposal 13:
Build on the IMF-FSB Early Warning Exercise (EWE) to ensure policy follow-up from the global risk map.

Proposal 14:
Stitch together the various layers of the GFSN to achieve scale and predictability.

Proposal 15:
Establish a standing IMF liquidity facility to give countries timely access to temporary support during global liquidity shocks.

Proposal 15a:
Use a country's qualification for the IMF's liquidity facility in considering the activation of RFA support.

Proposal 16:
Enable the IMF to rapidly mobilize additional resources in large and severe global crises.

Proposal 17:
The G20 should refocus on a multi-year, strategic agenda, rationalize workstreams, and devolve more work to the IFIs.

Proposal 18:
A G20-led group, with representation from key non-G20 constituencies and the IFIs, should steer the reorientation of development finance over the next three years before handing the coordinating role to the IFI Heads. This should include building complementarity among all development partners, and a clear system of metrics to track impact and value for money

Proposal 19:
A biennial strategic forum convened by the IMFC and DC should identify development risks before they manifest, and the required collective responses.

Proposal 20:
The Executive Board of each IFI should focus on strategic priorities for the institution and advancing systemwide goals.

Proposal 21:
Adopt a practical, risk-based approach to delegate greater responsibility to IFI Management, and hold them accountable for outcomes.

Proposal 22:
Ensure diversity and better match the skills available to IFI Boards and Management to the shift in the business models and increased complexity of challenges.

To read more about each proposal please visit:
www.globalfinancialgovernance.org

Sustainable Infrastructure and the Private Sector

Lord Nicholas Stern, CH, Kt, FBA, FRS

IG Patel Professor of Economics and Government at the London School of Economics and Chair of the Grantham Research Institute on Climate Change and the Environment

The world economy will roughly double in size in the next 20 years and the world's infrastructure likely more than double in that period with, in both cases the strongest growth being in emerging markets and developing countries. At the same time, to meet the targets of the Paris agreements (COP21) on climate emissions of greenhouse gases will have to fall in those two decades by 40% or more. This means radical change in the way we invest and produce, particularly in infrastructure which is associated with around 70% of emissions. This is also the period when the world must drive towards the achievement of the Sustainable Development Goals set for 2030, most of which are dependent on the sustainability of, and access to infrastructure. It was crystal clear therefore that the infrastructure we build in the next two decades is decisive for the future of the planet and its peoples. If there is any delay in making our infrastructure sustainable we will be setting on a path towards a temperature increase of 3 degrees centigrade or more, which we have not seen on the planet for around 3 million years. This will likely transform lives and livelihoods, likely leading to many hundreds of millions of people having to move with great risk of severe and extended conflict. The climate is just one of the challenges of the global commons, but it is the most important because of the urgency and scale of necessary action and because it has a profound effect on the others including biodiversity, oceans and epidemics.

Fortunately, there is a different and much more attractive path of

sustainable and inclusive development available to us. Further, the world is awash with savings and there are tremendous opportunities in new and sustainable investment. The challenge is to set in place the policies that can pull through those opportunities into real projects and programmes, and to generate the right kind of finance in the right place, at the right time. This is where the multilateral banks working with the private sector are so important. And it is where the recommendations of the EPG are so relevant.

First, the MDB can help create the governance, policies and human capital which together provide the investment climate, particularly for infrastructure, which can translate investment opportunities into reality. Improving the MDBs ability to do exactly this was a key recommendation of the EPG. Second, those investments are much more likely to materialise if there is in place what we call in the EPG a strong country platform. This means a clear plan, with priorities, for investment in the country, with infrastructure at centre stage. This makes it much easier for all investors to see the opportunities, how they are related and how they support each other, and to further help investors to see where their particular strengths could be most effectively applied. Both in helping the country shape its country platform and investing in it, the MDBs can work much more effectively as a group than they have in the past. Indeed, working more effectively as a group was a key recommendation of the EPG.

A strong investment climate and a clear country platform reduces risk, lowers the cost of capital and enhances investment for both private sector and other actors. There is much more the MDBs can do on the finance side to bring the right kind of finance at the right scale at the right time. The presence of the MDBs itself reduces risk because government interference becomes less likely if the MDB is a part of the story. The MDB can be a trusted convenor and put financing coalitions and syndicates together to share risk. The MDB, through its ability to take equity and offer guarantees can help take projects through the early and particularly risky stages. And the MDB can develop particular skills, for example as the EBRD has in energy efficiency, which sharpens the effectiveness of projects. The MDBs have enormous potential not only for bringing projects through but also for financing them in a way that enables the private sector to play a strong role.

The challenge is to set in place the policies that can pull through those opportunities into real projects and programmes, and to generate the right kind of finance in the right place, at the right time. This is where the multilateral banks working with the private sector are so important. And it is where the recommendations of the EPG are so relevant.

The scale of investment in the coming years—particularly in infrastructure—would be far more than public finances could manage, as was argued, for example, at the UN conference on financing for development in Addis Ababa in July 2015.

It is crucial that public finance, private finance, ODA and international flows come together. An MDB system working more closely as a group to enhance the investment climate, develop country platforms, and manage and reduce risk could play a central role. In so doing, it could greatly enhance its private sector multipliers; the recommendation to increase these multipliers, and methods to do so were at the heart of the EPG report.

For all these reasons, the implementation of the recommendations of the EPG report would be of immense value both to the sustainable development of the world as a whole, and to the private sector taking an expanded and central role. ◆

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Lord Nicholas Stern is IG Patel Professor of Economics and Government at the London School of Economics and Chair of the Grantham Research Institute on Climate Change and the Environment. He is a member of the G20 Eminent Persons Group on Financial Systems and is President of the Royal Economic Society (2018-2019). He was President of the British Academy (July 2013 – July 2017) and elected Fellow of the Royal Society (2014). He was Chief Economist at both the World Bank, 2000-2003, and the European Bank for Reconstruction and Development (1994-1999) and was Head of the UK Government Economic Service (2003-2007). He produced the landmark Stern Review (2006) on the economics of climate change. His most recent books are "Why are We Waiting? The Logic, Urgency and Promise of Tackling Climate Change" MIT Press, 2015.) and "How Lives Change: Palanpur, India and Development Economics" (with Himanshu and Peter Lanjouw), published in August 2018 (OUP).

He was knighted in 2004, made a cross-bench life peer in 2007 and appointed Companion of Honour in 2017 for services to economics, international relations and tackling climate change.

Investing in Human Capital: The Role of the Global Financial System

Nora Lustig

Samuel Z. Stone Professor of Latin American Economics, Director of the Commitment to Equity Institute at Tulane University and a nonresident fellow of the Brookings Institution, Center for Global Development and the Inter-American Dialogue

Human capital is a key determinant of economic and social progress. The salient importance of human capital was prominently acknowledged in Proposal 1 of Making the global financial system work for all, the report by the G20 Eminent Persons Group on Global Financial Governance, released during the IMF and World Bank Annual meetings in 2018. More precisely, the report calls for refocusing on human capital as a foundation for a stronger investment climate, building more inclusive societies, and reaching the Sustainable Development Goals (SDGs).

