GROUP OF TWENTY

G20 Summit

Seoul, Korea; November 11-12, 2010

GROWTH AND DEVELOPMENT IN EMERGING MARKETS AND OTHER DEVELOPING COUNTRIES

Report prepared by Staff of the World Bank for

G20 Growth Framework and Mutual Assessment Process

THE WORLD BANK

Table of Contents

Executive Summary

Growth in developing countries increasingly matters for global growth. Led by the fast growing emerging markets, developing countries are now contributing about half of global growth. They are leading the recovery in world trade, with their import demand rising twice as fast as that of advanced economies. Links among developing countries are growing; South-South trade now accounts for about 40 percent of developing country imports. The potential to contribute to global growth is not limited to the emerging market growth poles. Sub-Saharan Africa achieved annual growth of about 6 percent in the five years preceding the crisis, and is now rebounding quickly. In a progressively multipolar world economy, the goals of global growth, rebalancing, and development are increasingly interlinked. The G20 Framework for Strong, Sustainable and Balanced Growth and related Mutual Assessment Process (MAP) provides a valuable opportunity to address this interconnected agenda in an integrated and cooperative manner.

Much attention in the G20 currently focuses on reduction of large external imbalances. But rebalancing of global growth should not be a zero-sum game, rotating demand from one to another. The objective is to lift growth, not just shift growth. Developing countries can be an important source of new demand for stronger and more balanced global growth. The Seoul Action Plan that emerges from the G20 Growth Framework/MAP should reflect these win-win interconnections between global growth and development.

Developing countries offer abundant opportunities for high return/high growth potential investments, such as in critical infrastructure that removes bottlenecks to growth. Many, especially low-income countries, however, face a binding financing constraint. Infrastructure investment and maintenance needs in developing countries amount to $900-plus billion annually; actual spending is just above half that level (about $500 billion). Promotion of growth in developing countries through more support for investment that removes bottlenecks to their growth would be a global win-win. It would support their development and it would contribute to stronger growth at the global level and to the rebalancing of global growth—by creating new markets and investment opportunities and more sources of growth in global demand. The role of developing countries in supporting global growth is even more important in the present conjuncture, as advanced economies face strong headwinds in the wake of the financial crisis.

Progress achieved by developing countries in improving macroeconomic policies and pursuing structural and institutional reforms in the years prior to the global financial crisis helped them cope with the crisis with much greater resilience than previous crises. Nonetheless, the crisis is going to leave some long-lasting scars, especially in terms of its social impacts. Even relatively small declines in growth can have significant effects on poverty. By the end of 2010, there will be an estimated 76 million more people living in poverty (on less than $2/day) than would have been the case without the loss of output and incomes caused by the crisis. The ground lost in progress toward the Millennium Development Goals will be hard to recover. It is not only the low-income countries that felt the impact on poverty. The nine middle-income countries that are members of the G20 account for more than half of the estimated increase in poverty resulting from the crisis.

While developing countries in general are recovering relatively well from the impact of the crisis, there are risks in the outlook:

- There are significant uncertainties associated with the global growth outlook. Downside risks have increased, not least those related to potential currency conflict and attendant risks of protectionism.
- Several emerging markets are seeing a strong surge in capital inflows, especially portfolio equity and bond flows, in part driven by ultra low interest rates in advanced economies. Indeed, some are taking policy actions to restrain inflows, concerned about macroeconomic implications of capital flow volatility and the potential for new bubbles. These developments underscore the importance, for advanced economies as well as emerging markets, of a successful outcome of G20 discussions on coordination of monetary and exchange rate policies and reduction of excessive external imbalances.

- But the pattern of private capital flows across developing countries is highly concentrated and uneven. Five emerging market economies—Brazil, China, India, Mexico, and Russia—account for about two-thirds of gross private capital flows to developing countries, and the distribution of the flows may have become even more concentrated in the current circumstances. Many developing countries, especially low-income countries, in contrast face the prospect of scarcer and costlier capital in the post-crisis period—especially capital that supports long-term development. The rise in fiscal deficits and debt in advanced economies and concerns about crowding-out, tighter financial sector regulation and banking system consolidation, and a re-pricing of risk are likely to raise the cost of capital and limit access to financing for many developing countries. In the aggregate, net private capital flows to developing countries are likely to remain well below pre-crisis levels for some time.

- Fiscal strains have increased in many developing countries, especially low-income countries. In responding to the crisis, many have used up much of the fiscal space they had built prior to the crisis and now face severe constraints in sustaining core infrastructure and social (health, education) programs important for growth and poverty reduction.

Against this background, the report offers the following main messages:

- Global growth is central to development. The most important way advanced economies can support development is by restoring strong growth. As the recovery matures, the longer-term growth agenda should take center stage, with a shift in focus from demand to supply stimulus: fiscal, financial, and structural reforms that enhance medium- to long-term potential growth—and remove bottlenecks to employment growth. The upside scenario presented in a companion report by the IMF illustrates how collective action by the G20 along these lines can boost growth with benefits for all. The 2 percent gain in global GDP by 2014 in that scenario would be associated with a 1.9 percent GDP gain in developing countries and 37 million fewer people living in poverty.

- For emerging market economies, structural reforms are crucial to sustaining their strong growth performance. In emerging surplus economies, actions to strengthen infrastructure investment and social safety nets would also help with the rebalancing of growth by boosting domestic demand. This report has a special focus on structural reform submissions by the nine G20 countries that are emerging/middle-income economies. The paper reviews their indicated policy plans in the areas of infrastructure investment, social safety nets and related labor market policies and offers suggestions for possible additional actions that could be considered. Overall, the structural reform submissions would benefit from a higher level of ambition and greater specificity. Going forward, drawing on its deep engagement with these countries, the Bank could provide fuller analyses of their structural reforms and national development policies as an input into the G20 MAP discussions.

- Infrastructure gaps are large across the developing world. G20 emerging market countries with strong financial positions are well placed to boost infrastructure investment, while ensuring that investment programs are well designed in terms of efficiency and environmental sustainability. Infrastructure gaps are especially large in low-income countries. Helping to build financial and institutional capacities for infrastructure investment in these countries—by catalyzing scaled-up and coordinated efforts by governments, multilateral development banks, and the private sector—can be a key area for G20 collective action in support of development.

- G20 efforts to reform financial sector regulatory and supervisory frameworks are critical for financial system stability. It is important to ensure that the proposed reforms do not have unintended adverse consequences for developing countries. There will be a need for expanded technical and capacity building assistance to developing countries to help them implement higher standards adapted to their specific circumstances. This can be another important area for G20 support, complementing ongoing initiatives in financial inclusion to improve access to financial services by underserved populations and small and medium enterprises.

- The crisis revealed the need to develop effective and fiscally affordable social safety nets that can be readily expanded when needed, not only in low-income countries but in emerging market economies as well. Well-designed safety nets provide protection to the poor and vulnerable against shocks but also contribute to growth by promoting human capital accumulation and labor force participation.
- With many developing countries facing tighter capital market access in the wake of the global financial crisis, official flows take on added importance, both in directly providing development finance and in leveraging private flows. DAC estimates show that the Gleneagles targets for 2010 for official development assistance (ODA) will likely be missed by a significant margin. While G20 members address development financing in their MAP submissions, this policy area remains the least developed part of the policy templates. It would be desirable to have a coordinated position among the G20 to protect aid programs as fiscal consolidation strategies are designed and implemented.
- In particular, the need for concessional finance has risen as fiscal space in low-income countries has come under pressure while spending needs, including expansion of social safety nets, have increased in the aftermath of the crisis. These developments reinforce the need to ensure adequate ODA, including achieving an ambitious IDA 16 replenishment. They also point to the need to ensure more effective use of resources to achieve development results, a core emphasis of IDA 16.
- Fiscal stress in donor countries heightens the need to supplement traditional financing with innovative forms of finance, including risk-mitigation guarantee and insurance mechanisms for private investment, sovereign wealth fund investments, South-South investments, carbon finance, and innovative public-private partnerships. Multilateral approaches involving pooled public-private funding are playing an increasingly important role in addressing the global public goods agenda. The scale of resource needs calls for both a renewed commitment by G20 members to key global programs and renewed vigor and creativity in exploiting the potential of innovative approaches that leverage private capital.
- Concerns about a renewed surge in food prices, and the vulnerability of many poor countries to higher food costs, underscore the need to follow through on international initiatives to enhance food security, notably the Global Agriculture and Food Security Program. They also call for a commitment to refrain from food export restrictions.
- Open trade and investment are essential for growth and rebalancing. G20 leaders can boost market confidence by renewing their commitment to refrain from protectionist measures. An even stronger signal would be a collective pledge to unwind the protectionist actions that have been taken since the onset of the crisis. While open protectionism has been resisted relatively well, there is concern that opaque protectionism has been on the rise. Resort to measures such as antidumping actions, safeguards, preferential treatment of domestic firms in bailout packages, and discriminatory procurement has increased. Strengthening multilateral trade disciplines and moving ahead swiftly with the Doha Round therefore are important. A Doha Round agreement would impart a strong, non-debt creating stimulus to the global economy.
- To improve poor countries’ market access, all G20 countries could consider extending 100 percent duty-free and quota-free access to the Least Developed Countries, with liberal rules of origin. Improved market access for poor countries needs to be complemented with a strengthening of trade facilitation and aid-for-trade programs to enhance their trade capacity. The G20 could call on relevant international organizations to coordinate a collective effort to scale up trade facilitation and lend support to such an initiative.

Introduction

In the first phase of the G20 Growth Framework and Mutual Assessment Process (MAP), which culminated in the summit in Toronto, the report prepared by the World Bank focused on analysis of economic prospects and linkages between the G20 and developing countries and on identification of broad policy areas where G20 collective actions would enhance growth and development prospects in developing countries.[1] As agreed at the Toronto summit, the second phase of the Growth Framework/MAP, leading to the summit in Seoul, seeks to build on the first phase in two important respects: identifying and committing to more specific policy measures ("an action plan") in the broad policy areas identified in the first phase, in order to achieve a better outcome for the shared growth and development objectives; and conducing this exercise at the level of individual G20 countries, in contrast to a focus on broad country groups in the first phase. The Bank report for the second phase of the Growth Framework/MAP has been prepared in line with that guidance.

This report is structured in two parts. The first part assesses the outlook for growth and development in emerging markets and other developing countries, linked to the submissions made by the G20 members on their policies and plans and the IMF's analysis of the global macroeconomic implications of the G20 submissions.[2] The analysis highlights linkages between advanced economies and developing countries in an increasingly multipolar pattern of global growth.

The second part of the report assesses more specifically the G20 policy submissions and plans in key areas of structural reforms and development policies and presents some policy options and actions for consideration by the G20. The assessment covers the following areas:

- Structural reforms and national development policies in emerging market members of G20, with a focus on infrastructure investment and social safety nets and related labor market reforms.
- Financial market reforms, with a focus on their implications for developing countries.
- External development policies, with a focus on trade policies and financing for development.

On development issues, in addition to the Growth Framework/MAP, the Bank is working closely with the G20 Development Working Group. The analysis and discussion of development as part of the Growth Framework and the work of the Development Working Group complement each other. The Growth Framework brings development in an integrated way into the broader G20 discussion of the global growth agenda. The Development Working Group focuses more specifically on some of the identified key areas of development policy with a view to developing concrete action plans in those areas.

Part I: Global Outlook and Developing Countries

Developing Countries in a Multipolar Global Economy

Growth in developing countries increasingly matters for global growth. International linkages now truly work both ways: not just North-South but South-North as well. The pattern of global growth is becoming increasingly multipolar, with a rising significance of "reverse linkages" from developing to advanced economies (Box 1). Developing countries are making an increasingly important contribution to global growth. Their role in supporting global growth in the present conjuncture is even more important, as advanced economies face strong headwinds in the wake of the financial crisis. The agenda for growth and

---

[1] *G20 and Global Development*, report prepared by staff of the World Bank for G20 Growth Framework and Mutual Assessment Process, G-20 Summit, Toronto, Canada, June 26-27, 2010.

[2] *G-20 Mutual Assessment Process-IMF Staff Assessment of G-20 Policies*, prepared by staff of the International Monetary Fund, October, 2010.

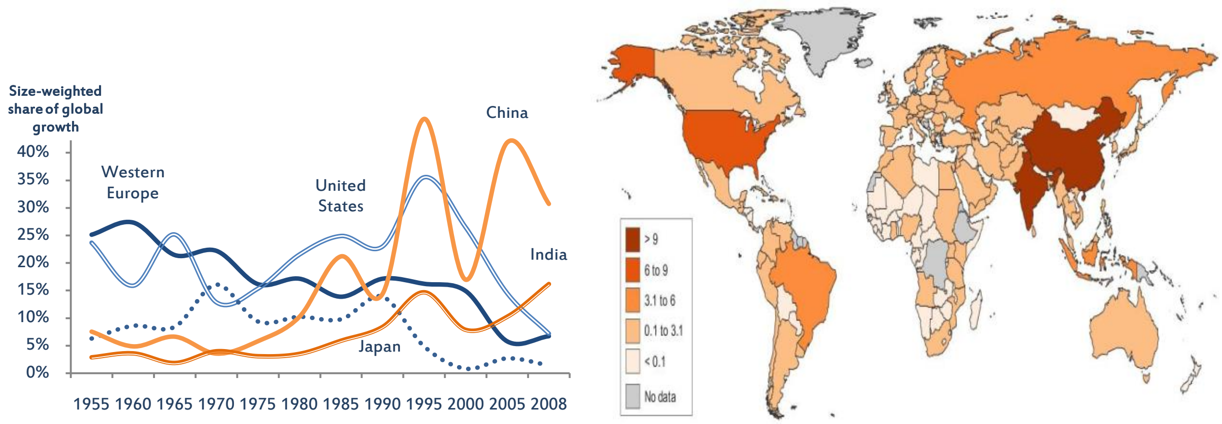
development in developing countries is therefore very much an integral part of the agenda for strong, sustainable, and balanced global growth that is the focus of the G20 MAP.

Box 1: Toward a Multipolar World Economy

As the second decade of the 21st century unfolds, the world economy is acclimating to shifting economic growth poles, evolving trade and finance paradigms, and new mechanisms of international policy coordination. While the large developed economies of today were undeniably the drivers of global growth over the past century, these polarities appear to be shifting (Figure, left). After the bursting of the asset bubble in Japan in the early 1990s, Japan's growth polarity fell sharply over the next two decades. In a similar fashion, the polarities of the United States and the economies of the euro zone have moderated over the past decade, and their trajectories appear to be trending downward.

