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Strengthening efforts at all levels to promote pro-poor sustained economic growth, including through equitable macroeconomic policies

Report of the Secretary-General

Summary

In its decision 2007/206 of 2 March 2007, the Economic and Social Council decided that the thematic discussion of its high-level segment would be on the theme "Strengthening efforts at all levels to promote pro-poor sustained economic growth, including through equitable macroeconomic policies". The present report is in response to the decision and includes both conceptual and policy issues related to the theme.

Historical evidence is strong that sustained economic growth is an important factor in reducing poverty. The linkage between growth and poverty reduction is, however, complex. The report examines different approaches to the concept of "pro-poor growth". It proposes that the objective of policy should be to promote broad-based growth that will contribute to the achievement of the internationally agreed development goals, including the Millennium Development Goals.

The experiences in sustained economic growth and poverty reduction have varied considerably among countries. In most of the rapidly growing economies, inequalities have also increased. At the national level the basic case for a broad-based approach for macroeconomic policies is for it to become the principal instrument for promoting pro-poor sustained economic growth.

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Globalization, spurred by the growing interdependence in the areas of finance, trade and technology, requires that international policies should be geared towards supporting national efforts to promote inclusive pro-poor growth. For many economies the impact of forces outside their direct control calls for special efforts in creating an international environment supportive of national efforts. The present report highlights a need for international and regional coordination of macroeconomic policies in order to create more stable conditions for growth.

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I. Introduction

1. In the 2005 World Summit Outcome (General Assembly resolution 60/1), Heads of State and Government reaffirmed their commitment to eradicate poverty and promote sustained economic growth. Sustained economic growth is an important factor in reducing poverty, but the linkage between economic growth and poverty reduction is complex. For this reason, the term “pro-poor growth” has been introduced in different contexts in an effort to focus attention on achieving economic growth that is accompanied by a reduction in poverty. The present report identifies different schools of thought regarding the concept as well as the varied national development strategies, policies and approaches to realize the objectives of inclusive pro-poor growth.

2. Experiences of economic growth among countries since the second oil shock in 1979 and the sudden increase in world interest rates around 1980 have varied considerably. Drawing on these experiences, the report makes the case for a broad-based approach with macroeconomic policies as the principal framework at the national level for achieving pro-poor growth. The report considers a range of policies that could be applied in order to ensure that growth will be accompanied by a reduction in poverty.

3. With increased global economic and financial integration and interdependence, external conditions have a direct bearing on the effectiveness and policy space available for the design of each country’s national development strategies. To this end, the report highlights the need for international and regional coordination of macroeconomic policies in order to create more stable conditions for growth.

II. Concept of pro-poor sustained economic growth

4. Broadly speaking, the term “pro-poor growth” has two broad definitions. The first and more straightforward definition focuses on the link between economic growth and the absolute level of poverty, defining growth as pro-poor if it reduces poverty. “Poverty” here could be any agreed measure but, as a matter of expediency, the term most commonly refers to income poverty. The second definition of pro-poor growth is based on the relative concept of inequality and defines pro-poor growth as growth that reduces the (relative) gap between the rich and the poor. According to this definition, growth is considered pro-poor if the percentage increase in the income of the poor is, on average, more than that of the non-poor.

5. Both definitions have their limitations. The first does not address the issue of inequality so that growth can be called “pro-poor” as long as it raises the incomes of the poorest, even if it increases inequality. In an extreme case, for example, growth would be called “pro-poor” as long as the poor gain, even minuscule increases, despite others gaining far more. In contrast, under the second definition, high growth, which has reduced absolute poverty substantially, may be considered less “pro-poor” than slower growth where the benefits reaped by the poor are greater than for the non-poor.

6. Against these definitions, a third definition focuses on absolute changes in income and requires that the poor should have a larger share of additional income generated by growth in absolute terms. In this case, there would be a greater absolute increase in the per capita income of the poor.