Investing in broad-based human capital distinctly creates a three-way win-win. Human capital is key for economic growth. Human capital investments are also key for building equitable societies. And human capital is not only "capital"—that is, an input for production—but higher levels of human capital immediately translate into superior quality of life. Better health and nutrition, achieving literacy and numeracy, and access to modern sanitation services not only make people more productive but vastly improve their living conditions and well-being. Human capital improvements translate into longer, healthier, and more fruitful lives.

Is the global financial system ready to support human capital investments of the type and in the scale that the world needs? For now, it is not. The required type and scale of human capital investments will only happen if financial resources, data, knowledge, coordination, leveraging, surveillance capacity, and governance in the IFIs are revamped and realigned. The EPG report recommends actions and reforms conducive for the needed revamping and realignment of the IMF and the multilateral development banks.

Human capital improvements translate into longer, healthier, and more fruitful lives.

The international financial institutions (IFIs) are indeed in a unique position to help governments achieve the human capital/human development goals embedded in the SDGs. IFIs could provide adequate support with:

- **Better inter-institutional coordination:** Proposals 2 and 3 focus on building country and regional collaboration platforms to facilitate joint and mutually re-enforcing efforts, while Proposal 7 proposes integrating trust fund activities into core operations to avoid fragmentation.
- **Better data and cutting-edge knowledge:** Proposal 8 focuses on the importance of IFI's continuing to invest in data and policy-relevant research.
- **Innovation and capillarity at the grassroots level:** Proposal 9 focuses on the importance of leveraging more on the ideas and operating networks of business alliances, NGOs, and philanthropies.

The IFIs are also uniquely positioned in helping governments estimate how much reaching the human development goals would cost and find the mechanisms to finance these investments. In particular, the IFIs can help governments ensure tax collection is efficient and progressive and target resources where they are most needed, reduce waste and corruption in public spending, and adopt best practices in the deployment of education, health, and sanitation services.

The IFIs can also provide realistic assessments of how much of the financing of investments in human capital can actually rely on improvements in domestic resource mobilization. The IMF estimates that, on average, low-income developing countries will need additional annual outlays of 14 percentage points of GDP on average in the areas of education, health, water and sanitation, roads, and electricity to achieve the SDGs. Across 49 low-income developing countries, about $520 billion a year in additional spending is needed.

However, where will the additional needed resources come from? Boosting domestic tax revenue is an obvious option, especially for emerging economies but it will not be sufficient to meet the financing needs of most low-income developing countries. In fact, too much emphasis on domestic resource mobilization—especially in the poorer countries—could backfire: if, for instance, consumption taxes are raised, the poor may be left worse off. Moreover, borrowing may not be an option for many of these low-income countries because they are at risk or are already experiencing debt distress. Foreign assistance will have to continue playing its part, but this too will not suffice. Recognizing these limitations, the EPG report makes a central recommendation: Proposal 4, to shift the basic business model of Multilateral Development Banks from direct lending towards risk mitigation (including political risk insurance schemes) to mobilize significantly greater private equity investment.

As important as finding ways to invest more and more efficiently in human capital is, it is also crucial to prevent human capital from falling. We often forget that one of the greatest costs of financial crises, natural disasters, and pandemics is the destruction of human capital, which often can never be rebuilt. Malnutrition at an early stage in life cannot be reversed by consuming more food at an older age. Adult literacy programs cannot replace not attending school or not completing primary school.

Hence Proposal 6, which focuses on the importance of strengthening the joint capacity of the IFIs to tackle

Malnutrition at an early stage in life cannot bereversed by consuming more food at an older age.

challenges of the global commons. Challenges include preventing and coping with environmental threats related to climate change, degradation of ecosystems, water scarcity, systemic health risks from pandemics, and the rapid spread of antimicrobial resistance. Crucially, the EPG report devotes an entire section (Section II) to recommendations that should prevent financial crises from happening in the first place and help countries manage crises at the minimum cost to their economies and people. In particular, it calls for: strengthening the risk surveillance and policy follow-up capacity of IMF and other central actors (Proposals 12 and 13), ensuring an adequately-resourced and reliable global financial safety net at the earliest (Proposal 14), establishing a standing IMF liquidity facility to give countries timely access to temporary support (Proposal 15), and enabling the IMF to quickly mobilize additional resources in the face of severe global crises (Proposal 16). ◆

Nora Lustig is Samuel Z. Stone Professor of Latin American Economics and Director of the Commitment to Equity Institute (CEQ) at Tulane University. She is also a Nonresident Senior Fellow at the Brookings Institution, the Center for Global Development and the Inter-American Dialogue. Professor Lustig's research is on economic development, inequality and social policies with emphasis on Latin America. Her most recent publication Commitment to Equity Handbook: Estimating the Impact of Fiscal Policy on Inequality and Poverty, (Brookings 2018) is a step-by-step guide to assessing the impact of taxation and social spending on inequality and poverty in developing countries. Prof. Lustig is a founding member and President Emeritus of the Latin American and Caribbean Economic Association (LACEA) and was a co-director of the World Bank's World Development Report 2000, Attacking Poverty. She serves on the editorial board of the Journal of Economic Inequality and is a member of the Society for the Study of Economic Inequality's Executive Council. Prof. Lustig served on the Atkinson Commission on Poverty, the High-level Group on Measuring Economic Performance and Social Progress, and the G20 Eminent Persons Group on Global Financial Governance. She received her doctorate in Economics from the University of California, Berkeley.

Taming Capital Flow Volatility

Andrés Velasco

Dean of the School of Public Policy at the London School of Economics and Political Science.

"Today it is a sin to run a current-account deficit, and that is crazy," lamented Singapore Deputy Prime Minister Tharman Shanmugaratman at the annual gathering of the International Monetary Fund and the World Bank in Bali in October 2018. Ministers who boasted of their balanced current accounts, while officials from deficit countries were treated like reprobates. Yet, as Tharman reminded the crowd, countries like South Korea and Singapore "grew by running current-account deficits at early stages of development, so we could invest ahead for growth while our savings were being built up."

Economic theory is squarely on his side. A family need not wait until it has savings equal to the value of a house before buying one. Instead, it makes sense to borrow while the parents are young and their income is still relatively low, and to repay once they are better off. The same logic applies to a developing country, which in order to escape poverty should run a deficit and borrow while still poor.

In a poor country, capital – factories, infrastructure, or schools – is scarce, so the rate of return on new investment is high. It is precisely the gap between the profitability of its investment and the interest rate it pays on loans that allows a poor country to prosper. That was the strategy that allowed Singapore, South Korea, and other successful economies to grow rich.

And yet deficit countries are treated like sinners, because running a deficit makes a country dependent on notoriously fickle foreign capital. Borrowing from abroad can boost a country's growth, but also leave it vulnerable to crises.

All is well as long as foreign lenders keep lending and the country keeps investing.

All is well as long as foreign lenders keep lending and the country keeps investing. But if lenders get cold feet, the resulting "sudden stop" in capital flows requires the country to cut back on key imports overnight, triggering a recession.