In contrast, the growth polarities of the emerging economies appear to be synchronously rising, with the global growth contribution of the group as a whole in recent years a multiple of that of the United States, and an order of magnitude larger than that of Japan. Indeed, in many respects, China can already be regarded as a current growth pole in its own right. Other developing economies that are likely to be future growth poles include India, the Russian Federation, and Brazil—the other so-called BRIC economies—along with several other large emerging markets, such as the Republic of Korea, Mexico, and Turkey (Figure, right). At the regional level, with rising South-South linkages, major developing countries are playing an increasingly important role as regional growth poles. For example, studies have shown that a one-percent growth of South Africa's GDP is associated with a 0.4-0.9 percent growth of the GDP of the rest of Sub-Saharan Africa.

Figure B1: The global growth balance is shifting toward a multipolar order, with developing countries leading the way



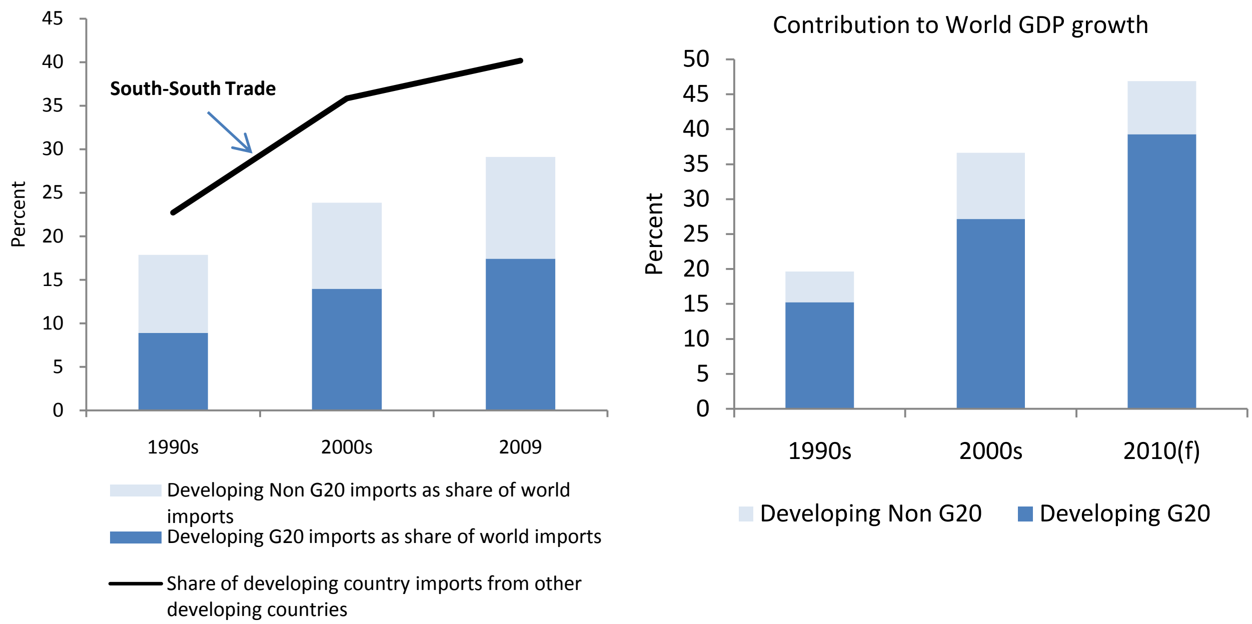
Historical evolution of global growth shares, major poles *Distribution of global growth shares, 2006-08*

Source: World Bank Global Development Horizons, 2011 (forthcoming).

An increasingly multipolar world is likely to change the way in which the world does business. The manner by which these emerging poles grow—whether their growth is driven more by exports or domestic demand—can have a major influence on the future evolution of global growth and external balances. The global corporate landscape is gradually being transformed by Southern firms, which have implications for the competitive balance, industrial structure, innovation, and trade and investment patterns in the global economy. Cross-border mergers and acquisitions by emerging market multinationals rose from 7 percent of the worldwide M&A transactions in 1997-99 to 26 percent (close to $1 trillion in dollar amount) in 2007-09. More than a third of foreign direct investment in developing countries now originates in other developing countries. In a multipolar global economy, international policy coordination and cooperation will become all the more important, as the institutions for global governance adapt to the rising importance of the emerging poles in the international trade and financial system.

Developing countries have been growing at a much faster average rate than high-income countries. Whereas their GDP represented about 18 percent of global GDP in 1980, as of 2009 their share had increased to 28 percent when measured at market exchange rates (close to 45 percent if purchasing power parity weights are used). Their weight in global trade has grown even quicker, rising from 20 percent in 1995 to close to 30 percent in 2009 (Figure 1, left panel). Not only has their share in activity increased, their faster growth rates mean that their overall contribution to global growth is larger still. Developing countries contributed around 40 percent of global growth in the past decade. In 2010, their projected contribution will approach 50 percent (Figure 1, right panel). They are leading the recovery in global trade, with their import demand rising at twice the rate of that in high-income countries.

Figure 1: Developing Countries rising share of world trade and growth



Source : WDI Database and UN Comtrade.

Source: World Bank Staff Estimates

Linkages among developing countries, or South-South linkages, also are becoming more important. South-South trade has risen to 40 percent of developing country imports. Within regions, trade among developing economies has increased substantially, further strengthening regional growth poles. South-South foreign direct investment has accounted for a third or more of total such investment going to developing countries in recent years. South-South migration is larger than South-North migration.

Developing countries possess a large potential for future growth. They offer abundant opportunities for high return/high growth potential investments (such as in critical infrastructure and human capital that remove bottlenecks to growth) and they have undertaken important reforms in recent years to improve the development effectiveness of their programs and investments. Many, however, face a financing constraint in fully exploiting these growth opportunities. Promotion of growth in these countries through more support for investment that removes bottlenecks to their growth would be a global win-win. It would support their development and it would contribute to stronger growth at the global level and to the post-crisis rebalancing of global growth by creating new markets and investment opportunities and hence more sources of growth in global demand.

Rebalancing of global growth needs to look beyond a narrow focus on external balances and macroeconomic policy adjustments to include structural rebalancing. Supporting multiple growth poles is a key element of structural rebalancing. Promotion of growth in developing countries should be seen as part of the architecture for more balanced global growth.

The potential to contribute to global growth and rebalancing is not limited to the rapidly growing emerging market growth poles. Better policies have improved growth performance and opportunities in many low-income countries, including in Sub-Saharan Africa (average regional growth of about 6 percent in the five years preceding the crisis). They offer markets for investment, not just destinations for aid. Net foreign direct investment to the region more than doubled from $14 billion in 2001 to $34 billion in 2008. There is much potential for further growth in these investment flows. Some economists have posited that the next generation of BRICs could come from Africa (Box 2).

Box 2: Can Africa Become the Next BRIC?

Despite the severity of the global crisis, Sub-Saharan Africa has shown remarkable resilience. While the crisis appreciably slowed the continent' economy in 2009, growth is expected to rebound to 5 percent in 2010-11. Sub-Saharan Africa's economic growth rose from an average of 3-3.5 percent per year at the turn of the decade to an average of 6.2 percent in the five years preceding the recent crisis. New research suggests that several African economies may be on the verge of an economic takeoff (McKinsey 2010; see also Young 2009, and Pinkovsiy and Xala-i-Martin 2009).[1]

Some analysts are comparing improving prospects to the rise of the BRICs (emerging economic giants Brazil, Russia, India, China). According to Jim O'Neill, who coined the BRICs acronym, "The continent's combined current gross domestic product is reasonably similar to that of Brazil and Russia, and slightly above that of India. Moreover, of the "next 11" countries – as my colleagues and I have dubbed the group of populous emerging countries after the Brics with the most promising outlooks – two are in Africa: Egypt and Nigeria…..If you were to think about Africa collectively, and consider it in the same framework that informs our 2050 scenarios for the Brics, next 11 and other major economies, you would see an economy as big as some of the Brics. If you then look at the potential of the 11 largest African economies for the next 40 years (by studying their likely demographics, the resulting changes in their working population and their productivity) their combined GDP by 2050 would reach more than $13 trillion, making them bigger than either Brazil or Russia, although not China or India."[2]

Africa's improved growth performance and resilience are not accidents but the results of sustained reform efforts made in most countries over the past decade or so. Radelet (2010) identifies five fundamental changes at work: more democratic and accountable governments; more sensible economic policies; the resolution of the debt crisis and changing relationships with donors; the spread of new technologies; and the emergence of a new generation of policymakers, activists, and business leaders. Moreover, the security situation is improving.[3]

The potential and promise of Africa's future is clear. But continued success is not guaranteed. Realization of Africa's promise will depend on the continuation of policy reforms and institutional development that have underpinned the recent improvement in economic performance, building on the foundation that has been laid. It will also call for supportive partnership on the part of the international community.

[1]Leke, A. et al. 2010. "What is Driving Africa's Growth?" *McKinsey Quarterly*, June; Pinkovskiy, M. and X. Xala-i-Martin, 2009. *African Poverty is Falling...Much Faster than You Think!*, New York, Columbia University, mimeo; Young, A., 2009. *African Growth Miracle*, London School of Economics, mimeo. [2]O'Neill, Jim. "How Africa Can Become the next Bric." *Financial Times*, August 26, 2010. [3]Radelet, S., 2010. *Emerging Africa: How 17 Countries Are Leading the Way*, Washington D.C., Center for Global Development.

Base Case Outlook for Growth in Developing Countries

The global economy continues its recovery, led in no small degree by developing countries, from a crisis that triggered what has been termed "the great recession". As the world economy moves from a stimulus-assisted bounce-back phase toward a more sustainable path, growth rates are slowing. Although that slowdown had been widely anticipated, its actual manifestation in some advanced economies has been less smooth and controlled than economic models might have suggested. Supporting the economic recovery, world trade rebounded strongly, with an expected increase of as much as 17 percent in 2010 following an 11 percent decline in 2009, but is projected to slow in 2011 to more sustainable growth in the 7-8 percent range. Overall, the IMF's base case projections foresee a moderate global recovery over the medium term as economies gradually close output gaps and return to potential growth rates, with the strength of the recovery varying across countries and country groups. Despite the recovery in growth, high unemployment and spare capacity are likely to persist in many countries for several years.

World Bank staff have reviewed the base case outlook for developing countries in light of the revised base case scenario prepared by the IMF for the G20 for the second stage of the MAP. The overall outlook for growth in developing countries is broadly similar to that presented in the Bank's report for the first stage of the MAP. Growth in developing countries will be somewhat higher in 2010 than projected before, reflecting a stronger outcome in the first half of the year, partly offset by slightly slower growth in 2011 as the pace of economic recovery moderates.

Developing countries are projected to grow by an average of 6.2 percent in 2010-12, well in excess of the projected growth of 2.5 percent in high-income countries (Figure 2 and Table 1).[3] Growth will be strongest in middle-income countries, particularly among major emerging market economies that are members of the G20. Growth in middle-income countries, which were more seriously affected by the financial crisis given their deeper integration with international capital markets, is projected to recover quickly from a low of 1.8 percent in 2009 to the 6-6.5 percent range, strong though still appreciably below average growth of pre-crisis years. Low-income countries were affected by the crisis primarily through the trade channel. They were initially less impacted by the crisis because of their weaker capital market links but saw their growth drop, though by less than in middle-income countries, as the resulting recession depressed demand for their exports and caused export volumes and commodity prices to decline. Low-income country growth is projected to return to above 5 percent in 2010 and strengthen further in subsequent years toward the pre-crisis growth rates. Overall, progress achieved by developing countries in improving macroeconomic policies and pursuing structural reforms in the years prior to the crisis helped them cope with this crisis with much greater resilience than previous crises.

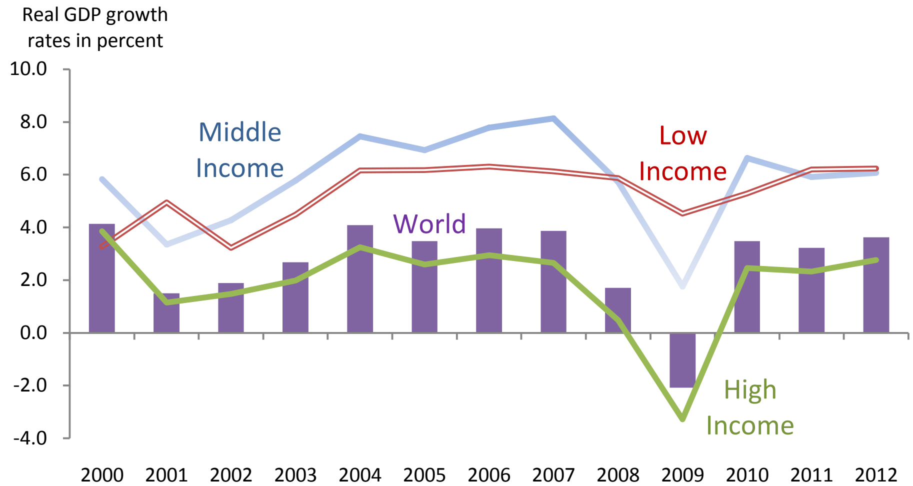
Among developing regions, growth is projected to be most robust in Asia. The Europe and Central Asia region is expected to see more moderate growth, as several countries in the region were among the hardest hit by the crisis. Sub-Saharan Africa is expected to return to growth on the order of 5 percent in 2011, with prospects in several countries in the region tied closely to recovery in commodity markets.

Growth in developing countries will be a key determinant of the pace of the global economy. Just under half of global growth in 2010-12 is projected to emanate from developing countries. The projected much faster growth in developing countries mainly reflects faster growing domestic demand.

As the recovery matures, the longer-term growth agenda should increasingly be the focus of G20 policy coordination. In advanced economies, this includes fiscal, financial, and structural reforms that enhance long-term growth potential. How much and how fast countries should shift from demand stimulus to a focus on supply-side policies to boost productivity growth differs from country to country. In developing countries, growth prospects will depend on building on past progress on reforms in macro-fiscal management, investment climate, and governance and achieving requisite investment levels in infrastructure and human capital underpinning growth (priorities across countries will of course depend on country specific circumstances).