7. These debates on definitions should not, however, detract from efforts to achieve sustained economic growth. A starting point is not the definition, but each country's situation, the objectives that each Government tries to pursue, and the policies to achieve those objectives. If one of the main objectives of a Government is to achieve target 1 of the first Millennium Development Goal, namely, to halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day, the first definition may suffice. However, Governments are likely to address other internationally agreed development goals in their national development strategies. Each government's national development strategy will therefore define the "pro-poorness" of its policies. The pro-poorness of the outcome can then be considered against the goals of the initial strategy as well as the other yardsticks implied by the definitions.

8. It may be useful to have a commonly shared understanding of the concept of "pro-poor growth" so that assessment and measurement can be conducted in a consistent manner and the consideration of effective policy options for such growth can be more focused. Different outcomes in terms of reducing poverty are not only the result of different patterns of growth per se, but also the consequence of differences in policies and approaches.

9. The objective of the United Nations is not only to eradicate poverty, but to achieve the internationally agreed development goals as a whole and to promote sustained economic growth that will support this broad objective. Therefore, for the international community, the desirable form of growth could be termed "pro-poor" growth or broad-based growth that will contribute to the achievement of the internationally agreed development goals, including the Millennium Development Goals.

III. Policies to promote pro-poor sustained economic growth

10. Success in achieving sustained economic growth and poverty reduction has varied considerably among countries. In general, stable economic growth over a long period of time has proven to be beneficial for the poor. However, the impact of growth on poverty depends on socio-economic conditions, including the initial extent of income inequality. At the same average income level, the more unequal a society, the higher the growth rate required to reduce absolute poverty, particularly in the absence of progressive redistribution policies. Hence, regardless of whether economic inequality is a policy concern in its own right, it has a direct bearing on efforts to reduce poverty.

11. Recent experience suggests that despite growth there has been an increase in inequality. For example, economic growth in sub-Saharan Africa has improved since the mid-1990s but the incidence of extreme income poverty in the region has remained at around 44 per cent owing to rapid population growth, high and growing inequality and limited job creation. During the 1990s, the average country Gini coefficient in sub-Saharan Africa was 47.1, compared to 35.6 in Asia.

12. Even in Asia, where many countries are experiencing rapid growth, increasing inequality is a growing concern. In addition to income inequalities, there are growing social inequalities, involving unequal access to health and education, compounded in many countries by reduced government provision as well as gender, ethnic and cultural biases.

13. Latin America emerged from the 1980s with a per capita income 10 per cent lower than at the start of the decade and with 47 per cent more people living in poverty. For Latin America, the first part of the 1990s was a relatively favourable period with improved economic growth and a decline in inflation. With increased public expenditure on health and education, poverty declined. However, while most countries saw some reduction in poverty in the 1990s, inequality increased in most cases.

14. Eastern and Central Europe, on the other hand, have seen more growth since 2002. After a "lost decade" in the 1990s, growth has generally been broad-based and has contributed to poverty reduction through a number of channels, including employment generation, tax revenue creation and wage growth.

15. The linkages between poverty and socio-economic factors, including economic growth, are multifaceted. Cross-country studies reaffirm that growth is fundamental for sustained poverty reduction, but that growth itself does not seem to reduce inequality. Obviously, growth accompanied by progressive distributional change is better than growth alone for poverty reduction. High initial inequality seems to affect negatively the rate and sustainability of growth and its effectiveness in reducing poverty in the future. The review also indicates that education, infrastructure and macroeconomic stability seem to have a favourable effect on both growth and the distribution of income. The effects of policy reforms are not so evident: similar reforms may have different impacts in different countries, depending on country-specific circumstances. Gender inequality also has an impact on pro-poor growth: inequalities in education and employment negatively affect both growth and its impact in reducing poverty, while inequality in access to productive assets and resources limits pro-poor growth. The role of employment in pro-poor growth is also critical, as the incomes of poor people largely depend on the nature and extent of employment that economic growth generates.