Frightened lenders may then not only refuse to extend now loans, but also demand repayment of old ones. Local firms and banks then have to liquidate investments, but if there are many sellers and few buyers, asset prices can only go south, triggering bankruptcies and a full-fledged financial crisis. The pessimistic expectations of lenders are then vindicated.

That is exactly what happened to countless emerging economies over the last quarter-century. It is also what happened to Argentina in 2018: after a sudden stop in capital flows, the local currency lost half of its value and the economy lurched into recession (mercifully, a full financial crisis did not follow). No wonder current-account deficits are viewed as sinful.

Understanding such risks, emerging countries often do one of two things. They run monetary and fiscal policies that are so tight that current-account deficits are impossible, or they hold large stocks of international reserves. The first strategy is equivalent to having a family forego all loans when buying its own home. The second strategy amounts to borrowing only as much as one has already saved. Neither makes much sense from the perspective of efficiency.

Re-enter Tharman, who chaired a group appointed by G20 governments to propose international financial reforms (I was also a member). In a report submitted to the finance ministers and central bank governors gathered in Bali, the group argues that it should possible for countries to benefit from international capital flows without risking excessive market volatility and crises. But that requires deep changes in the local and global policy frameworks.

The report begins by recognizing that emerging economies should deepen their domestic financial markets. Some financing for investment must come from local sources, just as the down payment on a home must come from a prudent family's saving. Local loans also tend to be in domestic currency, so borrowers are shielded from exchange-rate risk.

The report also proposes an enhanced global surveillance mechanism. The fact that some financial crises are triggered by self-fulfilling pessimism should not obscure the reality that others are caused by inadequate policies. If those mistakes are identified and corrected before it is too late, the world has a better chance of avoiding the next round of meltdowns. And because financial crises have large and costly spillovers, better surveillance means that innocent bystanders will also be safer.

Most crucially, the report calls for an enhanced global financial safety net to ensure that countries are well protected against excessive capital-flow volatility and self-fulfilling financial market panics.

The global financial safety net has grown since the financial crisis of a decade ago. In 2006, the report shows, 90% of available resources came from the IMF. By 2016, the Fund accounted for only one-third of those resources, with regional financial arrangements and bilateral swap agreements accounting for the rest.

But regional arrangements are not found everywhere, while only a limited number of central banks has access to swap agreements. Moreover, these new financing mechanisms "have not been crisis-tested," according to the report, they "are subject to conditions in providing countries," and "do not cover several systemically significant" economies. Last but not least, "the system as a whole lacks the necessary coordination."

To ensure that countries have timely access to temporary support during

liquidity crunches, the various layers of global financial safety net need to be stitched together, and a new IMF standing liquidity facility should be at the core of the enhanced global safety net. And to guarantee that the facility is large enough to deal with global liquidity events such as that of 2008-2009, the IMF will need access to more resources, whether via market borrowing by the Fund or other means.

Skeptics will point out that previous attempts at building standing liquidity facilities at the IMF have failed, because accessing them was either too cumbersome or stigmatizing. But that is no argument for failing to try again – especially in view of the mounting evidence that liquidity crunches can easily morph into solvency problems that quickly spill over national and regional boundaries. The resulting losses of employment and output cause much human suffering that could be avoided if only we had the right policies in place.

To deal with standard moral hazard objections, the new facility would require that countries pre-qualify by demonstrating sound domestic policies. And pre-qualification for IMF support would also imply access to the relevant regional financial arrangement, if any, thus helping integrate the overall system.

At the Bali meeting last October, the World Bank unveiled its new Human Capital Index. Singapore and South Korea were at the very top. While emerging economies should aim to emulate these two countries' educational and health achievements, they should also try to emulate the way Singapore and South Korea paid for all those schools and hospitals: by borrowing abroad and running external deficits whenever necessary. But that will be impossible without bold new global policies that tame harmful capital-flow volatility. The report shows how; now we need the political will to make change possible. ◆

Andrés Velasco is the Dean of the School of Public Policy at the London School of Economics and Political Science.

In 2017-18 he was a member of the G20 Eminent Persons Group. During 2015-16 he co-chaired the Global Panel on the Future of the Multilateral Lending Institutions. In 2013-16 he was a member of the Global Oceans Commission.

Mr. Velasco was a presidential candidate in Chile in 2013. He also was the Minister of Finance of Chile between March 2006 and March 2010. During his tenure he was recognized as Latin American Finance Minister of the Year by several international publications. His work to save Chile´s copper windfall and create a rainy-day fund was highlighted in the Financial Times, the Economist, the Wall Street Journal and Bloomberg, among many others.

How the G20 and International Financial Institutions Can Work Together to Achieve the SDGs

Fabrizio Saccomani

Chairman of the Board of Directors of UniCredit

As the global economy is still in the midst of unprecedented policy uncertainty with increasing risks of a widespread slowdown of trade and economic activity, the G20 is going to examine in the coming months the proposals of the G20 Eminent Persons Group (EPG) on Global Financial Governance. The EPG Report was broadly endorsed by G20 Leaders at their Summit in Buenos Aires last December and its implementation is currently being considered by the relevant technical instances under the aegis of the G20 Japanese Presidency.

The EPG proposals are considered valuable, although most of them are deemed to require a multi-year time commitment. It is understood that the Japanese Presidency will identify a limited number of proposals for early discussion and possible approval by Leaders at the Summit in Osaka at the end of June 2019. The EPG made 22 proposals covering three separate chapters of the Report: Development (9 proposals); Finance (7 proposals); Governance (6 proposals). Of these 7 are expected to be considered: 4 in the Development agenda and 3 in the field of Governance; regrettably, none of the Finance proposals have been selected.

While this outcome reflects current political disagreements among G20 countries on the functions and institutions of multilateralism, it is important that development issues are put at the center of the Leaders' debates as soon as possible. Indeed, the main conclusion of the EPG report is that: "The magnitude of the development challenge will require greater resources than before, from

As proposed by the EPG, a prerequisite for such gigantic mobilisation of finance is the build-up of effective country and regional platforms to identify investment priorities and to coordinate the activity of all development partners. Primary responsibility for the design and operation of such platforms would fall on Multilateral Development Banks (MDB), namely the World Bank and regional development banks.

every source - domestic savings and public revenues, and external financing from private, official and philanthropic sources. Even by conservative projections, the gap in infrastructure financing alone is well over USD $1 trillion annually. This gap in financing must be closed to ensure the quality and scale of investments in economic and social infrastructure that will be critical in the next decade."

As proposed by the EPG, a prerequisite for such gigantic mobilisation of finance is the build-up of effective country and regional platforms to identify investment priorities and to coordinate the activity of all development partners. Primary responsibility for the design and operation of such platforms would fall on Multilateral Development Banks (MDB), namely the World Bank and regional development banks. This proposal has been endorsed by the Japanese Presidency and seems to have garnered a broad consensus among G20 members.