[3] Aggregate growth rates in this document are calculated using fixed weights derived from market exchange rates (MER) in 2005. This contrasts with the method employed by the IMF, which uses weights derived from purchasing power parities (PPP). Because developing country GDP measured at PPPs tends to be higher than when measured at market prices and because developing country growth rates are higher than high-income country growth rates, PPP-based global growth rates tend to be higher than MER-based growth rates.

Figure 2: Base case outlook for economic recovery and growth



Source: World Bank staff estimates.

Table 1: Breakdown of growth in developing countries – base case scenario

	2005 -2007	2008	2009	2010	2011	2012
			(% per year)			
Developing Countries	**7.6**	**5.9**	**1.8**	**6.6**	**5.9**	**6.1**
Middle Income Countries	7.6	5.7	1.8	6.6	5.9	6.1
- Of which: G20 Members	8.0	6.1	2.3	7.5	6.4	6.5
Low Income Countries	6.2	5.9	4.5	5.3	6.2	6.2
East Asia & Pacific	10.2	8.4	7.1	9.0	8.0	7.8
Europe & Central Asia	7.1	4.1	-6.5	4.6	4.2	4.6
Latin America & Caribbean	5.4	4.4	-2.2	5.1	3.9	4.0
Middle East & North Africa	5.4	5.6	3.2	3.5	3.8	4.3
South Asia	8.7	4.9	7.1	7.7	7.3	7.9
Sub-Saharan Africa	6.0	5.1	1.8	4.9	5.0	5.0
Memo:						
Developing Countries excl. China & India	5.9	4.3	-1.8	4.9	4.3	4.6

Source: World Bank staff projections linked to IMF G20 base case scenario. As such, they may differ from the Bank's *Global Economic Prospects* projections.

Implications for Poverty and MDGs

Even as the recovery gathers strength, growth is expected to be insufficient to close output gaps for several years. As a result, progress in raising average incomes in developing countries will remain below the pre-crisis expected levels and poverty will be higher than had been expected pre-crisis. In this sense, there has been a long-lasting impact on the pace of development progress. Only policies to accelerate growth beyond pre-crisis potential growth levels can reverse the negative impact of the crisis.

By the end of this year, there will be an estimated 64 million more people living in developing countries on less than $1.25/day (76 million more on less than $2/day) than would have been the case without the crisis. With economic growth poverty will continue to decline, but at a slower pace than under the pre-crisis growth path. Even by 2015, the number of additional poor attributable to the impact of the crisis would be 53 million and 69 million based on these two poverty lines, respectively (Table 2).

Labor market developments have been an important transmission channel for the impact of the crisis on poverty. The ILO estimates that unemployment increased globally by 34 million people during 2007-09, of which 21 million were in developing countries (those covered in ILO surveys). In addition, there have been sharp increases in youth unemployment, a troubling development for future employment prospects. Recent World Bank analysis of a sample of developing countries shows that even where employment held up better, workers experienced income losses because of a compression of earnings. Another recent Bank study estimates that the growth shock added more than 40 million people to the undernourished in 2009.

Table 2: Projections for poverty in developing countries

	1990	**2005**	**2015**	**2020**
Percentage of population living on less than $1.25 a day				
Post-crisis base case	41.7	25.2	15.0	12.8
Pre-crisis trend	41.7	25.2	14.1	11.7
Number of people living on less than $1.25 a day (millions)				
Post-crisis base case	1,817	1,371	918	826
Pre-crisis trend	1,817	1,371	865	755

Source: World Bank staff calculations based on PovcalNet.

The growth shock entails implications for the Millennium Development Goals (MDGs) more broadly. Growth collapses are particularly damaging for human development outcomes. There is an asymmetric response to the economic cycle, with more severe deterioration during downturns than the improvement during upturns. In addition, the impacts reach full severity with a lag. As a result of the crisis, it is estimated that 1.2 million more children under five may die between 2009 and 2015, and 350,000 more students may not complete primary school in 2015. It is estimated that about 100 million more people may remain without access to safe water in 2015 as a result of the crisis impact. In brief, the outlook for achieving many of the MDGs was worrisome before the crisis, and the crisis has imposed a further setback. This was recognized at the recent UN Summit on the MDGs where world leaders called for intensified efforts to accelerate progress toward the goals.

It is not only the low-income countries that saw the growth slowdown impact poverty and human development outcomes. A large part of the crisis-related rise in poverty occurred in middle-income countries, which still account for about two-thirds of the world's poor people. Many of the middle-income countries are still a considerable way from achieving some of the MDGs. Nine G20 members are middle-income developing countries that continue to face major development challenges, for example, large infrastructure and human development needs, and in some cases large concentrations of poverty. They are home to 54 percent of the world's extreme poor (58 percent based on $2/day poverty line). These nine countries account for more than half of the estimated increase in global poverty resulting from the crisis. Several of these countries, based on trends to date, are not on track to achieve some of the MDGs.

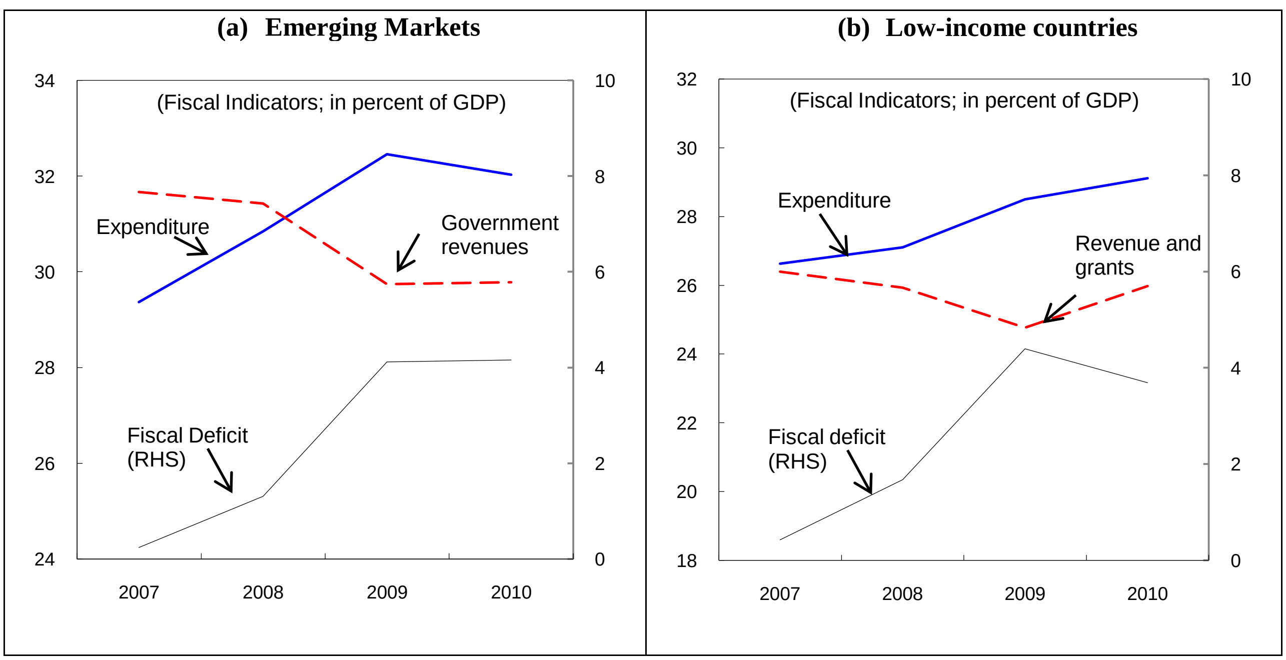
Risks and Challenges Facing Developing Countries

The base case outlook for growth in developing countries summarized above is subject to risks and uncertainties. Some of the uncertainties, especially those relating to the global economic environment, have increased since the first stage of the MAP. Domestically, developing countries face increased fiscal strains. Externally, the risks pertain to the prospects for the global economy and financial markets. Recent increases in world prices of key grains have raised concerns about a renewed surge in food prices.

Fiscal sustainability. The crisis has left in its wake increased fiscal sustainability concerns in a number of developing countries. Fiscal deficits in developing countries rose by an average of more than 2.5 percent of GDP in 2009 (Figure 3). Some countries, especially emerging markets, put stimulus measures in place. However, in many countries, especially low-income countries, the widening deficit resulted mainly from declining revenues. Some emerging markets rapidly regained access to international capital. In developing countries with more limited external financing, about half of the deficit increases on average were financed domestically, mainly through bank borrowing. This has raised fiscal sustainability concerns in many countries. The risk of debt distress has risen in low-income countries. In the absence of higher concessional flows, many low-income countries would be forced to cut spending.

Thanks to the macroeconomic policy buffers built up during the pre-crisis period, such as improved fiscal and reserve positions, countries were able to cushion the impact of the crisis on core spending on health, education, and infrastructure—even though spending growth slowed. Restoring growth in core spending to pre-crisis levels will be a challenge, especially in those countries with limited access to capital markets. Adding to the fiscal challenge will be the need to replenish the buffers. Core human development and infrastructure spending is critical for poverty reduction and growth but is likely to face particularly severe constraints in low-income countries. The need for spending on social safety nets will remain elevated in view of the higher unemployment and poverty resulting from the crisis. In many countries, the crisis revealed the need to develop effective and fiscally affordable social safety nets that can be readily expanded when needed.

Figure 3: Fiscal outlook in emerging markets and low-income countries

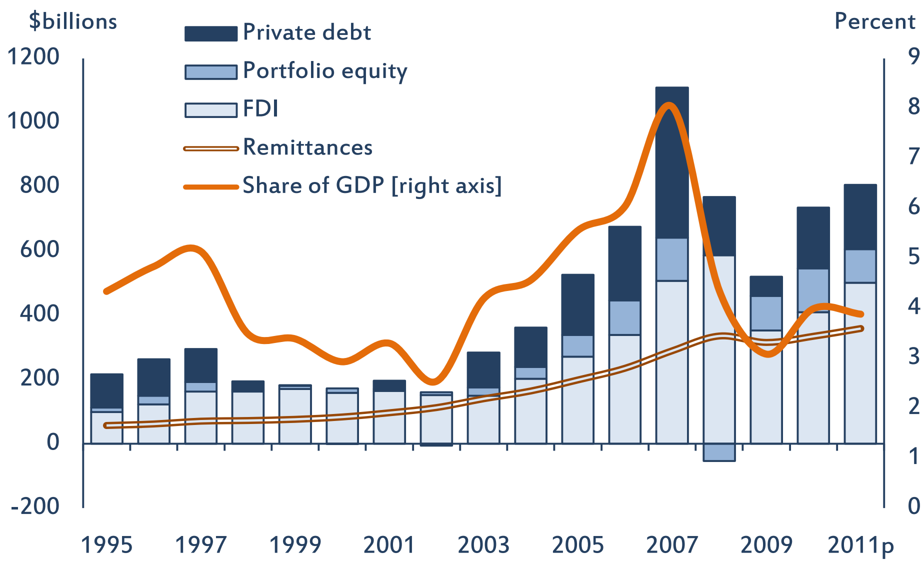


Source: IMF/World Bank, 2010, *How Resilient Have Developing Countries Been during the Global Crisis.*

Risks in the global economic and financial outlook. The global financial markets are recovering, but the recent crisis will have longer lasting implications for financial flows to developing countries. Some major emerging market countries are now seeing a strong rebound in capital inflows. Indeed, some are facing the dilemma of how to respond to large capital inflows attracted by interest rate differentials at a time when interest rates in advanced economies have been pushed to very low levels as part of policies to stimulate demand. However, many developing countries face the prospect of scarcer and more expensive capital in the post-crisis period (five emerging market countries, including Brazil, China, India, Mexico, and Russia account for about two-thirds of gross private capital flows to developing countries). The rise in fiscal deficits and debt in advanced economies and related concerns about crowding-out, tighter financial sector regulation and banking system consolidation, and a re-pricing of risk are likely to limit access to financing and raise the cost of capital for many developing countries.

Net private capital flows to developing countries fell precipitously in 2008-09 as a result of the financial crisis, falling from a peak of about $1.2 trillion (8.3 percent of developing countries' GDP) in 2007 to about $520 billion (3.1 percent of GDP) in 2009 (Figure 4). They are now recovering, especially portfolio equity, bonds, and foreign direct investment, but bank lending remains weak. In the aggregate, net private capital flows to developing countries are likely to remain well below pre-crisis levels for some time, reaching a projected level of about $805 billion (3.9 percent of GDP) in 2011.

Figure 4: Net private capital flows to developing countries



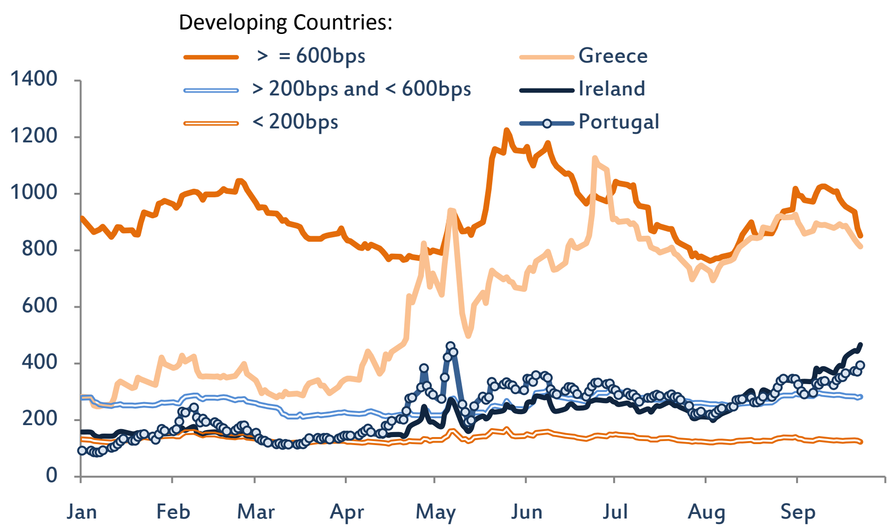
Source: World Bank staff estimates.

Bank staff estimate that the tighter conditions in international financial markets for many countries, reflected in scarcer and costlier capital, could depress investment and lower growth in affected countries by up to 0.7 percentage points annually over the next 5 to 7 years compared with the pre-crisis trend. Potential output could be reduced by up to 8 percent in the long run relative to its pre-crisis path. Even relatively small declines in growth can have cumulatively large impacts on poverty. Our simulations suggest that a 0.5 percentage point decline in developing country growth can mean nearly 80 million more people living on less than $2/day in ten years.