16. There is thus a need for careful analysis of a country's specific circumstances before embarking on any major policy initiatives, making it inappropriate for the present report to prescribe what might constitute an effective policy-mix. The remainder of the report therefore focuses on a broad framework that developing countries can consider and on some policy approaches that have succeeded in bringing about "pro-poor growth".[1]

A. National level

1. Establishing a national development strategy

17. A well-defined national development strategy can contribute to the success of a country's efforts to eradicate poverty. At the 2005 World Summit, Heads of State and Government agreed to adopt, by 2006, and implement comprehensive national development strategies. To ensure that they reflect the concerns of all sections of society, such strategies should be developed through multi-stakeholder consultations. They should serve as the overarching long-term framework to

[1] For a consideration of the broader effort to eradicate poverty and hunger and achieve the internationally agreed development goals, see the report of the Secretary-General entitled "Strengthening efforts to eradicate poverty and hunger, including through the global partnership for development", to be submitted to the Economic and Social Council at its current session.

integrate all short-, medium- and long-term development policies, including macroeconomic policies, education and human development policies, health policies, other social policies and environmental policies, as well as the development of basic infrastructure, including power, transportation, water and sanitation. Full consideration should be given to the gender dimension and impacts of all these policies.

2. A broader approach to macroeconomic policies

18. There is general agreement that sustained economic growth is beneficial for the poor. It is also broadly accepted that a stable macroeconomic environment is conducive to long-term economic growth and hence to reducing poverty. The converse also applies: macroeconomic disequilibrium that manifests itself in high inflation or a balance-of-payments crisis usually has a disproportionately negative impact on the poor, largely because of their lack of resources to weather such disruptions.

19. Policies focused on creating and maintaining a stable macroeconomic environment should therefore form an essential part of any framework to reduce poverty through sustained economic growth. At the same time, some of these policies, despite their best intentions, could adversely affect the poor relatively more than the rest of the population owing either to their design or the way they are implemented. For example, while price stability may be favourable for the poor, oversimplistic or overzealous use of monetary policy to achieve price stability could adversely affect the poor by raising interest rates and reducing their access to finance. Similarly, restrictive fiscal policies could reduce social welfare expenditures. In considering macroeconomic policy options, the short-term impact on the poor should always be addressed. "Equitable macroeconomic policies" refer to macroeconomic policies whose impacts are favourable for all segments of society. Such policies take full account of distributional impacts and incorporate equity considerations.[2]

20. Since the experience of macroeconomic instability in many developing countries in the early 1980s, the Bretton Woods institutions have been promoting policies that have come to be referred to as the Washington Consensus. These so-called "adjustment programmes" generally consisted of stabilization programmes supported by the International Monetary Fund (IMF) and structural adjustment programmes supported by the World Bank. The World Bank launched structural adjustment loans in 1980 and IMF expanded the number and types of adjustment loans during the 1980s. Those IMF loans, which often served as a prerequisite for World Bank adjustment loans, stressed macroeconomic stabilization, in particular fiscal adjustment and inflation stabilization, as well as exchange rate devaluation. In the 1990s, increased attention was given to poverty reduction and support for sustained social and structural policy programmes, and capacity- and institution-building were started. However, the narrow focus on price stabilization continued, while inflation was no longer a problem. Owing to this narrow focus, broader objectives of development encompassing human development and other social goals were not given sufficient attention. These programmes also ignored fundamental

[2] See "Macroeconomic and growth policies: background note" (http://esa.un.org/techcoop/policynotes.asp).

objectives, such as employment generation, which are at the heart of efforts to eradicate poverty.

21. The experiences of the past two decades have led to a broader view of macroeconomic stability, leading to adoption of a broad-based approach to macroeconomic policies. The Monterrey Consensus[3] called for sound macroeconomic policies aimed at sustaining high rates of economic growth, full employment, poverty eradication, price stability and sustainable fiscal and external balances so that the benefits of growth reach all people, especially the poor. These objectives require the re-establishment of a long-term, broad-based development approach. Such an approach needs to be growth centred, to place full employment as the ultimate objective and to integrate short-term, counter-cyclical fiscal and monetary measures with long-term development policies. Under such a framework, macroeconomic policy should be developed in a coordinated manner, so that fiscal, monetary, exchange rate and capital management policies are consistent with growth objectives and public investment strategies.