However, official resources, both national and multilateral, are likely to fall significantly short of the targeted amounts. It is therefore crucial to adopt a comprehensive strategy to involve private investors in the process. This will not be realistically possible unless a new approch is introduced to maximize the potential of capital markets and institutional investors. The EPG recommended a fundamental shift in the basic business model of MDBs from direct lending towards risk mitigation aimed at mobilizing private capital. This goal could be achieved in several ways, which are analyzed in detail in the EPG report. For example, MDBs could offer credit enhancements to private investors by taking a first-loss piece in a synthetic securitization structure, allowing them to take a standardized senior debt exposure at a price that would reflect the lower risk. Moreover, MDBs could adopt the model of the Multilateral Investment Guarantee Agency (MIGA) of the World Bank to develop a system-wide political risk insurance, standardizing contracts and processes and expanding the use of private reinsurance markets. Another option would be to build a developing country infrastructure asset class by pooling investments from the MDB system into securitized assets with the scale and diversification required to attract private capital.

The G20 has so far only taken note of these innovative proposals, limiting itself to endorse the suggestion of building on the MIGA risk insurance capabilities. This prudent approach may be understandable, but the G20 could also recommend that the preliminary work conducted by the EPG be completed by involving a more systematic way representatives of private banks, insurance companies, capital market intermediaries and institutional investors, as well as companies specialized in project design and execution. This broad consultation among the official and private sectors would give a fundamental contribution to the identification of the appropriate financial instruments and procedures to be submitted for approval by the G20 and the MDBs. The early activation of such consultation process would give a positive signal to global markets and public opinion that the G20 is indeed determined to promote a massive program of infrastructural investment, thus reducing policy uncertainty and downside risks or the global economy. ◆

Fabrizio Saccomanni has been appointed Chairman of the Board of Directors of UniCredit in April 2018 for a period of three years. He has been a member of the Board since November 2017.

He is Deputy Chairman of the Italian Banking Association and member of the Board of Directors of the Institute of International Finance in Washington. Since December 2018 he is President of the Orchestra Filarmonica della Scala Association in Milan. Currently he is also Vice President of Istituto Affari Internazionali and Senior Fellow of the School of European Political Economy at LUISS Guido Carli University of Rome.

He has been a member of the G20 Eminent Person Group on Global Financial Governance (2017-2018) and a Visiting Professor at the Paris School of International Affairs at SciencesPo (2016-2017) and at the London School of Economics (2015).

He has been Minister of Economy and Finance in the Italian Government from April 2013 to February 2014.

He was Director General and member of the Governing Council of the Bank of Italy from 2006 to 2013. In this capacity, he held positions at the European Central Bank and at the Bank of International Settlements.

Report of the G20 EPG on Global Financial Governance
What Europe Should Do with it

Marek Belka

Former PM and Finance Minister of Poland,
Head of European Dept, IMF

2019 is another important year for Europe. The United Kingdom will most probably leave the EU and and we will all have to redefine our mutual relations within the continent and in the global community. In May 2019, election to the European Parliament will take place. Its future composition, but also the turnout at the polls in all 27 EU members may be decisive for the future of integration. Some time later, a new Commission will be formed, reflecting the ever-changing political landscape. This is a time for disscussing priorities and challenges facing Europe, even if realistically the "tyrany of status quo" will inevitably put a big pressure on us.

Four major factors shaped the fortunes and misfortunes of Europe in the last decades.

First, the creation of Euro - the common European currency, made the integration seem inevitable and irreversible, helped European firms to grow to a global significance but also made the economy of the continent more vulnerable to external shocks. This latter problem is generally attributed to the fact that the common currency lacks sufficiently solid institutional underpinnings.

Second, globalisation benefited people of the whole world, albeit not to the same extent, and even hurt some, including in the most advanced societies. It helped pull billions out of extreme poverty (particularly in Asia, and in Latin America), but having changed relative prices of production factors depressed the incomes of commodity importers and undermined the economic security of middle-class people in many advanced countries. We can see it in less dynamic and less agile European societies.

What the report recommends is a cooperative approach: with the host-country authorities, with private investors, among public and private donors, among IFI's, etc.

Third, the Global Financial Crisis of 2008 originated in the American financial sector, hit Europe most, and exposed its vulnerability and insufficient resilience. The crisis exacerbated the existing weaknesses in European economies and gave rise to populism.

Fourth, immigration into Europe has proceeded for decades, caused by colonial past of some European countries, poverty and war in the so-called Third World and relatively liberal approach to the immigrants in most of the continent. Drammatic change occured in the recent years. The belief in multicultural and multireligious societes was replaced by apprehension and growing animosity. This created a propitious environment for inward-looking and openly xenofobic political parties.

Europe faces many challenges and must tackle them in an open and pragmatic way, not giving up on her values. Most of these challenges can be effectively tackled in a context broader than intra-European.

Here enters the report, that was mandated by G20 under the G20 Presidency of Germany. The key issues covered by the report are how to achieve greater development impact, securing the benefits of interconnected financial markets and making the G20 itself and the IFI's work as a system. The report is predominantly a call in defence of global cooperation, a call on the G20 to take initiative to make the world better and its institutions to respond to the needs of the present time in a proper way. The authors of the report explicitely invite the G20 to refocus its activities on strategic issues, suggesting that "within three years it should steer the reorientation of development finance before handing the coordination role to the IFI Heads".

The implicit and, yes, explicit focus of the report is Africa. "To bend the arc of history, we must succeed in Africa". This is the region where progress in eliminating poverty is least obvious, where economy depends too much on the vagaries of commodity markets, where natural environment is most fragile, war is too frequent, and where climate change will have a punishing impact on the livelihoods of the people. Most importantly, Africa is still on the steepest part of the S-shaped curve of demographic development.

Suffice to say, in the coming decades there will be almost the same number of new labor market entrants as in the whole of Asia. Africa is a close neighbour of Europe and the main source of immigration. So, the succes in mitigating Africa's problems is of existential importance to Europe.

What the report recommends is a cooperative approach: with the host-country authorities, with private investors, among public and private donors, among IFI's, etc. Country and regional cooperation platforms should minimize duplication and waste, prevent corruption, and maximize development impact. What is thus needed is a culture of disscussion and compromise. Something that we in the EU are engaged in daily. Europeans practice it in the process of structural funds absorption, where national interests are reconciled with community considerations and more general rules. The IMF-EC-ECB troikas had to learn how to work jointly on country programs in the aftermath of 2008. The Vienna Initiative experience shows that Europeans are able to work within a very complex set of private and public institutions avoiding a temptation to dominate, instead looking for consensual solutions. So the know-how is there. European diversity is a clear strength.

What about instruments? There are plenty of them in Europe. Two DG's deal with it (International Cooperation and Development, Humanitarian Aid and Crisis Management), more than 10 billion Euro are spent by the Commission itself. EBRD and EIB with the European Development Fund provide a strong institutional infrastructure. If we add national development agencies, we may even conclude that Europeans have too many instruments and intra-European coordination may be a problem in itself.