This baseline outlook is subject to further downside risks, in view of increased concerns about sovereign debt in advanced economies. This has been illustrated by episodes of sharp rises in sovereign debt spreads for some highly indebted European economies. While contagion to developing countries has been relatively limited so far, developing countries in higher risk categories have seen their spreads rise further (Figure 5). If concerns about sovereign debt escalate into a crisis of confidence, developing countries could be impacted both through the ensuing lower global growth and a relapse in capital flows.

Figure 5: Sovereign debt risk

(5-year sovereign credit-default swaps, basis points (bps), 2010)



Source: Thomson Datastream and World Bank staff calculations.

With high and rising public debt, fiscal consolidation is a key priority for the advanced economies. Debt to GDP ratios in advanced economies are expected by the IMF to exceed 100 percent of GDP in the next 2-3 years, some 35 percentage points higher than before the crisis. Sovereign debt issuance by the G-3 alone exceeded $2.5 trillion in 2009, more than 7 times total net capital flows to developing countries. A simulation analysis by the Bank finds that strong and credible fiscal consolidation efforts in advanced economies would produce a global win-win outcome. Long-run growth outcomes would improve in the advanced economies. Although the fiscal adjustment would imply a loss of output in the short run, that could be offset by complementing fiscal action with growth-enhancing structural reforms. Developing countries would also benefit, with the loss through weaker demand for their exports being more than offset by gains from lower real interest rates and higher investment. The simulations suggest that fiscal consolidation would also go a long way in helping to reduce global trade imbalances.

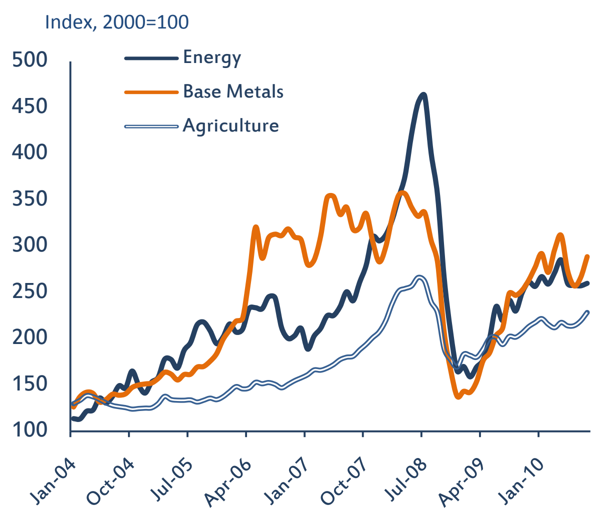
Rebalancing of global growth and financing for development can be linked in a virtuous circle. Three quarters of developing countries are net importers of capital. However, in aggregate, developing countries, including emerging markets, have in recent years run a surplus, mainly reflecting large surpluses of saving over investment in a few countries—notably China and developing oil and mineral exporters. So, considered as a whole, developing countries have recently been net exporters of capital to high income countries—a phenomenon sometimes referred to as capital flowing uphill. Capital inflows from the BRIC countries financed about 75 percent of the US current account deficit in 2008, up from 13 percent in 2001. Success in rebalancing in advanced deficit economies, thereby reducing their borrowing requirements, would allow more of the surplus global savings to flow to support investment and growth in developing countries which in turn would generate more import demand (and from multiple sources) to reinforce rebalancing.

Food price outlook. Commodity markets are critical for many developing countries, both in their role as consumers and producers of commodities. The commodity boom of 2007-08 was an unprecedented boon for producers, especially oil and metals producing countries, but a serious challenge for oil importing countries and net consumers of food. After recovering some of their late 2008 losses, most commodity prices had been relatively stable during the first half of this year. International agricultural prices had been relatively weak overall until the summer of this year when the price of wheat rallied due to weather concerns, increasing by 70 percent between June and October, and sparking fears of another generalized surge in food prices (Figure 6). Corn prices rose by 54 percent, but soybean prices were up by a much smaller 20 percent while rice prices increased by only 10 percent. The overall food price index rose by 18 percent. The US Department of Agriculture's October update in which grain supplies in several key countries for the 2010/11 crop year were revised downward added to the pressure on grain prices.

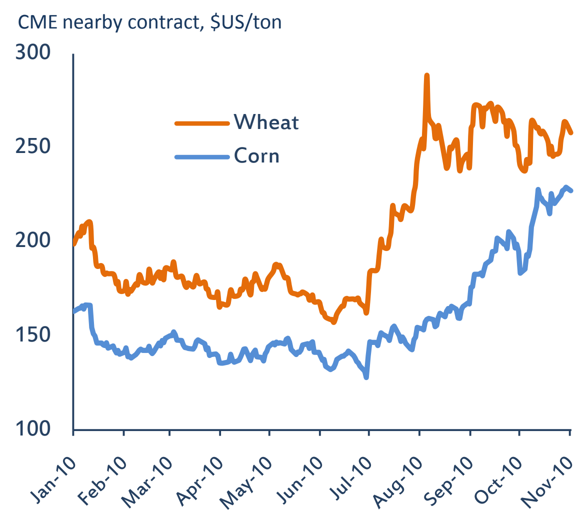
The spike in wheat and corn prices is explained by specific developments, such as unfavorable weather and reduced yields in some key producing countries. Barring further adverse supply and policy shocks, a generalized surge in food prices as in 2007-08 seems rather unlikely in current circumstances. Global market conditions are quite different today from two years ago. Global production of the three key grains (wheat, corn, and rice) is expected to decline by only one percent in 2010/11 compared to 2009/10. Stocks are expected to decline by 9 percent when compared to last season, still 27 percent higher than in 2006/07. Also, input prices (fertilizer and oil) have remained relatively stable.

Figure 6: Commodity market developments

(a) Commodity price indices



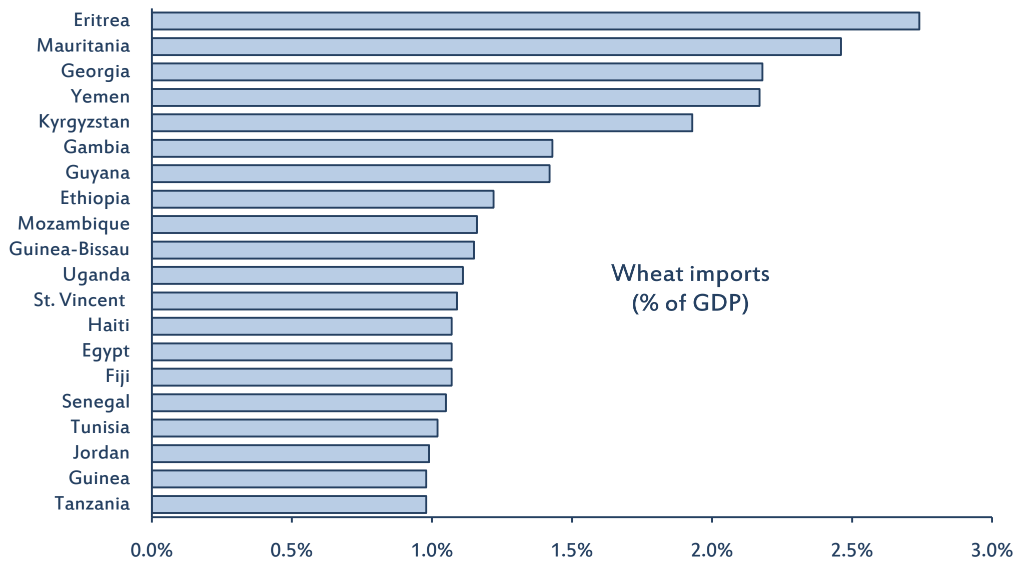
(b) Wheat and corn prices



Source: World Bank database; Chicago Mercantile Exchange.

Nonetheless, there are risks. Further supply, and policy, shocks cannot be ruled out. Many poor countries are vulnerable. Even relatively modest developments in global grain markets can have a much greater effect on domestic prices, with significant consequences for food security and even macroeconomic stability. Looking at vulnerability from a macroeconomic standpoint, 10 of the 15 countries with the highest wheat (and flour) imports to GDP ratios have per capita incomes of less than $850, including 7 countries from Sub-Saharan Africa—Eritrea, Ethiopia, Mauritania, Mozambique, Senegal, The Gambia, and Uganda (Figure 7). These risks and vulnerabilities underscore the importance for the international community to follow through on initiatives to enhance food security—such as the Global Agriculture and Food Security Program. They also call for a commitment to refrain from food export restrictions.

Figure 7: Wheat imports exceed one or more percent of GDP in several poor countries



Source: World Bank staff estimates.

An Upside Scenario

The companion report by the IMF presents an upside scenario to illustrate how additional collective action by the G20 on complementary and well sequenced policies can boost global growth with benefits for all. The policy enhancements envisioned in the Fund's upside scenario are consistent with the policy discussion above. They include stronger and coordinated actions on fiscal consolidation, increased investment in infrastructure, strengthening of social safety nets, and structural reforms in labor and product markets. The upside scenario produces a cumulative gain in global GDP by 2014 of 2 percent relative to the base case, as well as progress toward rebalancing of global growth.

Bank staff have assessed the implications of this upside scenario for developing countries. The results show an increase in GDP of 1.9 percent by 2014 for developing countries as a whole relative to the base case, with upper-middle-income countries benefiting to the tune of about 1.7 percent, lower-middle-income countries about 2.1 percent, and low-income countries about 1.8 percent.

The higher growth would enable additional gains in reducing poverty. Global poverty could decline by 18 million people by 2014 at the $1.25/day level and 37 million people at the $2/day level compared to the base case.

Part II: Policies for Growth and Development – A Review of G20 Policy Frameworks

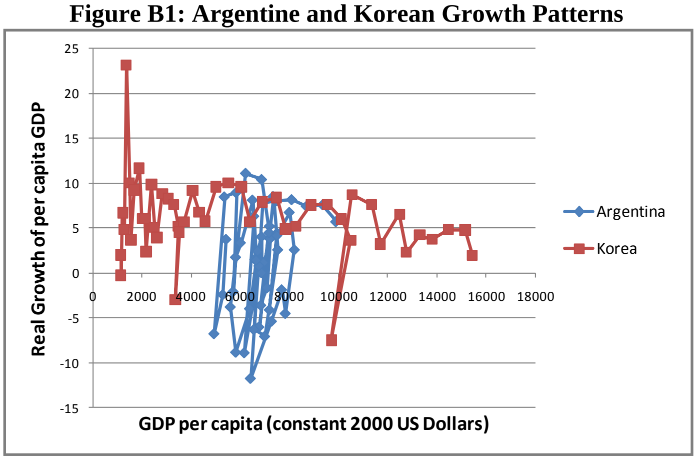
As noted above, the global financial crisis had dramatic impacts on economic growth and in slowing progress in poverty reduction. The impact, in many countries, is lasting in that there may be a decline in potential GDP growth or the recovery is not rapid enough to return to the previous growth and poverty reduction trajectories. Structural reforms are the key ingredient for addressing these challenges emerging from the crisis and restoring strong and sustainable growth. In addition to the World Bank, key international organizations have emphasized the importance of structural reforms in this regard.[4]

Box 3: Middle Income Countries—Challenges or Traps?

A number of middle income country (MIC) policy makers have raised concerns about the feasibility of passing the threshold into high income status.[1] Casual observation notes that few countries in recent decades have succeeded in this goal. In addition, there are a number of countries whose progress seems to have stagnated and have remained in the middle of the MIC range of income per capita for decades. Does this imply that these countries are caught in a "MIC trap"?

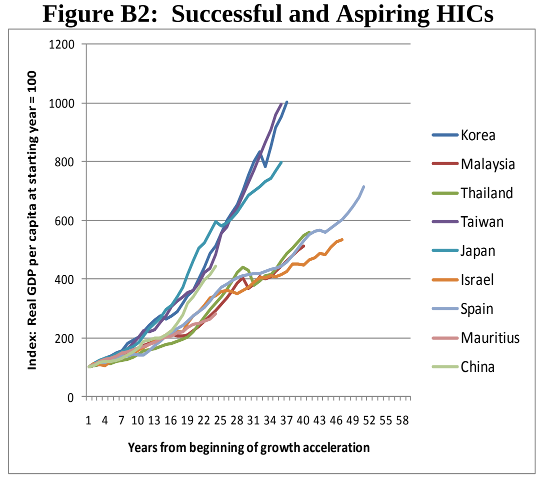
One of the hypotheses behind a MIC trap is that, in terms of international competitiveness and trade specialization, MICs may be caught between the low wage advantages of LICs and the technology superiority of the HICs.[2] This position may lead to stagnation or decline in a middle income country's share of global exports, resulting in low levels of GDP growth. There are other empirical phenomena that inspire the MIC Trap argument; for example, many MICs have experienced macroeconomic instability that leads to "stop and go" patterns of economic growth. Latin America is often cited as an example; however, the region now seems to be on a more stable macroeconomic path, raising hopes that the "trap" could be surpassed in the years to come. Figure B1 graphically shows the pattern of one Latin American country, compared to Korea's rapid accession to high income status.

Figure B1: Argentine and Korean Growth Patterns



Source: World Development Indicators

Figure B2: Successful and Aspiring HICs



Source: Maddison dataset (GDP per capita in constant Geary Kamis PPP dollars), Staff calculations.

Another consideration is simply the timeframe for progressing out of MIC status. Not all countries have achieved this goal at the same pace. Korea, Taiwan and Japan were extraordinarily rapid in this process; while Israel, Spain and Mauritius progressed at a more gradual pace. Figure B2 above shows the different patterns. In addition, it shows that China is on the fast-track, to date, while Thailand and Malaysia are progressing at a more gradual pace. The latter does not necessarily imply a "trap," but rather policies might focus on securing continued progress and perhaps accelerating progress.

Hypothesizing the existence of a MIC trap is a useful exercise in that it raises a number of important policy questions facing MICs: how to assure effective adaptation of technological progress, how to lead technological progress in some areas where these countries are at the technological frontier (e.g., agriculture), how to avoid the stop-go caused by macroeconomic instability, how to improve human capital so that the MIC workforce can compete in global markets. These are all important areas for research and potential knowledge sharing for G20 members and developing countries not formally represented in the G20.