22. The impact on growth will further depend on the interlinkages between macroeconomic policies and policies regarding the productive sectors and trade. With such a broad view of macroeconomic stability and its attendant multiple dimensions, the design of the macroeconomic framework has to address multiple objectives and consider numerous trade-offs, including the impact on the poor. To avoid adverse effects on the poor, an assessment of the possible impact of policy changes on poverty and other social variables should be carried out before, during and after implementation. The Poverty and Social Impact Analysis developed by the World Bank is an example of such analysis. Such assessments can enable social concerns to be addressed and integrated into policies and measures.

3. Creating space for counter-cyclical policies

23. Counter-cyclical policies have had a direct influence on long-run growth. There is a strong negative correlation between pro-cyclical fiscal behaviour and the rate of long-term growth. In addition, the costs of the adverse consequences of pro-cyclical policies for many developing countries are high. For example, in the upturns, imprudent fiscal spending could lead to inefficient resource allocation, contributing to the overheating of the economy. In the downturns, pro-cyclical policies, such as overtightening monetary policy and indiscriminate fiscal adjustments, could lead to substantial losses in many valuable social projects, weakening accumulation of infrastructure and human capital.

24. Structural adjustment loans were provided on condition that countries adopt restrictive macroeconomic stabilization programmes, with the current account and fiscal adjustments being carried out mainly by reducing expenditures. In many countries, these stabilization programmes tended to be contractionary and were exacerbated by a pro-cyclical pattern in government revenue (because of heavy dependence on primary commodities) and a pro-cyclical pattern of financial flows. Austerity policies are adopted during downturns matched by higher levels of expenditures during expansionary phases when financing becomes available again.

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[3] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex.

25. Fiscal policy since 1960 in Africa and Latin America has been highly pro-cyclical. In contrast, in the fast-growing economies in East Asia, fiscal policy has been either neutral to the business cycle or counter-cyclical. These regional differences are reflected in their respective growth outcomes: the pro-cyclical nature of macroeconomic policies in some developing countries has tended to exacerbate, rather than moderate, the adverse impact of downturns on long-run growth.

26. Fiscal policy can instead serve as a useful counter-cyclical device. However, in order to ensure sufficient policy space to conduct counter-cyclical fiscal policies, there is a need to exercise fiscal flexibility in a way that ensures both policy credibility and fiscal sustainability. Some developing countries, like Chile during the 1990s, managed to achieve fiscal targets independent of short-term fluctuations in economic growth. The adoption of this approach to counter-cyclical policy was one factor accounting for Chile's stronger growth performance in the region. Effectively managing such a system requires a prudent and consistent approach, as well as political support.

27. Fiscal stabilization funds can help smooth, over time, the revenues received from unstable tax sources, such as those based on exports of primary products. Some countries have used commodity stabilization funds to smooth the impact of volatile commodity prices on fiscal income. These include Chile's copper compensation fund, Colombia's coffee and oil stabilization funds and the cotton support fund of Burkina Faso. In addition, tax on capital inflows and temporary hikes of VAT rates during booms could be considered as counter-cyclical tax policies. Countries facing limitations on borrowing could also employ low-cost stimuli, such as a temporary sales tax cut and increase in unemployment benefits for low-income workers.[4] The institutional capacity to manage these instruments adequately is an important factor in their performance.

28. A certain degree of discretionary power should be retained by Governments. Since the 1980s, there has been a shift from discretionary macroeconomic policy arrangements to rule-based policies. In general, rule-based policies can function well under normal circumstances but, as the economic structure changes and when shocks occur, predetermined policy rules can become less relevant, or too rigid. Some rule-based regimes, such as inflation targeting, may bias macroeconomic stabilization towards a narrowly defined target, such as low inflation, and against broader development objectives, such as employment and growth.