The G20 EPG report focuses on issues that are of vital interest to Europe, it recommends a cooperative approach that conforms with our values and culture of operation. Finally, the report underlines the necessity for the IFI's and all public and private stakeholders to work as a system. Do not allow the report to be shelved! Use the G20 as a platform to showcase European leadership for sustainable development. ◆

Marek Belka is a politician and Professor of economics, a former Prime Minister and Finance Minister of Poland, former Director of the International Monetary Fund's (IMF) European Department and former Head of Narodowy Bank Polski (National Bank of Poland). From 1990 until 1996 Belka worked as consultant for the Ministry of Finance of the Republic of Poland and the World Bank. He served as Deputy Prime Minister and Minister of Finance in 1997 and from 2001 to 2002; and as an economic consultant of the President of the Republic of Poland in the meantime. He also served as Adviser to the three successive Prime Ministers of Albania from 1997 to 2001. Later, Belka worked as an advisor to JP Morgan for Central and Eastern Europe from 2002 to 2003. In 2003 he was responsible for economic policy in the interim Coalition Provisional Authority of Iraq.

Business Should Care About Public FInance for Development

Amar Bhattacharya
Senior fellow at the Global Economy and Development Program at Brookings Institution

Homi Kharas
Interim Vice President and Director of the Global Economy and Development Program

The G20 Finance Ministers requested an Eminent Persons Group (EPG) to make recommendations on global financial governance. The report of this group, delivered in October 2018, argues that "we need substantially greater impact in helping countries achieve sustainable development and inclusive growth, and in managing the growing pressures in the global commons. The current pace of change will not get us there."

The EPG report outlines reforms to position multilateral institutions at the center of a "cooperative international order suited to the 21st century." Only in a global context that is decentralized, yet resilient, can national policies align with international initiatives. Individual countries need such a system to achieve the universally-agreed set of UN Sustainable Development Goals (SDGs) by 2030. The world needs such a system if it is not to be overwhelmed by the challenges it confronts—climate change, low productivity growth and wage growth and sustainable infrastructure accessible to all.

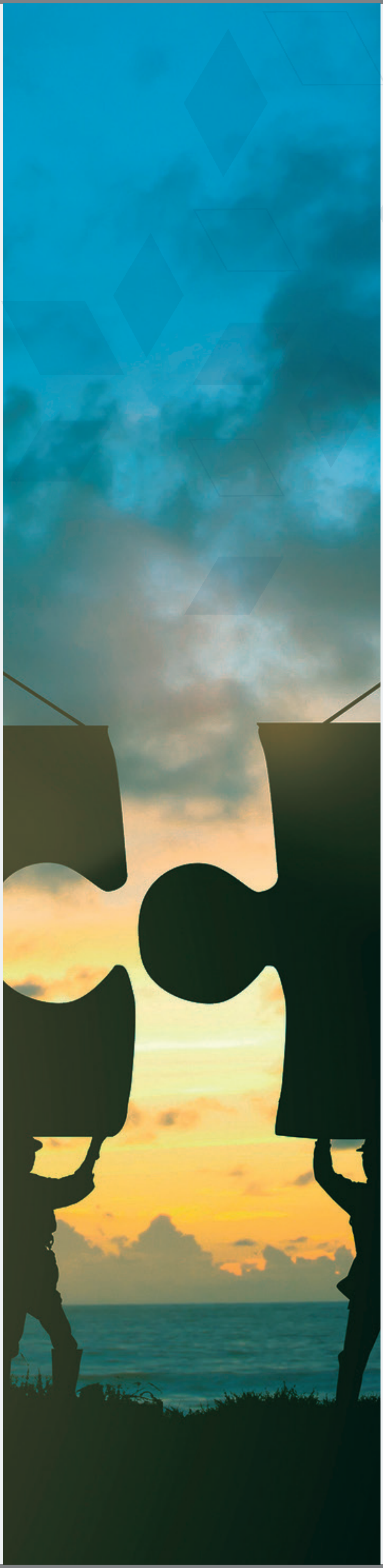
The thrust of the report's recommendations are that a much larger scale of private investment will be needed if we are to meet the sustainable development goals and tackle the pressing global challenges confronting the world in the coming two decades, including climate change. Multilateral institutions have a unique set of strengths to help unlock investment opportunities and mitigate risks to the private sector. They can assist countries to put in place better policies, regulations, governance, logistics and human capital. They can help countries prepare sustainable, bankable projects, especially where

some government finance is required. They can construct country platforms to bring investments to scale. They can catalyze and mobilize finance using their own resources, and by deploying new financial instruments, like first-loss guarantees and co-investment vehicles to crowd-in the private sector.

The EPG report calls on international institutions to "embark on system-wide insurance and diversification of risk, to create a large-scale [infrastructure] asset class and mobilize significantly greater private sector participation." The scope for unlocking investments through system-wide cooperation applies across all sectors. The returns could be considerable; one study estimates that achieving the SDGs would unlock $12 trillion in new opportunities in just four economic systems—food and agriculture, cities, energy and materials, and health and well-being.

Japanese leaders have understood these opportunities. Prime Minister Abe has outlined Japan's priorities for the G20. They include: infrastructure for development; global health; climate change; and advancement of the SDGs. The recommendations in the EPG report will promote these same priorities by creating an environment where business itself can find opportunities that are profitable and that generate desirable social and environmental outcomes.

The business community should care deeply about the construction of a cooperative international order that fosters a more efficient global allocation of public and private capital. But an open, interconnected world requires a modernization of international financial institutions and a strengthening of global financial systems. The EPG report provides a roadmap that would allow every country to become more prosperous by embracing smart growth, and for a new multilateralism that can deliver win-win outcomes in a multipolar and more complex world with shared opportunities and unprecedented challenges. ◆



The returns could be considerable; one study estimates that achieving the SDGs would unlock $12 trillion in new opportunities in just four economic systems—food and agriculture, cities, energy and materials, and health and well-being.

Amar Bhattacharya is senior fellow at the Global Economy and Development Program at Brookings Institution. His focus areas are the global economy, development finance, global governance, and the links between climate and development.

From April 2007 until September 2014 he was Director of the Group of 24, an intergovernmental group of developing country Finance Ministers and Central Bank Governors. In that capacity he led the work program of the Group, supported the deliberations of the Ministers, and was the principal point of interface with other organizations including the G20. He has therefore been an active participant in the global economic discussions and a key representative of the views of developing countries.

Prior to taking up his position with the G24, Mr. Bhattacharya had a long-standing career in the World Bank. His last position was as Senior Advisor and Head of the International Policy and Partnership Group. In this capacity, he was the focal point for the Bank's engagement with key international groupings and institutions such as the G7/G8, G20, IMF, OECD and the Commonwealth Secretariat.

The EPG report outlines reforms to position multilateral institutions at the center of a "cooperative international order suited to the 21st century." Only in a global context that is decentralized, yet resilient, can national policies align with international initiatives.

Homi Kharas is the Interim Vice President and Director of the Global Economy and Development program. In that capacity, he studies policies and trends influencing developing countries, including aid to poor countries, the emergence of the middle class, and global governance and the G-20.

He has served as the lead author and executive secretary of the secretariat supporting the High Level Panel, co-chaired by President Sirleaf, President Yudhoyono and Prime Minister Cameron, advising the U.N. Secretary General on the post-2015 development agenda (2012-2013). The report, "A New Global Partnership: Eradicate Poverty and Transform Economies through Sustainable Development" was presented on May 30, 2013.