1/ The World Bank's World Development Indicators currently uses a threshold of $12,195 for GNI per capita (Atlas method) as the dividing line between MICs and HICs.
2/ See, for example, Gill, I. and H. Kharas, 2007, *An East Asian Renaissance: Ideas for Growth*, The World Bank.

[4] See, for example, OECD, 2010: *Going for Growth* and *Pursuing Strong, Sustainable and Balanced Growth: The Role of Structural Reforms;* and the IMF report *G-20 Mutual Assessment Process—IMF Staff Assessment of G-20 Policies*, October, 2010.

The nine developing country members of the G20 are all middle-income countries (MICs), by World Bank country classifications. MICs face particular challenges in that they cannot use the "advantage of underdevelopment" to the same extent as low-income countries. Wages in MICs are high enough to open space for competition from low-income countries in labor intensive manufactures. Meanwhile, MICs' capital stock and the degree of technological sophistication generally lag the levels of the high-income countries. MICs may then be a caught in a competitiveness "trap" that can lead to stagnating growth, as noted in Box 3. These considerations imply an even greater importance for progressing on the structural reform agenda.

The agenda for strong, sustainable, and balanced growth emerging from the G20 MAP discussions includes a strong emphasis on structural reforms across both advanced and emerging market economies. Structural reforms in advanced economies are viewed as being important for repairing the damage to supply potential following the crisis and enhancing long-term potential growth, improving competitiveness, and reducing high unemployment. They are also viewed as important for sustained growth in emerging market economies, with actions in the areas of infrastructure investment and social safety nets also helping to boost domestic demand and contribute to a strong and balanced global economic recovery.

The review of structural reforms outlined by G20 members in their MAP policy submissions in this section focuses on developing country members of the G20, drawing on the Bank's engagement with these countries on these issues. The section also assesses the implications of G20 financial sector reforms for developing countries. Finally, the section reviews G20 external development policies—more specifically trade policies and financing for development.[5]

Structural Reforms and National Development Policies in Emerging Markets

This section provides an overview and analysis of country submissions on structural reforms in three key areas: infrastructure, social safety nets and labor markets. The latter two are treated together given the links between them.

Infrastructure

Infrastructure as a bottleneck for growth and development. In the submissions, governments emphasize the need for investing more in infrastructure for two reasons: to reduce bottlenecks for future growth; and to close the poverty gap. These objectives are supported by the empirical literature, which shows a strong linkage between infrastructure, growth and development. There is a wide variety of experience across the G20 emerging market members in terms of access and efficiency of infrastructure services, as illustrated in Table 3.

Infrastructure financing. With some exceptions, the country submissions do not describe how the new infrastructure will be financed. Some of them have ambitious targets for leveraging private participation but that would require addressing policy and regulatory risks and the development of new financial instruments. The government's role can be made more efficient and effective via several means: improved cost recovery and targeting of subsidies, improved investment planning, implementation, and asset management.

Sector Performance. Infrastructure expansion is necessary in a number of G20 countries; however, improving the performance of existing infrastructure also needs attention. Efforts to reduce electricity and

---

[5] The analysis of aspects of structural reforms (infrastructure, social safety nets/labor markets) of the nine G20 emerging market members summarized in the sections below and in annexes at the end of the report is preliminary. In future reports, the Bank could provide more detailed analysis, drawing on its engagement with these countries.

water losses, and to increase collection rates, can contribute substantially to reducing the fiscal burden of service provision. Most of the country submissions do not put much emphasis on these issues. Improving the functioning of the sector may in some cases also require reviewing the institutional setup--including budget execution, planning, and the role of implementation units.

Table 3: Infrastructure indicators for G20 emerging market countries

	Energy / electricity			Water & Sanitation			Transport	Telecoms
	Energy use (kg of oil equivalent per capita)	Electricity (% of population with access)	Electric power losses (% of output)	Improved water source (% of population with access)	Non revenue water (% of output)	Improved sanitation facilities (% of population with access)	Road density (km of road per 100 km^2 of land area)	Mobile and fixed-line telephone subscribers (per 100 people)
Argentina	1,850.2	97.2	15.6	97.0	31.0	90.0	8.0	141.0
Brazil	1,239.0	97.8	16.0	97.0	39.0	80.0	20.0	99.9
China	1,484.0	99.4	6.0	89.0	22.0	55.0	36.0	74.1
India	528.9	64.5	24.7	88.0	33.0	31.0	111.5	33.8
Indonesia	848.6	64.5	10.6	80.0	30.0	52.0	20.0	75.2
Mexico	1,750.2	*95.0*	16.3	94.0	28.0	85.0	18.3	90.2
Russia	4,730.0	..	10.3	96.0	21.0	87.0	5.5	172.2
South Africa	2,783.8	75.0	8.5	91.0	28.0	77.0	..	101.5
Turkey	1,369.9	*95.0*	13.9	99.0	59.0	90.0	54.5	112.7
Middle-income	1,216.6	..	11.4	88.0	..	56.7	..	71.9
High-income	5,215.9	..	6.0	99.6	..	99.5	..	152.5
Year:	2007	2008	2007	2008	*	2008	*	2008

Source: World Development Indicators, IEA database, and Ibnet. *Most recent estimate available.

Energy efficiency and power generation. Some countries' submissions do recognize the importance of improving energy efficiency. The benefits are twofold: energy efficiency contributes to reducing carbon emissions; and it also contributes to reducing the need for investment in new capacity. In many cases, the cost of one extra MW of power generation is higher than the cost of energy efficiency to save the same amount of power.

Green infrastructure. The country submissions do include some plans for the construction of natural gas plants or the improvement of urban transport systems to reduce CO2 emissions; however, in general, "green infrastructure" is not emphasized sufficiently. Addressing environmental concerns in infrastructure projects can increase the cost and complexity of the investment, but often the additional societal benefits outweigh these costs. Two key factors in achieving a balance between environmental benefits and costs in infrastructure are: the establishment of sound environmental performance standards; and removal of environmentally damaging subsidies that affect infrastructure demands (especially in energy and water).

Annex 1 provides summary highlights of the infrastructure sections of the MAP submissions by G20 emerging market members together with brief assessments. Bank staff country teams reviewed the proposals and provided assessments as well as suggestions for possible additional actions as inputs into G20 MAP discussions. The annex table provides only a brief summary of the staff analysis.

Social Safety Nets

Well-designed safety nets not only provide social protection against shocks but contribute to economic growth by promoting human capital accumulation and labor force participation. Despite progress, G20 emerging market members continue to face substantial challenges in social development. In some countries, social indicators lag middle-income country averages, while in other cases, countries are striving to reach high-income standards in social outcomes. Table 4 provides a summary of the status of social progress.

Table 4: Key social indicators – G20 emerging market countries

	Mortality rate, under-5 (per 1,000) 2009	Mortality rate, infant (per 1,000 live births) 2009	Maternal mortality ratio (modeled estimate, per 100,000 live births) 2008	Malnutrition prevalence, weight for age (% children under 5) (Most recent, 2002-2008)
Argentina	14	13	70	2.3
Brazil	21	17	58	2.2
China	19	17	38	6.8
Indonesia	39	30	240	19.6
India	66	50	230	43.5
Mexico	17	15	85	3.4
Russian Federation	12	11	39	..
Turkey	20	19	23	3.5
South Africa	62	43	410	..
Middle income	51	38	200	22.2
High income	7	6	15	..

Sources: World Development Indicators and Bank Staff calculations.

There appear to be three common trends among the country submissions: expansion of coverage to previously excluded and hard-to-reach groups; integration of multiple safety net programs; and moving social safety net beneficiaries into the labor market through skills training and microcredit. All of these are positive directions, with the ultimate goal of having a coherent national social safety net system that provides protection from shocks and promotes graduation from safety net programs into the work force. One common weakness in the submissions, with a few exceptions, is the lack of information on program costs and long-term sustainability.

Expanding coverage. Both Argentina and South Africa have instituted significant expansions of child grant programs for children under 18. In Argentina this costs 1.1 percent of GDP, while in South Africa expenditure on all social grants is 3.5 percent of GDP and child grants are the largest component of the social grants program. Brazil and Turkey are increasing safety nets services to the disabled, and India and China are expanding coverage to disadvantaged minorities. Brazil, Mexico and Turkey have large conditional cash transfer (CCT) programs that have proved very useful in expanding safety net coverage to households suffering from the negative impacts of the recent crises. Indonesia is currently piloting a CCT program as part of its expanded poverty reduction program. Table 5 provides latest available indicators on the coverage of social protection programs in the G20 emerging market countries.

Integrating multiple systems. Ultimately having a single national social protection strategy will allow countries to implement more effective and efficient safety nets programs and several of the G20 countries are moving in that direction. Turkey is piloting a 'smart card' system that will provide a single payment mechanism for multiple programs. Indonesia is integrating multiple family-based programs into a single family-based social assistance system and has given the Office of the Vice President responsibility for coordinating national poverty reduction efforts. Russia is proposing to revamp its social protection system over the next three years in order to better target the poor and provide a comprehensive set of services. None of the countries appears to be doing a comprehensive analysis of the efficacy of overall social protection systems, including subsidy programs that are expensive and often poorly targeted.

Table 5: Coverage rate of Social Protection programs[6]

(percent of population)

	All Social Protection	Social Insurance programs	Labor Market programs	Social Assistance programs
National				
Argentina[1]	32.4	21.3	0.6	12.4
Brazil	53.2	29.4	6.3	25.0
Mexico	32.9	10.9	n.a.	23.9
Indonesia	47.7	9.4	n.a.	45.2
India[2]	40.0	10.7	4.0	28.4
Russia[2]	58.5	43.1	n.a.	27.0
Turkey[2]	64.1	34.8	0.3	37.1
For the poorest 20% population				
Argentina[1]	36.5	9.7	0.6	28.8
Brazil	63.1	9.3	5.8	55.3
Mexico	45.4	2.4	n.a.	43.6
Indonesia	69.8	14.8	n.a.	66.8
India[2]	44.1	4.0	1.7	40.1
Russia[2]	73.1	47.4	n.a.	45.1
Turkey[2]	66.2	18.3	0.2	55.5

Source: SP Atlas - The World Bank

Notes: [1] Urban areas only; [2] Preliminary findings

Moving safety net beneficiaries into the labor market. An important aspect of an integrated social protection system is the ability to move households off social assistance by giving them the tools to move out of poverty. All the countries have programs to provide skills training, some of which are directly linked to other safety net programs in an effort to move people out of poverty. Some of the countries, such as Brazil, have microcredit programs targeting beneficiaries of safety net programs. Several countries, including Argentina and India, have skills training programs specifically targeting youth.

Labor Market Policies

In part as a result of the crisis, countries have been introducing policies to facilitate the creation of jobs and improve labor productivity. These can be grouped in four categories: upgrade skills and facilitate job search; protect income; support labor demand; and improve incentives for employment creation in the

[6] Figures in this table are preliminary estimates from ongoing work and may contain data gaps that underestimate actual progress. Note that the common definition used for social insurance includes only contributory programs. Non-contributory health insurance programs (such as Mexico's *Seguro Popular* that reached an estimated coverage of close to 35 percent in 2010) are not included. Note also that the three columns in the table may not add up to the total because of overlaps between programs.

labor market.[7] Governments have also made efforts to target their interventions towards vulnerable workers such as the unemployed and youth or workers facing layoffs.

Investing in Skills and Facilitating Job Search. All the countries have implemented and or expanded programs to provide skills training in specific sectors (e.g., Brazil, South Africa) and more broadly (e.g., China). Instruments include Technical Vocational Education and Training (TVET), On-the-Job Training, and training related Active Labor Market Programs. The main challenge has been to make training relevant and move away from supply-driven programs. One promising approach that could receive more attention is the *Jovenes* (youth) programs in Latin America, that combine demand-driven technical training with a wide variety of life-skills training, including problem-solving, workplace behavior, self-esteem, and job search strategies. Another successful program focuses on entrepreneurs, extending both subsidized credit and technical training to current or future small business owners (e.g., Turkey).

Countries have also invested in programs to address information problems in the labor market. These are in essence employment services including counseling, intermediation, skills certification, and job search assistance. Countries such as Korea and Russia have also introduced mobility grants. When these programs are decentralized, rely on private sector providers paid on the basis of performance, and make good use of information technologies, they can be a cost-effective way of facilitating access to jobs. Interesting experiences to follow include Turkey and Chile.

Protecting Income. Most countries have relied primarily on assistance programs (see above) given that unemployment benefit systems are generally underdeveloped. Even in countries such as Russia and Brazil the coverage of these systems is quite limited. A majority of countries rely instead on severance pay—which is problematic given that employers do not pre-fund their liabilities. Countries need to consider implementing and expanding the coverage of unemployment benefit systems. One alternative to consider is the creation of unemployment insurance savings accounts which provide better incentives to keep and search for jobs relative to unemployment insurance, and can be more easily expanded to the informal sector.

Protecting Jobs. Some countries have also intervened to protect or create jobs through wage subsidies and credit to SMEs (e.g., Turkey). The main concern with wage subsidies is that they can delay necessary reallocations of labor and capital—particularly during a downturn—and affect productivity growth over the medium term. They are often also poorly targeted.

Labor Regulations. Several countries have been reforming labor laws seeking to establish a better balance between flexibility and protection (e.g., China, Korea, South Africa). More efficient arrangements can be reached, where fewer restrictions are imposed on hiring and dismissal procedures while extending access to adequate income protection and job search assistance. Lighter and more flexible regulations can then focus on the enforcement of core standards regarding working conditions.

Annex 2 provides highlights of the social safety net and labor market policy sections of the MAP submissions by G20 emerging market members together with brief analysis and suggestions for possible additional actions prepared by Bank staff country teams as inputs into G20 MAP discussions.

Financial Sector Reforms: Implications for Developing Countries

Ongoing G20 efforts to reform financial sector regulatory and supervisory frameworks are critical for strengthening resilience of the global financial system. While the overall orientation and pace of the ongoing work seem appropriate, there is a risk of creating regulatory arbitrage, inconsistency across

[7] According to the recent ILO-WB survey on policies implemented internationally as a result of the crisis, the most common response has been strengthened job search assistance and training (adopted in 66 percent of the countries worldwide). The second most common interventions have been to protect income. Policies to directly protect or create jobs have been less common.

jurisdictions, and financial protectionism if the reform initiatives are not well coordinated. It is also important to ensure that the proposed reforms, including Basel III, do not have unintended adverse consequences for developing countries. Following are some potentially important implications for developing countries that merit attention.