29. In today's open economy, a competitive exchange rate is critical for achieving crucial development objectives, such as promoting growth and employment through the diversification of production and exports. Developing countries that are able to maintain a competitive real exchange rate have tended to fare better in terms of economic growth. An appropriate exchange-rate regime and policy for a specific country in a particular period depends on the broad macroeconomic policy framework of the country. Many countries have opted for an intermediate regime with some degree of targeting of the real exchange rate, such as managed floats or crawling pegs, combined with some capital account regulations and banking policy measures.

[4] See "Macroeconomic and growth policies" (http://esa.un.org/techcoop/policynotes.asp).

4. Pursuit of long-term and broad-based development objectives

30. Macroeconomic policies should be seen as part of a broader development strategy and should be fully integrated with other areas of economic and social policy necessary to promote pro-poor sustained economic growth. Social policies are also essential instruments in fostering employment and development, eradicating marginalization and overcoming conflict. Social policies should therefore form part of national development strategies to achieve growth and equitable social outcomes.[5]

31. In East Asian economies, this approach contributed to long-run growth with substantial poverty reduction. Fiscal policies in those economies have given priority to development spending, including not only investment in education, health and infrastructure, but also subsidies and credit guarantees for export industries. Monetary policy has been coordinated with financial sector and industrial policies. It has generally included subsidized credit schemes and managed interest rates, which directly influence investments and savings, while competitive exchange rates were considered essential to encourage exports and export diversification.

32. In contrast, macroeconomic policies in many Latin American and African countries since the 1980s have focused on much more narrowly defined short-term stabilization objectives and have often resulted in exchange-rate overvaluation. The narrow focus of stabilization policies tended to be pro-cyclical and did not generate a stable flow of resources for social spending.

(a) Public investment in infrastructure and human development

33. Public investment in infrastructure and human development plays an important role in long-term economic growth. Adequate infrastructure is needed to enable firms to raise their productivity. Countries need to build a critical mass of infrastructure by sustaining substantial levels of public investment over a period of time. Infrastructure projects can create jobs, particularly if conducted in a labour-intensive manner. The difference in infrastructure investment may be among the factors that have contributed to the differing growth experience between East Asian countries (with sustained public investment) and countries in Latin America and sub-Saharan Africa.

34. Countries with significant gaps in infrastructure and human development will have to increase the fiscal space for expenditures in these areas. There is therefore a need to mobilize large amounts of public resources to make the necessary investments in infrastructure and to provide social services. Strengthening the tax base is essential, particularly in countries with low government revenues. In addition, there is a need for public sector banks and the domestic bond market to provide low-cost, long-term financing in domestic currency. These financial intermediaries should also cater to the capital investment needs of the private sector. In general, development of financial institutions would not only help to promote investment, but would also encourage an increased propensity to save, leading to a more widespread expansion of flows of funds.

35. For spending on education and health, much could be achieved by improving efficiency — through better allocation of the relevant budgets, better targeting of

[5] See “Social policy” (http://esa.un.org/techcoop/policynotes.asp).

priority areas within the social sectors and realizing cost-efficiencies in public programmes. Improved financing schemes for infrastructure and addressing irregularities, such as corruption in contracting, could help to reduce costs. The resources required for such improvements, however, may be much higher than the efficiency gains.

36. For the low-income countries, domestic resource mobilization is likely to fall short of investment needs, and official development assistance (ODA) will have to play a crucial gap-filling role. However, with the fear of the adverse effects of currency appreciation and the perceived need to keep a high foreign exchange reserve level as a precautionary measure against potential financial crises, aid flows are not effectively used in many developing countries. It is important to ensure that ODA translates into higher public investment.

37. A further source of financing is public-private partnerships in the form of infrastructure funds. Regional development banks are promoting such public-private partnerships through institutions that facilitate exchange of information, enhance capacity-building and fund projects, such as the Infrastructure Consortium for Africa, the Asian Infrastructure Fund and the Infrastructure Fund in Latin America. There are also multi-donor initiatives, such as the Public Private Infrastructure Advisory Facility and the Private Infrastructure Development Group.