His most recent co-authored/edited books are The Imperative of Development (The Wolfensohn Center at Brookings, 2017), The Last Mile in Ending Extreme Poverty (Brookings Press, 2015), Getting to Scale: How to Bring Development Solutions to Millions of Poor People (Brookings Press, 2013); After the Spring: Economic Transitions in the Arab World (Oxford University Press, 2012); and Catalyzing Development: A New Vision for Aid (Brookings Press, 2011). He has published articles, book chapters and opinion pieces on global development policy, global trends, the global food crisis, international organizations, the G20, the DAC and private philanthropy.

A Public-Private Partnership for Promoting Development

Masood Ahmed
President of the Center for Global Development

Mark Plant
Director of Development Finance and Senior Policy Fellow at the Centre for Global Development

As the B20 community convenes in Tokyo this March to consider how to build "Society 5.0", we strongly urge them to review and support the G20 commissioned report of the Eminent Persons Group (EPG) on global financial governance. The recommendations of the report are foundational to the types of changes the Keidanren envisages as we move beyond the information society. As the EPG underscores, it is time to transform the post-World War II global financial architecture to avoid the "risk of drift into a fragmented world, with policies in different parts of the world working at odds with rather than reinforcing each other, and with all nations ending up losing."

The EPG report makes 22 concrete proposals for change. None is revolutionary, all are practical. Alone each would make some small difference in the way we work together across the globe. But taken as a package, the proposals have the potential for fundamentally shifting the governance of the financial system, and moving capital flows to those parts of the world where there are the greatest opportunities for economic advancement and the highest risks of human catastrophe if the system is left unchanged.

So, what in the report is of interest to business? First, it provides a plan of action to mobilize the financing that will be needed to support development across the globe. The world has recognized that going from "billions to trillions" in development finance will require a concerted effort to mobilize private capital for development. However, bringing private investors together with viable project opportunities will

not be easy, specially in low income countries where the institutional structures and business environment can be more challenging even as the needs are greatest. The multilateral development banks (MDBs) can play a valuable role of intermediation in this regard: they know how to do business in developing countries; they have patient capital which can mitigate risks and leverage private capital; they can help make markets, where none existed before. But to play this catalytic role better, their business models and operations need to change, and they need to work better as a system. The first nine proposals the EPG makes are focused on how the MDBs can work better together and, with the private sector, create the business environment that brings about profitable (both privately and socially) net inward investment flows.

For such inward investment to developing countries to be sustained, global financial markets must be stable, open, and transparent, with risk being broadly shared across the world. In addition, financial markets in developing countries need to mature. And countries need to have confidence in regional and global safety nets to avoid an excessively prudent build up of reserves and other mechanisms of self insurance. Recommendations 10-16 of the EPG focus on what is needed to bring about better-structured financial markets that provide long-term patient capital needed by developing countries.

The final six recommendations of the EPG focus on the role of the G20 in governing the international financial institutions (IFIs, which are the MDBs plus the IMF). While much of it may seem like bureaucratic "shop talk," global businesses will prosper if there are consistent global rules of the game, which in turn requires global strategic direction. While regional and country markets will never disappear, the IFIs can only pull in the same direction if their shareholders set that direction.

The multilateral development banks (MDBs) can play a valuable role of intermediation in this regard: they know how to do business in developing countries; they have patient capital which can mitigate risks and leverage private capital; and they can help make markets, where none existed before.

What can business do to support implementation of the EPG's recommendations?

- Be clear with the IFIs and MDBs on the changes required to scale up private investment in developing countries. Many of the first nine proposals will require extended frank conversations to realize the synergies between the MDBs and business. Active participation by the business community will be essential.
- Lend a supportive voice to financial market and governance reforms and hold leaders accountable for enacting those reforms.
- Continue to engage in the B20 and other public forums that support multilateralism and eschew the isolationist trends that are increasingly prominent in the global political dialogue.

Moving beyond the information society will require us to think, act and cooperate in new ways. The EPG report gives a practical blueprint to start to do so. ◆

Masood Ahmed is president of the Center for Global Development. He joined the Center in January 2017, capping a 35-year career driving economic development policy initiatives relating to debt, aid effectiveness, trade, and global economic prospects at major international institutions including the IMF, World Bank, and DFID.

Ahmed joined CGD from the IMF, where he served for eight years as director, Middle East and Central Asia Department, earning praise from Managing Director Christine Lagarde as a "visionary leader." In that role, he oversaw the Fund's operations in 32 countries, and managed relationships with key national and regional policy makers and stakeholders. In previous years, he also served as the IMF's director of External Relations, and deputy director of the Policy Development and Review Department.

From 2003-2006, Ahmed served as director general, Policy and International at the UK government's Department for International Development (DFID). In that role, he was responsible for advising UK ministers on development issues and overseeing the UK's relationship with international development institutions such as the World Bank.

Mark Plant is director of development finance and a senior policy fellow at CGD. He is also an adjunct professor of economics at the University of Virginia. His appointment to CGD follows a long career at the International Monetary Fund (IMF), where he was most recently the director of Human Resources. Prior to that, Plant worked extensively with African countries, culminating in his appointment as deputy director of the IMF's African Department. He also held a range of senior positions in the Strategy, Policy and Review Department, where he had oversight of the IMF's policies towards low-income countries, including its work on the Multilateral Debt Relief Initiative (MDRI) and the Heavily Indebted Poor Countries (HIPC) Initiative. Before joining the IMF, Plant held senior positions in the US Department of Commerce and at the General Motors Corporation. He began his career teaching economics at the University of California, Los Angeles.

Sustainable Infrastructure and Development Requires Financial Innovation

Torben Möger Pedersen
CEO of Pension Denmark

Jens Lundsgaard
Board member of the European Bank for Reconstruction and Development (EBRD)

Preventing devastating climate change will require large scale investments in renewable energy, smarter cities, buildings, and many other assets. Part of these investments will be in advanced economies, but to effectively tackle climate change and achieve other Sustainable Development Goals, large capital flows between advanced, emerging and developing economies are needed.

As estimated by the Global Commission on the Economy and Climate, a total of USD $90 trillion investments in infrastructure is needed globally over the 2015-30 period – roughly doubling past investment levels and delivering more than the world's entire current infrastructure stock. This will hardly happen without financial innovation. Hence the G20 Eminent Persons Group on Global Financial Governance has, rightly, emphasized that significantly greater private investments could be mobilized, including by building a sustainable infrastructure asset class with sufficient scale and diversification to attract institutional investors.

We would like to share Denmark's experience on how to do so in practice.

Take the case of wind energy. Wind farms have financial properties that are well suited for placing considerable pension savings while offering a relatively stable cash-flow over the 25-30 years of service life. Building on the pioneering investments made more than ten years ago, we have therefore now seen pension funds not just in Denmark but all over Europe invest in wind farms.

The key enabler for this development has been an adequate distribution of risks between the producers of

turbines, energy companies and investors. With the right incentives in place, operational efficiency has improved dramatically. Over the past year, several auctions for off-shore windfarms in Germany have been won by zero-subsidy bids as companies consider they will be able to produce electricity from wind at costs that are at par or even below the market price of electricity based on nuclear, gas or coal-fired power plants.