Home-host aspects. It is imperative for both home and host supervisors to collaborate in order to ensure effective supervision of international banking groups both at the consolidated as well as single entity levels. Host supervisors are not only concerned with risks in branches and subsidiaries within their jurisdiction but also any potential build-up of risks within the parent or the consolidated group operating outside. Absence of or inadequate exchange of information, differences in home-host perceptions about the significance of operations, lack of clarity on enforceability of legal or de-facto commitments by parent banks to support their subsidiaries or branches operating in other countries, lack of inclusiveness in supervisory colleges, and costs associated with participation in supervisory colleges at distant locations are some of the factors that can impede effective home-host relationships. In this context, it is important that home authorities be required to (a) supervise the adequate distribution of capital and liquidity in all foreign operations, including those that might be seen as materially less significant from their perspective but could be major from a host jurisdiction perspective; (b) supervise the appropriateness of intra-group transactions and their pricing (for example, management fees, servicing contracts, and hedging operations); and (c) provide access to host authorities or assure them of the adequacy and appropriateness of risk management functions that are housed outside the host-jurisdictions or that are outsourced.

Potential implications of Basel III proposals. The *proposals to enhance capital, liquidity, and leverage requirements* are important for financial sector stability but can have the effect of increasing the cost of finance and limiting the capacity to meet credit demand. While developed countries are better equipped to handle these adjustments, developing economies, particularly the ones at the lower end of the spectrum, can be impacted significantly, not least on account of lack of non-bank financing options. The proposed risk weighting rules can act as a disincentive to lend to small and medium enterprises. On trade finance, the Basel Committee could consider requiring a lower credit conversion factor than the current 100 percent for the proposed leverage ratio for off balance sheet trade finance with a maturity of less than a year, in view of the largely self-liquidating, low-risk and short-maturity nature of these products. Also, the need to meet additional capital and liquidity requirements could create incentives for cross-border banks to draw capital/ liquidity from “less important” jurisdictions to support their “main” operations.

The proposed adoption of a private credit-GDP gap as a key determinant for activation or deactivation of the *countercyclical capital buffer* has important implications for low- and middle-income countries. Besides the issues of quality and availability of data and instability of the ratio due to structural factors, it is likely that application of the proposed guideline could result in erratic activations and de-activations of the buffer as the proposed indicator might not effectively capture build-up of systemic risk in some situations or might overstate risk in others. For example, this indicator may signal a need for additional capital even in low-income economies where increases in the ratio of private credit to GDP are justified because of a low initial base or efforts to improve financial inclusion. There is a case for further examination of the behavior of the indicator and its deviations from trend in a representative sample of low- and middle-income countries to either refine the proposed methodology or include other early indicators.

The proposals for the *liquidity coverage ratio and net stable funding ratio* could prove to be very onerous for a number of developing countries. Care would need to be exercised to strike an appropriate balance between prudent liquidity requirements and the risk of excessively constraining credit growth. The concerns arise mainly on account of structural differences between developing and developed countries, including the former’s generally lower savings rates and relatively small pools of stable retail deposits, and small and less liquid nature of local capital markets that limit banks’ ability to bolster liquidity buffers and/ or lengthen liquid asset maturity profiles. As structural issues take long to be addressed, it is likely that these reforms could face implementation hurdles in some member and a number of non-member countries.

The proposed reforms, with their focus on tightening regulations in the banking sector, can have the consequence of placing banking at a competitive disadvantage relative to non-bank financial sectors. This provides scope for regulatory arbitrage and incentives for *build-up of risk in non-bank or shadow banking segments,* unless the non-bank sectors are subject to an equally tight regulatory regime. Financial sector supervisory frameworks in most developing economies are largely bank-centric and are not adequately equipped to handle non-bank supervision or risks outside the banking system. This can have serious implications unless these supervisory systems adapt well to address the changing dynamics.

Weaknesses in calibration process. The impact assessment and calibration processes for the proposed reforms have been confined to members of the Basel Committee on Banking Supervision (BCBS), leaving out the majority of low- and middle-income countries. This can result in suboptimal calibration outcomes, non-identification of some country- or region-specific implementation issues, and ultimately reduced effectiveness of the reforms in supporting national and global financial stability. Understandably, it would be quite challenging for the BCBS to involve more countries in its impact assessments and calibration exercises. However, in a fast globalizing world, there is a need for a mechanism to bring in the perspectives of low- and middle-income countries in the global reform initiatives and to assess the implications of these initiatives for them. For its part, the World Bank has been playing a facilitating role in bringing the views of its developing country members into the financial regulatory reform process, including through its engagement with the Financial Stability Board and Basel Committees.

Need for flexibility. In view of the wide diversity among developing countries in the level of economic and financial development, it is important to provide adequate scope for them to adapt the reform initiatives to local circumstances. In the past, implementation schedules were indicative rather than binding, and there is value in continuing with a similar approach. While the implementation schedules that are proposed for various regulatory reforms are primarily intended for G20 members, others are generally expected or encouraged to adopt the same schedule. However, given the lower capacity of the supervisory and regulatory institutions in developing countries, and the time needed to undertake impact assessments and to customize reform initiatives to specific local conditions, it would be helpful for non-member countries to have sufficient flexibility to tailor implementation schedules to their circumstances.

Technical assistance needs. The rapid pace of global reforms in the area of financial regulation and supervision in a short span of the last two years has been overwhelming even for some of the G20 countries, which is partly reflected in the phasing-in and stretched implementation schedules. One of the biggest challenges for developing countries will be the translation of these changes into national rules, regulations and legislation, as appropriate for their systems. Given the considerable capacity constraints in many of these countries, it is clear that most of them will need technical support for implementation. Since the onset of the crisis, a number of developing countries have sought technical assistance from the World Bank, and the demand for assistance is expected to increase substantially in the period ahead. Providing adequate and timely technical assistance to developing countries to bolster their regulatory and supervisory capabilities following FSAPs and ROSCs, and therefore promote their adherence to improved international standards, will be a high priority. This can be an important area for G20 support, including, for example, through expanding participation in and contributions to the Financial Sector Reform and Strengthening (FIRST) Initiative.

External Development Policies

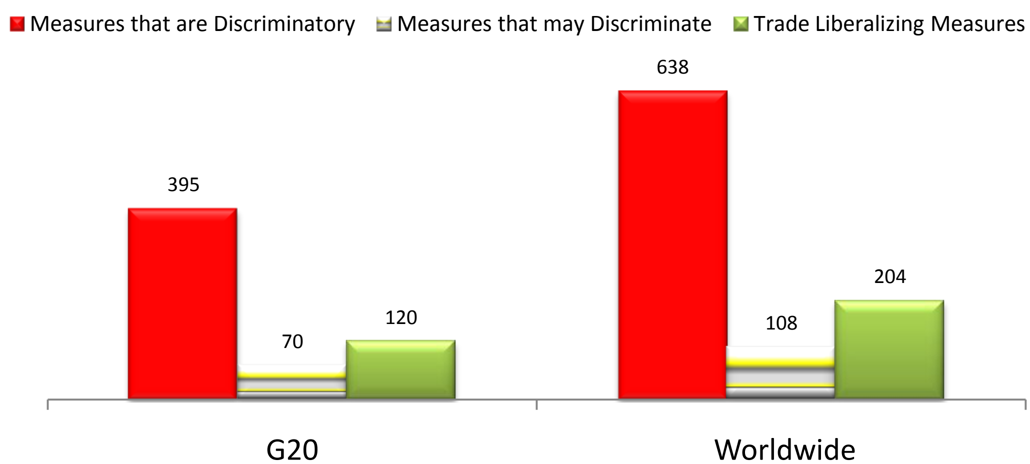
Trade Policies

An open trade environment is essential for a sustained economic recovery and for enabling the growth rebalancing to work. Keeping trade open will be important for sustaining the recovery as the fiscal and monetary stimuli are withdrawn. Trade, supported by investment and associated technology flows, is a key channel for multipolar growth and diversification of global demand.

Trade policy developments. Notwithstanding the difficult circumstances of the recession and rise in unemployment, the G20 have by and large adhered to the commitment made at the outset of the crisis to avoid protectionism. Although restrictive actions have been taken by practically all G20 countries, the trade coverage of these actions has been small. However, while open protectionism has been resisted relatively well, there is concern that opaque or murky protectionism has been on the rise.

Between November 2008 and August 2010, governments worldwide have implemented about 950 trade measures, including about 640 trade-distorting measures. G20 members have imposed close to two-thirds of these measures (Figure 8). Over the same period, about 200 trade liberalizing measures were taken worldwide, about three-fifths of which by G20 members.[8] The recent surge in wheat prices led to the imposition of export restrictions by some countries. While these restrictions are often introduced as an attempt to address the political economy of rising domestic food prices, they only make matters worse in the longer term both from a global and domestic perspective.

Figure 8: Trade measures implemented worldwide and by G20, November 2008-August 2010



Source: GTA Database

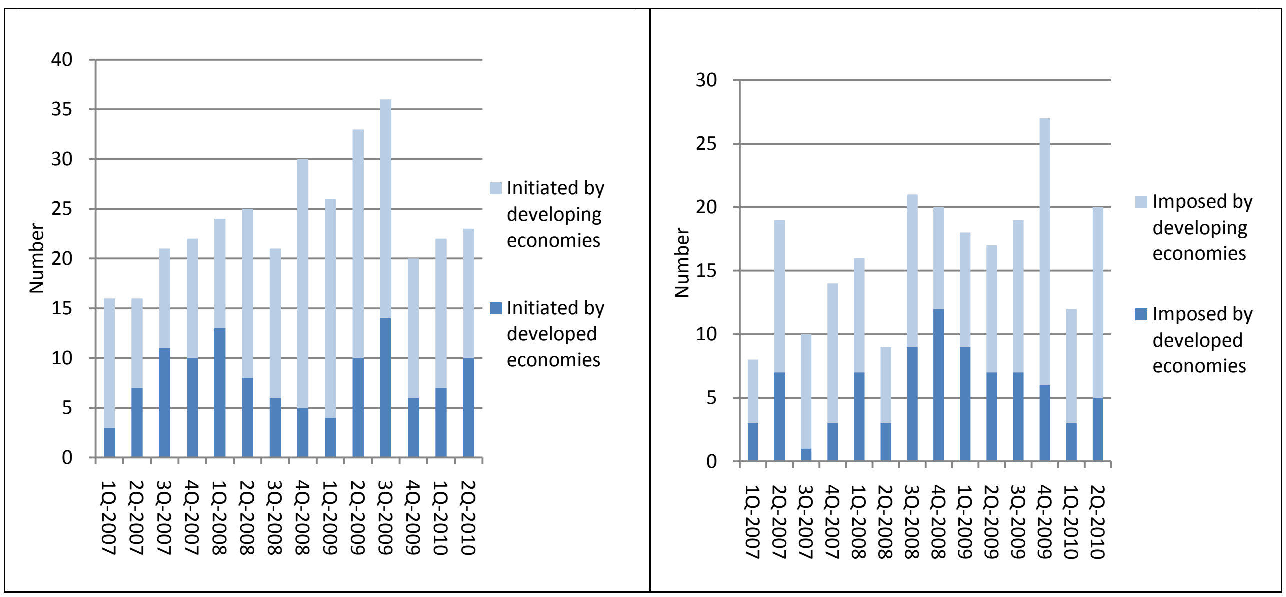
Among the trade measures implemented, there has been a sharp rise in the use of antidumping actions, safeguards, preferential treatment of domestic firms in bailouts, and discriminatory procurement. The major G20 users of antidumping actions, countervailing duties, and safeguards combined to have 25 percent more import product lines subject to these barriers at the end of 2009 than they did in 2007. More recent data indicate that resort to these actions has subsided relative to 2009 (Figure 9), though it remains elevated relative to the pre-crisis period. Such actions are not just North-South. About half of such barriers in 2009 were South-South in nature. Another risk to watch out for is that as fiscal retrenchment occurs, there might be a temptation to replace subsidies and preferential treatments granted in bailout

[8] Based on the Global Trade Alert, including data reported by the WTO quarterly Trade Policy Review.

programs with new trade barriers. Bailouts and state aid programs account for an estimated one-third of all discriminatory trade measures imposed during the crisis period.

Overview of G20 policy submissions. G20 submissions on trade policy present a mixed picture. Several submissions, notably from developing country members of the G20, include measures to reduce tariff barriers (e.g., Australia, Canada, China, Mexico, Turkey, South Africa). Many tariff reduction measures proposed by G20 countries are targeted at low-income countries with a view to improving their market access (e.g., China, EU, India, Korea). A few G20 members also indicate actions to increase tariffs or maintain previous increases (e.g., Argentina, Russia, South Africa). Few G20 submissions include actions or proposals to reduce non-tariff barriers. Also, few G20 members mention the potential for further liberalization of trade in services (e.g., Australia, Indonesia, Korea, Russia). A number of G20 members, especially developing countries, include measures to encourage foreign direct investment and promote exports (e.g., Canada, China, India, Mexico, Saudi Arabia, South Africa, Turkey, US). A majority of G20 members do not mention the Doha Round in their submissions. (Australia, Brazil, Germany, India, Japan, Saudi Arabia, and US are among those which do.) In contrast, preferential trade agreements are on the agenda of most G20 countries. About half of the submissions explicitly mention support for aid for trade (Australia, EU, France, Germany, UK, US among them), with some providing more specific details.

Figure 9: Combined G20 use of antidumping actions, countervailing duties, and safeguards



Source: Global Antidumping Database

Priorities in the trade agenda. G20 leaders recognized early on the potential systemic risks stemming from protectionist policy responses. They can boost market confidence by renewing their commitment to refrain from protectionist measures. An even stronger signal would be a collective pledge to unwind the protectionist measures that have been put in place since the onset of the crisis in August 2008. In particular, G20 leaders could announce their intention to review all contingent trade measures introduced since August 2008, such as anti-dumping and safeguard measures, with a view to eliminating some proportion (say half) of them by the time of their next meeting. Also, G20 leaders could commit to deal with possible food price hikes in a cooperative manner and not resort to food export restrictions and to review this commitment at their next meeting.