(b) Policies to empower the disadvantaged

38. Policies that explicitly promote economic and social inclusion, empowerment of the disadvantaged and social investment are required to ensure that growth is pro-poor. Attention to the gender dimension is particularly important. Gender-responsive budgeting that disaggregates expenditure and revenue according to their different impacts on women and men could serve as a useful tool in this regard. Besides cash transfers, other policies that should be considered include: land reforms, transfer of such assets as homestead land, employment schemes, microcredit schemes, pension reform and social security, and legislation to empower the disadvantaged, such as law reform and constitutional guarantees for basic health, education and increased public involvement.

(c) Increasing institutional capacity

39. Institutional capacity is key to effective policy formulation, delivery and implementation. Institutional capacity affects the ability of governments to ensure that the poor will benefit from growth and that public investments will effectively link the poor to growth. Democratic accountability and the existence of clearly established citizenship rights and obligations are among the institutions necessary for linking the poor to growth.

40. Institutional capacity covers a wide range of governance aspects, from making and enforcing rules and laws to public administrative and management capacity, including the provision of public goods and services. A wide range of skills is required to effectively pursue a broad-based macroeconomic approach, including effective macroeconomic management, strong government financial management, multi-year expenditure programmes, effective expenditure monitoring, strong tax administration, statistical capacity, and the ability to deliver public services effectively and efficiently. There is also a need to build institutions, such as the financial intermediaries and infrastructure funds.

41. Institutional capacity is also required for effective aid management and for managing global public goods, such as the fight against infectious diseases, including HIV/AIDS, and preserving the environment, including efforts on climate change. For example, the ability of developing countries to benefit from possible international incentives for the production of low-cost HIV drugs or vaccines, and to channel such supplies to the needy poor will depend on their institutional capacity in managing such situations.

B. International and regional levels

42. Growing interdependence in the areas of finance, trade and technology requires that international policies should be geared towards supporting the national efforts to promote pro-poor growth. There is also increasing evidence of the cross-country effects of national policies. The current global payments imbalances pose the risk of a potentially disorderly adjustment in the world economy.

43. Those circumstances call for international coordination of macroeconomic policies in order to improve the stability and efficiency of the global economy. In addition, as the financial crises have shown, existing international coordination mechanisms need to be made more effective.

44. The regional nature of recent financial crises and a globalization process including "open regionalism" have raised interest in regional cooperation. Regional cooperation could go some way towards filling the current lacunae in international coordination and could play a role in promoting regional stability, thereby contributing to growth.

1. International macroeconomic policy coordination

45. A number of financial crises in the past two decades have affected a large number of developing countries and have led to an increase in poverty, as people lost their jobs and incomes. These episodes of financial volatility, reinforced by the pro-cyclical nature of the macroeconomic stabilization policies, have disrupted efforts towards pro-poor sustained economic growth.

46. The volatility of capital flows has caused boom-bust capital account cycles in developing countries. Moreover, these cycles have often been contagious, affecting neighbouring countries even when their macroeconomic fundamentals were sound. There have been two such medium-term cycles: a boom in external financing in the 1970s, mostly in the form of syndicated bank loans, followed by a debt crisis in a large part of the developing world in the 1980s; and a boom in the 1990s, mainly of portfolio flows, followed by a sharp reduction in net flows after the Asian crisis of 1997.

47. Financial markets tended to view developing countries, particularly neighbouring countries, as similar and apply a similar risk premium to them all. Credit ratings tended to be pro-cyclical and caused financial flows to behave in a similarly pro-cyclical fashion. In addition, short-term capital is highly volatile, and reliance on such financing is risky, as evidenced in the Asian crisis. These series of events are beyond the purview of national policies and call for stronger international macroeconomic policy coordination and stronger surveillance by an authoritative body.