The first investments were characterised by institutional investors taking limited risk exposure, essentially providing financing at a guaranteed return. But as experience accumulates, investors have become more comfortable with assessing the risks and other financial properties of sustainable infrastructure – like for properties, shares, corporate bonds and other assets. Moreover, new types of market participants have emerged, such as a EUR 7 billion fund dedicated to investment in the development, construction and operation of renewable energy assets like on- and off-shore wind farms (a "club" with more than 40 institutional investors, including the EIB, and managed by Copenhagen Infrastructure Partners).

All this can be replicated in emerging and developing economies – both for renewable energy and other assets related to sustainable development. A first condition is that the right regulatory environment must be put in place: to attract capital, foreign investors must be able to rely on well-defined ownership also for these types of assets. Moreover, regulations of utilities and energy markets must be transparent and stable to mitigate risks. International financial institutions would have an important role to play here since economic reforms and the rule of law are as important for sustainable development as for other investments.

As more experience is gained with sustainable infrastructure assets, the natural aspiration would be that such assets could be traded with more liquidity in financial markets. Ultimately, it is only by leveraging the inherent abilities of the financial sector and markets to assess, pool and diversify risk that the necessary investments can be achieved. Public support can be useful to overcome first-mover disadvantages and to underpin the establishment of standardised data that can reduce uncertainty and transaction costs in financial markets. As such, the challenge is similar to that of developing financial markets in general in transition economies around Europe, where the EBRD has deep experience.

In fact, Europe's financial history is a rich source of inspiration. During the 19th century, industrialisation entailed a strong private-sector build-up of infrastructure assets financed via the exchanges in notably London and Paris. By the 1840's railways accounted for more than a quarter of private investment in England, and in the 1850-60s, the construction of the Suez Canal was financed by stocks sold to 40,000 investors on the Paris exchange. Still today, this canal caries over 10% of the global maritime transport, giving immense CO2-savings compared to sailing south of Africa on the way from Asia to Europe.

So, if financial markets could handle this asset class in the 19th century, could financial markets learn to do it again? We believe so. And profitable investments in support of the sustainable development goals can also be made outside infrastructure. Last summer, the Danish SDG Investment Fund was launched. By blending private capital from institutional investors with that of the Danish government's Investment Fund for Developing Countries, the purpose is to spear-head commercial investments that can promote sustainable development in locations where perceived risks would otherwise deter private investors. While more data is still needed, experience suggests that the actual risks are often more manageable than perceived by markets and many analysts.

As estimated by the Global Commission on the Economy and Climate, a total of USD $90 trillion investments in infrastructure is needed globally over the 2015-30 period – roughly doubling past investment levels and delivering more than the world's entire current infrastructure stock.

With millennials making up a rising share of investors, private banks and fund managers are also increasingly interested in assets with a positive global footprint. Combining these forces, private investments and ingenuity can bring the solutions needed to avoid global climate change and to promote our global Sustainable Development Goals. ◆

Torben Möger Pedersen is CEO of Pension-Danmark – a position he has held since the organization was established in 1992. Torben Möger Pedersen holds a number of board and investment committee memberships including Arbejdernes Landsbank, University of Aalborg, Danish Insurance Association, Copenhagen Infrastructure Fund I, II, III Danish Climate Investment Fund, Danish SDG Investment Fund, Center for Pension Research (PeRCent) at Copenhagen Business School and Danish Society for Business and Education. Torben Möger Pedersen is also a member of UN's Green Climate Fund's Private Sector Advisory Group and World Economic Forum's Global Agenda Council on Investments as well as part of the Steering Committee of the World Economic Forum's Council on Investment.

Jens Lundsgaard is a board member of the European Bank for Reconstruction and Development, and founder of Lundsgaard Economics & Strategy. Previously he was an economist at the OECD and served as Deputy Permanent Secretary in Denmark's Ministry of Industry, Business and Financial Affairs.

How to Make the Global Financial System Work Better

Karolina Ekholm

**Professor of Economics at Stockholm University.
Former State Secretary at the Swedish Ministry of Finance
and former Deputy Governor of the Swedish Central Bank**

Today's world seems to be awash with financial capital seeking a decent return. And yet it is difficult to finance much needed investment in infrastructure, energy and education in poor countries, leading to obstacles to sustainable development. Large amounts of financial capital flows in and out of countries, often create problems for both the senders and receivers. Exchange rates become misaligned, sovereign debts unsustainable, and economies destabilized.

Surely, we should be able to make the global financial system work better. Financial capital should be steered to where it could do the most good, without having as a side effect that receiving countries from time to time have to go through severe financial crises. Such crises set them back years in terms of economic growth.

The Eminent Persons Group on Global Financial Governance has been tasked with coming up with ideas of how to make the global financial system work better. More specifically, they propose changes to the way international financial institutions (IFIs) work and interact with one another in order for them to become better equipped to promote sustainable growth and financial stability and deal with global threats such as global warming and pandemic diseases. Their report Making the Global Financial System Work for All takes a systemic view and focusses on where changes could make the system as a whole work better.

A key recommendation of the report is to refocus the operations of IFIs from financing investment with their own resources to using those

resources to mobilize private capital. The investments needed to achieve sustainable and inclusive development in poor areas of the world are simply too substantial to be financed solely from official sources. The report suggests ways that the IFIs can become more effective in stimulating private investment by reducing and managing risk. It recommends, for example, the creation of new asset classes for private investors by pooling and diversifying risks across the development finance system. The report also emphasizes that risk-mitigating tools should be used to stimulate private investment in low-income countries not only in middle-income countries), which, which tends to be the case today.

The report does not propose to revolutionize the global financial system. It rather suggests ways to tweak the system in new directions. This is a strength by making the report's recommendations viable. But it is perhaps also a weakness by stopping short of proposing reforms that could fundamentally change the way global financial markets are being governed.

To me it seems as if the chosen balance between viability and rather than radical change is roughly the appropriate one in the area of development finance. The proposals for how IFIs can cooperate better among themselves and with other development partners, for how they can mobilize private capital and focus on managing and reducing risks all seem doable. At the same time, they have the potential to truly improve the development impact.

Personally, however, I would have wished for a somewhat more radical approach regarding reforms for global financial resilience. A recurrent problem is the disruption that international capital flows can lead to for open economies. One of the recommendations in the report is that the International Monetary Fund's framework for policy guidance should enable countries to move towards open capital flows and at the same time manage financial stability. However, it is not at all clear how this could be done. Maybe open capital flows simply come at a relatively high price in terms of risks to the financial stability. How should then the benefits and costs of this openness be judged? There is ample evidence that foreign direct investment brings significant economic benefits, particularly by providing recipient countries with much needed technological knowledge and know-how. But what are the benefits of

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short-term flows of portfolio investment? This seems to be an especially pertinent question after the experiences during the global financial crisis, when markets that were considered highly liquid suddenly dried up, wreaking havoc on the system. Maybe short-term flows of portfolio investment need to be governed in a fundamentally different way than today. Here, I wish the Eminent Persons Group had provided more guidance by stating their own view on the issue.