Trade rules matter. Areas that are not subject to multilateral discipline or where the coverage is unclear or limited are the ones that have seen more restrictive actions. Strengthening multilateral trade disciplines and moving ahead swiftly with the Doha Round therefore are important. Conservative estimates put the global real income gains from a successful Doha agreement at $160 billion. A Doha Round agreement would impart a non-debt creating stimulus to the global economy.

Harmonizing the programs of trade preferences granted by developed and emerging countries to the Least Developed Countries (LDCs) would help increase their overall usefulness. Currently, trade preference programs provide high levels of product coverage but with important exceptions, mostly related to agricultural products and apparel. All G20 countries could consider extending 100 percent duty-free and quota-free access to LDCs, with liberal rules of origin.

For developing countries, building trade capacity can be at least as important as improved market access in boosting trade. So a complementary priority is the strengthening of support for trade facilitation to address behind-the-border constraints to trade—improvement of trade-related infrastructure, regulations, and logistics such as customs services and standards compliance. Research shows that raising logistics performance in low-income countries to the middle-income average can boost trade by 15 percent or more. One possible initiative would be for the G20 leaders to call on international organizations active in this area to coordinate a collective effort to establish a pool of trade facilitation experts that developing countries could call on for in-country and results-oriented trade facilitation upgrades. In support of trade facilitation, aid for trade should be scaled up substantially. The Global Aid for Trade Review in 2011 provides a timely opportunity to renew and expand commitments. Public-private partnerships in aid for trade can make the resources go further by leveraging the dynamism of the private sector in strengthening trade capacity.

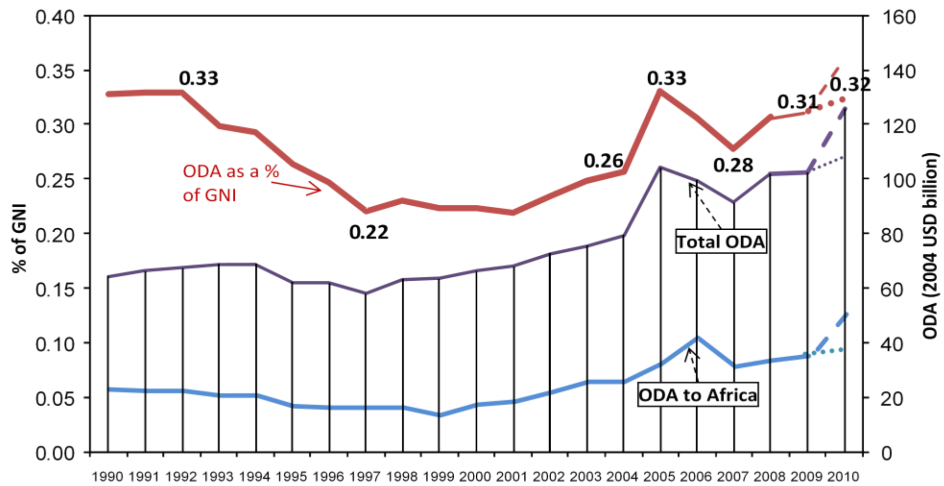
Financing for Development

With a tighter post-crisis outlook for private capital flows to many developing countries, official flows take on added importance, both in directly providing development finance and in leveraging private capital. This includes ensuring adequate official development assistance (ODA) and supporting multilateral lending with enough capital. While ODA has trended upward in recent years, overall it is falling short of donor commitments and the needs of low-income countries for which it constitutes an especially important source of financing (Figure 10). Net ODA by members of OECD-DAC is estimated to rise by only two-thirds of the $50 billion increase by 2010 envisaged at Gleneagles. Net ODA to Africa is estimated to rise by only one-half of the $25 billion increase targeted at Gleneagles.

In their policy submissions, several G20 members, including both traditional and emerging donors, indicate their plans to maintain or boost development aid and make it more effective. However, not all submissions address external assistance with sufficient detail or specificity. It would be desirable to have a coordinated position among the G20 to protect aid programs as fiscal consolidation strategies are designed and implemented. At the same time, more can be done, by donors and partner countries working together, to further progress on the Accra Agenda for Action to improve aid effectiveness—stronger country ownership and alignment with development priorities, improved aid predictability, and a stronger focus on results. The current economic context reinforces the need to ensure more effective use of resources to achieve development results.

Multilateral development bank (MDB) financing played an important countercyclical role in supporting developing countries' efforts to respond to the crisis, complementing financing provided by the IMF. Total MDB financing rose sharply in response to the crisis, with the World Bank Group contributing close to three-fifths of the total. The International Bank for Reconstruction and Development (IBRD) alone delivered a record $77 billion in new commitments during FY09-10, triple the pre-crisis annual lending. Thanks to the MDB capital increases agreed over the past year, MDB commitments could average about $65 billion a year in the next several years, compared to the average pre-crisis level of about $38 billion a year. Nonetheless, in terms of net flows, MDB lending will remain small compared to developing country needs for long-term capital.

Figure 10: DAC members' net official development assistance



Note: Dashed line indicates the growth-adjusted trajectory envisaged at Gleneagles.
Dotted line indicates estimates based on donors' reported intentions or budget plans.
Dotted line for Africa indicates DAC estimate of likely actual spending.
Source: OECD Development Co-operation Report 2010.

Much of the increase in MDB financing during the crisis was in non-concessional financing. Concessional financing rose more modestly. The MDB concessional windows, especially the International Development Association (IDA) and the African Development Fund, need strong replenishments to enable them to meet the increased needs of low-income countries responding to the financial crisis, as well as the aftermath of the food and fuel crises that preceded it. The need for concessional finance has risen as fiscal space in low-income countries has come under pressure while social spending needs, including expansion of social safety nets for poor and vulnerable groups, have increased as a result of higher poverty and unemployment. Innovations such as the IDA crisis-response facility have improved the responsiveness of concessional financing to crises (Box 4).

Supplementing traditional financing with innovative finance. The conjuncture of tighter capital market access for many developing countries and fiscal stress among donors implies the need for supplementing traditional modes of development financing with innovative forms of finance to help mobilize additional resources and increase value for money. In their policy submissions, several G20 members refer to their support for various innovative finance initiatives.

Ensuring adequate financing for development will require innovations in leveraging private capital. With a rise in market perception of risks, there will be more demand for guarantees and insurance mechanisms (multilateral and bilateral) to mitigate the risk faced by long-term private investors in developing countries. Such instruments can provide significant leverage. For example, the World Bank Group issued about $7.7 billion in guarantees between 2000 and 2008 to support investments in financial and productive sectors of developing countries. These guarantees leveraged total investments of about $20 billion, a leverage ratio of roughly 2.6. Since the onset of the food, fuel, and financial crises, there has been a surge in interest among developing countries in products to help manage risks linked to natural disasters, commodity price volatility, interest rate and currency volatility, and financial contagion.

Public-private partnerships offer much potential and a variety of possibilities. A potentially important source of development financing is the multi-trillion-strong sovereign wealth funds (SWFs). An innovative example that offers scale-up possibilities is the recent investment by several SWFs in an IFC equity fund. A complementary element is ongoing progress in strengthening international financial safety nets. Reduced demand for reserves for self-insurance against risks of economic volatility and capital flow reversals could free up more of developing countries' own resources for investment.

Box 4: IDA 16 Replenishment

IDA 16 will cover the critical period to 2015, the target date for the MDGs. A strong replenishment is needed to match a high level of ambition. The overarching theme of IDA 16 will be a stronger focus on development results. The goal will be to achieve better and faster development outcomes by further strengthening IDA's results framework.

One of the world's largest sources of aid, IDA provides support to the 79 poorest countries—39 of them in Africa. These countries are home to 2.5 billion people, 1.5 billion of whom survive on $2 a day or less. IDA funds are not tied to any given sector. Governments determine their own priorities. And should conditions change—in the face of economic shock or natural disaster—IDA funds can be redirected as needed. IDA's 2010 commitments reached a record $15 billion—$7.2 billion of that for Africa. About one-fifth of this funding was provided as grants, the rest is in the form of interest-free, long-term credits. IDA also helps maximize scarce aid resources: every $1 of IDA aid leverages, on average, another $2.

With help from IDA, 27 countries—home to 2.1 billion people or 34 percent of the world's population—have "graduated." Their economic development means they are no longer reliant on IDA support, and many have gone on to become IDA donors.

During the past decade, IDA funding helped save at least 13 million lives. IDA financing immunized 311 million children; provided access to water and sanitation for 177 million people; helped more than 47 million people receive health services; provided nutrition supplements to 99 million children; and brought better education to more than 100 million children each year.

South-South financing and investment—from SWFs, corporations, and governments—are rising and offering new opportunities. Some countries, such as China, are trying to improve the standards governing these flows. For example, China has worked with the IFC to introduce Equator Principles into its operations. China and the World Bank are collaborating on investments in infrastructure, industrial zones, and health in Africa.

Remittance flows to developing countries—with officially recorded flows currently running at about $330 billion annually— have grown to almost three times the size of total net ODA. The 5x5 initiative that followed from the 2008 G8 summit in Hokkaido and that aims to reduce remittance fees by 5 percentage points in 5 years can increase remittance flows by an estimated $15 billion annually. Diaspora bonds are another innovation that seeks to tap into the wealth of the stock of migrants from developing countries.

Financing of global public goods and programs. Innovation and partnerships—involving governments, private sector, international institutions—will be particularly important in the financing of global public goods (GPGs) and development-linked global programs, notably in health, food security, and climate change. Multilateral approaches involving pooled donor funding increasingly are playing a central role in addressing the GPG agenda.

- Private aid, which on some estimates approached $50 billion in 2007 (close to one-half of ODA in that year), has been playing an increasingly important role in partnership with public funding in programs to combat communicable diseases (e.g. Global Fund to Fight AIDS, Tuberculosis, and Malaria and Global Alliance for Vaccines and Immunizations). Other important innovations include the International Finance Facility for Immunization that frontloads financing needed for immunization programs in poor countries, the Advance Market Commitment mechanism that subsidizes private costs of vaccine production for developing countries, and voluntary solidarity contributions such as the UNITAID international solidarity levy on air travel.

- The Global Agriculture and Food Security Program launched this year provides an innovative public-private partnership mechanism to support national and regional plans for agriculture and food security in poor countries.
- Innovative partnerships, such as the Climate Investment Funds, are playing a key role in addressing the challenges posed by climate change. Carbon markets have emerged as a potentially important source of development finance, especially in helping to meet the large investment needs to increase developing countries' access to affordable and clean energy.

Estimated financing needs in some of these areas are large. For example, the High Level Task Force on Innovative Financing for Health Systems estimates that in addition to current domestic and external health financing, about $36 billion annually would be required to achieve the health MDG and support national health systems to address communicable diseases in the 49 poorest countries. The Global Strategy for Women's and Children's Health launched at the conclusion of the 2010 UN Summit on MDGs, which aims to mobilize public and private resources of around $40 billion over the next five years, is therefore a welcome initiative. The International Food Policy Research Institute estimates the incremental public agricultural investment needed to reach the MDG on reducing hunger to be about $14 billion a year. The World Development Report 2010 estimates that current climate-dedicated financial flows to developing countries cover less than 5 percent of what these countries will need to spend on climate change mitigation and adaptation in coming years. The scale of the resource needs calls for both a renewed commitment of support by the G20 to such key global programs and for renewed vigor and creativity in exploiting the potential of innovative approaches in development financing and partnerships that leverage private sector funds.

Domestic resource mobilization and financial sector development. External financing can only complement stronger domestic resource mobilization by developing countries themselves. This includes efforts to mobilize revenues through improved tax policies and strengthened administration and to upgrade expenditure management. Revenues were already low in many poor countries prior to the crisis and have declined further. There is also a need to continue to improve the environment for private investment, domestic and foreign.

Financial market development is important, both for effective engagement with globalized finance and for better mobilization and allocation of domestic resources for development. Inefficiency of domestic financial sectors can make borrowing costs in developing countries as much as 1,000 basis points higher than in advanced economies. Simulations suggest that if developing countries can improve domestic financial intermediation to lower interest rate spreads by an average of 25 basis points a year, they can raise their long-run potential output by 7.5 percent, with the largest gains accruing to countries and regions currently facing the highest spreads.

Some aspects of financial sector development, such as improving access of the poor to financial services and strengthening SME finance, are already the subject of attention in the G20—including setting a global target for progress on financial inclusion and developing a global partnership in support of that goal. This is important: almost 70 percent of the adult population in developing countries or 2.7 billion people lack access to basic financial services, and surveys show that SMEs are at least 30 percent more likely than large firms to rate financing constraints as a major obstacle to growth. But there is also the need to strengthen financial systems in developing countries more broadly. Expanded technical and capacity building assistance to financial sector reforms in developing countries can be a key area for G20 collective action in support of development.

Annex 1: Overview of Infrastructure Policies – G20 Emerging Market Countries

Highlights from country submissions	Comments	Additional actions for consideration
(1) Argentina -Increase in public infrastructure investment from 1% of GDP (1990s) to 3.1% currently. -Focus on *Energy* sector, including electricity, gas, hydro and nuclear power investments. -Launch of National Program for Rational and Efficient Use of Energy. *Transport*: Regional roads in several poorest provinces; urban transport in Buenos Aires.	-These developments are positive and important for sustaining strong and inclusive growth. -Need to translate strategy and plans into sound specific investments and policies.	-Infrastructure needs of poorest provinces in *Norte Grande* region are one priority. - Current plans promising, but large infrastructure gap in these lagging provinces.
(2) Brazil -Growth Acceleration Program (PAC 1 and 2). - PAC 1 of $375 billion and 46 % has been concluded by May 2010. -Six major investment areas, ranging, from urban upgrading, housing, transport, energy and water. -Energy, housing and transportation investments account for 95% of total amount in PAC 2. -*Sports Events:* World Cup/Confederations' Cup ($ 21.7 billion); Olympics ($ 14.9 billion).	-Higher investment in water-sanitation, but may not reach universal access in 10 years. -Housing program: challenge to reach lower-income segments (0-3 MW). -Climate investments: may need to clarify roles and responsibilities for licensing across levels of government.	-Consider moving toward a results-based approach for water-sanitation. Conditional tax reduction for water and sanitation service providers as one possible instrument. - Lessons from the recent South Africa experience on the World Cup could be useful.
(3) China -Fiscal stimulus: new central government investment totaling 1.18 trillion yuan over 2 years—leverage of private investment resulting in total investment of 4 trillion yuan. -Investments in many areas, ranging from housing and rural social infrastructure to energy conservation and emissions reduction; post-disaster reconstruction. -*Policy:* measures to further expand the scope of private investment; reduce restrictions on private investment.	-Late-2008 stimulus package was heavily investment-led, quickly implemented, and effective as stimulus. -Composition of the package: broadly in line with China's emerging challenges. -Strong track record in infrastructure development; this area not likely to be a critical bottleneck for the economy.	-More financing by direct fiscal channels rather than off-budget, quasi-fiscal ones. -Consider greater use of multi-year budgeting. -Reform of intergovernmental fiscal relations -Attention to O&M with rapidly rising infrastructure stock.
(4) India -Target: increase total investment in infrastructure from around 5% of GDP in 2006-07 to 9% by 2011-12. -Contribution of private sector in total infrastructure investment of 34% in first 2 years of 11th Plan. - Increase ratio of infrastructure investment/GDP to about 10.7% by end of 12th Plan, with at least 50% from private sector. -Other targets: Triple electricity capacity in current five year plan; 20 km a day in highway investment. -*Energy Subsidy:* Petrol and diesel to be market-determined (except for price spikes).	-Targets strong but implementation remains a constraint. Achievements during first two years of the 11th Plan lower than expected. -Implementation uneven across sectors: roads, water supply, power generation and railways likely to face shortfalls. -Infrastructure quality remains an issue.	-Consider greater focus on rural access to services. -Greater attention to implementation. -Regulatory reforms to lower regulatory risks for PPPs. -Consider new financing instruments, such as proposed infrastructure debt fund and credit enhancements. -Consider pricing reform to improve incentives for renewable energy.