Still, my hope is that the recommendations in the Eminent Persons Group's report are met with broad support and that steps are taken to implement them. The stakeholders of the IFIs, which are mainly governments around the world, need to focus on what is in their common interest in spite of the fact that they also have many diverging interests. The report

The report suggests ways that the IFIs can become more effective in stimulating private investment by reducing and managing risk. It recommends, for example, the creation of new asset classes for private investors by pooling and diversifying risks across the development finance system.

can help them do that. Other parts of society, such as the business community and NGOs, need to put pressure on the stakeholders to take action. We deserve a better functioning global financial system and it is high time to do something about it. ◆

Karolina Ekholm served as state secretary at the Swedish Ministry of Finance between October 2014 and January 2019. She was Deputy Governor of Sveriges Riksbank between March 2009 and October 2014. During this time she was on leave from a position as professor at the Department of Economics, Stockholm University. She was a member of the Swedish Fiscal Policy Council from its inception in August 2007 until she was appointed Deputy Governor in 2009. Her research has primarily dealt with international trade and investment. She has published academic papers in the Journal of International Economics, *Journal of the European Economic Association*, *European Economic Review and Economic Journal*.

Piloting the Country Platform

Erik Berglof

Professor, Director, Institute of Global Affairs, London School of Economics and Political Science

R. Kyle Peters, Jr.

Coordinator of the 15th Replenishment of the African Development Fund at the African Development bank

Country platforms have become the first proposal to be taken forward from the report from the G20 Eminent Persons Group on Global Financial Governance (EPG). The idea applies to the EPG's systemic approach to coordination of the global financial system to an individual country. A full-scale implementation of country platforms would be a game changer for global development, but the proposal must not be rushed through – they must emerge from within countries. Development initiatives that are not country owned and country driven almost always fail.

What did the EPG have in mind? The key idea is a systemic approach - the system working as a system - is needed to meet the more complex and intertwined development challenges. This can only be achieved through three important changes in the way the development community operates: 1) a more coordinated and collaborative approach among development agencies, 2) crowding in the ideas and financial capacities of the private sector, and 3) placing the country (its policies, capacities, and development needs) at the center. Only the G20 has the convening power and authority to drive these changes.

Why country platforms? Platforms offer an approach that retain country leadership, enable synchronisation across ministries and agencies, encourage healthy competition among development partners and preserve the Government's flexibility to choose specific partners for specific programs and projects. They would allow coordinated policy reforms and transparency, guaranteeing uniform access and sharing of relevant information. They need not become a

"straight jacket on either the Government or development partners".

What are the core elements of a platform? Platforms should be inclusive of the main elements of a country's development plans. Countries should organize and convene. A multilateral could support implementation, a role calibrated to Government demand and capacity. Platform participants should prepare joint assessments, policy reform agendas and investment plans. They must operate according to five or six 'globally agreed' core principles with associated uniform processes that ensure a convergence to high standards, prevent a 'race to the bottom' form of competition, and aim at simplifying and ensuring uniformity to facilitate the involvement of multiple players. Finally, the platforms should aim towards integrated project preparation support and common templates and documentation.

What is different? While there are many existing 'country platforms', the EPG's concept differs in scale, scope, and involvement. Rwanda, for example, has developed a well-functioning donor coordination mechanism encompassing many of the key attributes of an effective country platform, but is primarily a donor coordination exercise. The National Reform Council in Ukraine, on the other hand, grew out of a need to coordinate across ministries and between the Presidency, the Governments and Parliament, and then became a coordinating device for donor-supported policy advice. But none have combined transparency, convergence to appropriately high standards, coordination to flexibly combine the IFIs' contributions according to their comparative strengths, and the standardised approaches needed to achieve a major step-up in development impact and to attract private sector investment.

How to start? The G20 has decided to support several pilot exercises. This is a good idea. A pilot, however, must start in a willing country and allow for a discovery process through which the Government defines their challenges are.

While we should embrace diversity, acknowledging that countries have different capacity, it is important to keep the systemic approach. At the same time, we must not overload the exercise, repeating the overbearing bureaucratic processes of Paris-Accra-Busan. New communication technologies and different context can make coordination easier and less burdensome. We would suggest three 'principles' for the pilot. First, borrowing from regulatory policy, we suggest in each of the pilots to employ the principle of 'comply or explain' – when a country deviates from a standard template, it should be forced to explain the reasons. Second, official donor support for the platform should take the issue of implementation capacity seriously. Donors, especially the MDB's, should really commit to engaging in implementation support. Finally, ensure that the platforms include the private sector and facilitate their involvement, while recognising that some discussions are more properly held with just the official sector in the room. ◆

Erik Berglof is the inaugural Director of the Institute of Global Affairs (IGA) and its newly launched Global Policy Lab at the London School of Economics and Political Science (LSE). He was a member of the Secretariat for the G20 Eminent Persons Group on Global Financial Governance.

He is also a member of the World Economic Forum Global Futures Council on the Financial and Monetary Systems, Non-Resident Fellow at the Brookings Institution and the Institute for New Economic Thinking in New York, Research Fellow of the Centre for Economic Policy Research (CEPR) and Senior Fellow of the European Council for Foreign Affairs (ECFR). Prior to joining the LSE, Professor Berglof was the Chief Economist and Special Adviser to the President of the European Bank for Reconstruction and Development (EBRD) and Director of the Stockholm Institute of Transition Economics (SITE) and Professor at the Stockholm School of Economics. He was Assistant Professor at Universite Libre de Bruxelles and has held visiting positions at Harvard, Stanford and Massachusetts Institute of Technology (MIT). He has also served as Special Adviser to the Prime Minister of Sweden. In 2013 he was awarded the Leontief Medal (2013), for contributions to economic reform by the Leontief Centre, St Petersburg and honoured with "Flag flown over the Capitol" at the request of Senator Mark Warner and the US Treasury, in recognition of his contributions during the financial crisis.

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R. Kyle Peters, Jr. was a Member of the Secretariat, G20 Eminent Persons Group on Global Financial Governance.

Currently, he is the Coordinator of the 15th Replenishment of the African Development Fund at the African Development bank. He is also a Senior Advisor to BCG in its public sector and people and organizations practices and a senior advisor to the President of the International Fund for Agricultural Development (IFAD. He also served on the UN Reference Group—a sounding board of experts--formed by the UN Secretary General to guide the UNSG's reform program.

Previously, Kyle had three decades of experience at the World Bank. In his last position as Senior Vice President, Operations, and interim Managing Director and COO, Kyle led the World Bank's worldwide operations. In previous roles at the World Bank, he played a key role in the World Bank's financial and operational response to the 2008 financial crisis and was actively engaged in the 2010 IBRD capital increase, as well as the early engagements on the proposed 2018 IBRD capital increase. Over the course of his career, he has accumulated more than two decades of experience on economic and development issues, with exposure to all regions, especially East Asia and Eastern Europe.

He has a BA degree from the College of William and Mary, and a Masters in economics from SUNY-Buffalo.

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