Highlights from country submissions	Comments	Additional actions for consideration
(5) Indonesia -Policy consolidation related to use of land; -Goal to build or improve 19,370 km of road by 2014. -Subsidized housing for 836,000 poor families by 2012. -Canal development to manage routine floods in Jakarta1 by 2012 and in Central Java by 2013. -Finish construction of an optical fiber network for telecommunication in eastern Indonesia. -Upgrade transport network in four cities. -Presidential Regulation 13/2010 to strengthen government guarantees/government finance for infrastructure; procurement reform. -Creation of PT Indonesia Infrastructure Finance.	-Government spending on infrastructure as a share of GDP similar to pre-1997/98 crisis level. -Private investment has not recovered as much. -Likely to see some increases in government spending and execution of budgets; private investment to remain a challenge. - PT Indonesia Infrastructure Finance a positive step to increase PPPs.	-Consider pricing reform of utilities/ infrastructure services. -Consider tighter prioritization of projects. -Address remaining bottlenecks (primarily land). -Consider how other countries have dealt with similar problems, eg. India, which has benefited from a surge in private investment in infrastructure.
(6) Mexico -Investment in infrastructure now 5% of GDP, higher than average level of 3.5% for OECD countries. -Increase of 40% in investment/GDP ratio during first 3 years of the current administration compared with 2000-2006 average. -Federal investment in roads: increase of almost 100% relative to its 2006 value; water by more than 60%. -Higher investment to be complemented by a series of legal reforms (before Congress), including a PPP law. -Modification of rules for Institutional Retirement Accounts to allow for investment in infrastructure funds.	-Large share of investment (2% of GDP) and of the increase in investments in government-owned oil sector. -Progress in private participation in public infrastructure more modest than originally hoped. -Proposed public-private partnership law should facilitate private participation. -Limited fiscal space and project preparation capacity are issues.	-Consider institutionalizing M&E of implementation of national infrastructure program, given roles of multiple agencies. -Consider setting up a public-private partnership coordination unit that promotes the use and assists in design of PPP schemes. -Consider creating additional fiscal space through a broad based tax reform.
(7) Russia -Investment activity at public enterprises in all sectors expected to rebound in 2011 and accelerate in 2012. -Main areas of the revival: transport infrastructure, and priority financing of strategic activities in high-tech areas (space sector, shipbuilding, aircraft industry and instrument-making industry). -Funding for these purposes in 2011 will increase by more than 15% over current year. -Scientific and technological complex (Skolkovo). -Construction of the facilities of the XXII Olympic Winter Games, the XI Para-Olympic Games of 2014, the XXVII World Summer *Universiade* of 2013, and the APEC Summit in 2012.	-More focus on policy initiatives aimed at addressing Russia's overall infrastructure constraints and funding gap. -BEEPS survey and World Economic Forum survey highlight transport infrastructure as increasingly becoming a constraint to growth. -Underinvestment in maintenance has resulted in rapid deterioration of road network.	-Support for new policy initiatives: comprehensive program to increase energy efficiency; private participation in infrastructure. -Draft budget law 2011-2013 indicates government's commitment to increase funding to road sector. An increase in road expenditures will be financed from an increase in excise taxes on gasoline over 2011-13.

Highlights from country submissions	Comments	Additional actions for consideration
(8) South Africa -Energy: R385 billion on construction of electricity generating projects. -Upgrades in urban transport underway, including a high speed passenger train, the *Gautrain*. -Investment in freight transport to improve rail freight services, expand harbor capacity, and improve harbor operations. -Investment in submarine fiber-optic cable projects. -Other projects: Gauteng Freeway Improvement Project, new multi-product pipeline between Durban and Johannesburg, construction of container terminal at Ngqura in Coega IDZ, and capacity expansion on iron ore and coal lines.	-Fairly aggressive infrastructure development program. -Significant challenges with respect to environmental degradation – GHG emissions, water management, air and water pollution, and biodiversity. -High energy intensity of the economy; reliance on coal for energy generation.	-Commitment to global climate change agenda, captured in Long-Term Mitigation Scenarios (LTMS) including a shift away from coal toward renewable energy and nuclear energy. -LTMS commitment is supported by an Integrated Resource Plan, a comprehensive long-term resource planning exercise vetted through an extensive consultation process.
(9) Turkey -Medium Term Program for 2010-2012 includes efforts to improve implementation and effectiveness of public sector investments. -Investment focus on education, health, technological research, transport, water and ICT. -Regional public sector investments, especially South Eastern Anatolian Project, Eastern Anatolian Project, and Konya Plain Project. -Legal framework for public private partnership (PPP) model to be completed in 2010. -Improved analysis of public investment decisions.	-Policy in the energy sector, a key potential growth bottleneck, continues to be strong, including further privatization of generation and transmission and cost pricing. -The PPP legislation, however, might not be passed in 2010.	-Passing the planned amendments to the Renewable Energy law could increase inward investment in this important sub-sector.

Annex 2: Overview of Social Safety Net/Labor Market Policies – G20 Emerging Market Countries

Highlights from country submissions	Comments	Additional actions for consideration
(1) Argentina -Old age insurance system managed by government and pay-as-you-go. -Non-contributory pension for 900,000 low income elderly. -Universal allowance per child (AUH): $47 per month to families with three or more children. (Coverage of 3.7 million children.) -Heads of Household Plan—assistance to unemployed heads of household -Social Inclusion Plan for families—cash transfers while promoting use of social services for children. -Solidarity Federal Fund for social investments in poor regions financed by 30% of collection of soy export tax. -Training and employment insurance program: blend of training and job search assistance. -Productive Recovery Program: subsidies to firms with financial problems to maintain employment.	- Implementation of the AUH a major step in design of a long-term national social policy that aims at reaching the most vulnerable. - Labor market reform initiatives for skill development, unemployment benefits and job search incentives, as well as tax benefit to formalize--all positive steps. -Some employment regulations seem to be less flexible in Argentina than in other countries in the region or the OECD. Nearly half of the labor force is informal--limiting social protection/legal protection for the workforce.	-Consider a Law to consolidate the legal status of the AUH and thus ensure long-term institutional sustainability. Key challenge is to include all eligible children in the program. -Pension coverage increased rapidly (from below 70% of the elderly to 95% in very few years); however, long term sustainability needs to be re-assessed. -Caution on minimum wages: evidence that minimum wage levels above 50% of the median wage lead to increases in unemployment/informality.
(2) Brazil -*Bolsa Familia* CCT program to be extended to 13 million families by end-2010. -Personal income tax deductions to encourage housekeepers' entrance into formal sector. -Minimum wage increases in real terms. -Small business tax simplification to provide an incentive for increased formal sector employment. -Unemployment insurance benefits extended by two months.	-The CCT program *Bolsa Familia* is the main tool of social policy. It is a well targeted program that costs only 0.4% of GDP per year but reaches over 12 million families – about 28 million people – 25% of the population – who mainly work in the informal sector.	-Consider strengthening labor market information systems, and linking training programs to job opportunities. -Reform of pension system of public sector employees has not advanced in Congress. It is key to achieving medium-term sustainability of the social security system.
(3) China -Improvements in basic living allowances in urban and rural areas. -More support to social insurance system, including both health and pensions. Over 2009-2011, increase of RMB 850 billion to support the reform of medical and health system. -Postponement of social insurance contributions to stimulate employment. -Enhance training programs, including life-long learning and a program of occupational qualification certificates. -Rural migrant workers—training programs, simplified labor contracts, extension of social programs.	-Over the 11th Five Year Plan period, strong progress in expanding coverage and raising benefits of various SSN programs, albeit from a very low base. -Part of labor market flexibility reflects extensive informal employment. New labor legislation in 2008 helped adjust the balance between flexibility and protection of workers' rights.	-Health insurance: consider more integration and pooling of insurance at regional level for efficiency and equity. -Proposal to have 90% insurance, premium-based, probably unrealistic for medium term; schemes currently 80-90% funded from general revenues. -Proposed vocational training regulations: important to ensure balance between "supply driven" government interventions and more "demand driven" ones led by the private/enterprise sectors.

Highlights from country submissions	Comments	Additional actions for consideration
(4) India -Expansion of health programs and national health survey in 2010/11. -Rural employment and rural health programs. -Active labor market policies to support employment. -National Social Security Fund for Unorganized Sector Workers established. -RSBY national health insurance—use of smart cards. -Employees' State Insurance Corporation (ESIC) implemented and targeted to lower income workers. -New training centers set up, including public-private partnerships (National Skills Development Corporation.)	-Key national employment generation and social security programs (eg MGNREGA, RSBY) have been expanded to support the poor during the crisis -Pilots being implemented to improve delivery, targeting and monitoring services (e.g. through use of smart cards). -Skills development mission has large potential impact on improving skills of the informal sector.	-Strengthening of the design, targeting, implementation, monitoring, and evaluation of major programs. -Consolidation of programs, particularly at the state level. -Improved coordination between skills training entities and a national vocational training framework.
(5) Indonesia -Increased budget projected for social programs. -Expansion of small credit program. -Revitalization of National Committee for Poverty Prevention. -Development Plan includes programs for: family assistance; community empowerment; and expanding opportunities for low-income households. -Pilot CCT (Program Keluarga Harapan, PKH). -Expanded health insurance.	-Ambitious program to improve the effectiveness of social assistance/ anti-poverty programs. With strong leadership, good prospects for success.	-Reduction of spending on untargeted subsidies that are still significantly larger than social assistance. -Extension of reforms to social protection programs (pensions, unemployment benefits) and labor market regulations. -Improved worker training programs.
(6) Mexico -Reform of the public employees' pension system. -Spending on *Oportunidades* CCT program—increase of 49 % in real terms from 2007 to 2010. -Resources for *Seguro Popular* health program—increase of 206% in real terms from 2006 to 2009. -Labor market reform presented to Congress in March 2010. Productivity established as main criterion for access to new vacancies; caps placed on legal claims; measures to improve transparency of labor unions.	-Timely and important increase in the *Oportunidades* CCT program to compensate for higher food prices. -Proposed reform to labor legislation provides for a modest step in the right direction but does not constitute a watershed overhaul of a very protective and costly legislative framework.	-Consider transforming the current severance payment scheme into an unemployment insurance program. -Consider introduction of a minimum, non-contributory health insurance and pension system paid out of general tax revenue (existing mandatory schemes serve as "top-up").
(7) Russia -Plan over 2010-12 period to form a modern and efficient system of compulsory social insurance. -Pension reforms to assure minimum level of support and increasing the target replacement rate. -Regional social contracts piloted for targeting social assistance to the poorest. -Minimum wage increases. -Programs to facilitate migration across jurisdictions within the Federation.	-Positive steps overall. -Increase in pension payments could pose fiscal challenge. -Improved targeting, but social assistance system still generally regressive. -Positive steps to facilitate internal migration (transportation subsidies for relocating unemployed).	-Consider parametric and funding reforms for pensions. -Consider an annual efficiency assessment of regional social assistance as part of Government Annual Report on performance of the regions. -Consider improving worker training programs to address skills mismatches.

Highlights from country submissions	Comments	Additional actions for consideration
(8) South Africa -More than 13 million receive social assistance grants (3.6% of GDP in 2009/10). -Second phase of national skills development strategy underway. -Expanded Public Works Program for job creation (target of 2 million jobs for the poor by 2014). -Training Layoff Scheme—training program for temporarily unemployed. -Labor reform proposals: new rules for dismissal; expansion of collective bargaining; expansion of duration and replacement rates of unemployment insurance; clarification of affirmative action guidelines; enhanced job search/matching services.	-Appropriate direction of reforms, keeping in mind the skills gap highlighted in many recent studies and deterioration of the unemployment situation during the global crisis. -Urgency of South Africa's extraordinary situation, with unemployment rate at 25. 3% (32.8% including discouraged workers) and mostly impacting the lower end of the labor market.	-A recent report by OECD has recommended limiting the legal extension of collective bargains and strengthening the coordination mechanism of wage bargaining to foster wage moderation. -Proposed consolidated contributory social security system would bring efficiency gains and enhance coverage. Specifics still to be developed.
(9) Turkey -Continued implementation of 2006 Social Security Institution Law. -Improved administration via reduced red tape, improved IT infrastructure and use of "smart cards." -Improved effectiveness of social assistance programs. -Strategy/Action Plan for improving training programs, with new qualification framework (à la EU), and institutional strengthening of Turkish Employment Agency. -Public works programs for temporary employment.	-Good progress since 2008 toward integrating separate social security systems under a single institute (SSI). -The significant expansion of the Green Card Program (health insurance to the poor) and family medicine model also important. -Promising employment strategy.	-Consider greater focus on inter-generational transmission of poverty and ECD. -Reduce fragmentation of social assistance programs run by central and local agencies and increase coverage (e.g. CCT). -Consider reforming severance pay and regulations facilitating short-term and part-time employment.