48. According to article IV of its Articles of Agreement, IMF has a mandate for ensuring that the international monetary system operates effectively and the policies of each member are conducive to orderly economic growth. IMF conducts "surveillance" through monitoring and consultation. The experience of the past 60 years, however, points to the need for improvement in this exercise. The Independent Evaluation Office of IMF has pointed out that the current multilateral surveillance process of IMF lacks a clear and comprehensive strategy, gives too little weight to the analysis of economic policy linkages, and has not sufficiently explored options to deal with global spillovers from national policies. It also observed the lack of effort in proactively engaging relevant intergovernmental groups.[6]

49. In response, IMF embarked on reshaping surveillance in the spring of 2006 by modernizing the framework and improving its implementation. To this end, IMF has initiated a series of proposed multilateral consultations. The first of these has involved five participants (China, the Euro area, Japan, Saudi Arabia and the United States of America) and has focused on global imbalances. These consultations aim to serve as a forum for discussion on an issue of collective concern. However, they need to be made more effective and should demonstrate their contribution to improved stability and balance in the world economy. IMF should assume greater responsibility for international macroeconomic policy coordination.

50. To enhance the legitimacy of multilateral institutions and better serve as a mediator, there is a general agreement that the governance structure of IMF should also be improved. As a first step, the States members of IMF agreed in 2006 that the quotas and votes for four heavily underrepresented countries — China, Mexico, the Republic of Korea and Turkey — should be increased. Work is now proceeding to the second stage, namely, the development of a new quota formula that can guide a second round of ad hoc quota increases to be finalized no later than the spring of 2008. Further work is also under way towards enhancing the voice and participation of low-income countries. This ad hoc approach, however, is viewed with scepticism by some since such an approach will be unlikely to bring sufficient change to the current skewed situation. The developed countries with only one sixth of the world's population have over 60 per cent of the total vote in IMF and the largest economy has veto power on matters requiring an 85 per cent majority. Despite the welcome effort in securing basic votes to ensure, as a minimum, the voting share of low-income countries, they only represent 2 per cent of total voting power, which fell from the original 11 per cent. Still, all seem to agree on the importance of securing adequate representation by all. It is hoped that the new quota formula will address the underrepresentation of developing countries, especially the rapidly growing ones.

51. Widening imbalances on the current account are a cause of concern, posing the threat of a disorderly adjustment. A gradual approach to managing the adjustment of these imbalances is preferable. In order to assure investors and avoid a large swing in financial flows, commitments by Governments for such a gradual adjustment must be credible. A multi-year schedule for adjustment would address such commitment problems. Similar schedules emanating from IMF consultations could be developed as the "multilateral letter of intent", which describes a sequence of

[6] Independent Evaluation Office of the IMF, *Evaluation summary: Multilateral surveillance*, 2006.

policy adjustments tied to a specific schedule. Such a multilateral letter of intent should be made public at the end of the multilateral round.

52. In the long run, only deeper and more far-reaching reforms of the global monetary and financial system as a whole will help to prevent a recurrence of the global imbalances of the current magnitude. The current situation is caused largely by overdependence on a single currency. In the long run, a new, supranational currency based on Special Drawing Rights should be considered but, as a more immediate solution, an officially backed multi-currency reserve system could be adopted.

53. Similar to the rules for the international trading system, a well-designed multilateral financial system should create equal conditions for all partners and avoid unfair competition. It should also bring more stability in the international financial system by avoiding the likelihood of major capital flight caused by overdependence on a single reserve currency.

54. The Group of Eight has addressed the stability of the world financial system and development issues. The Group has now developed into a more permanent coordination mechanism on wider issues ranging from foreign policy and international security to environmental and development policies. The five economically larger members of the Group made a major attempt in 1985, known as the Plaza Accord, to adjust the global imbalances existing at that time. Under that Accord, the Group agreed to devalue the United States dollar against the Japanese yen and the Deutsche mark through massive interventions in currency markets by their central banks.

55. Since then, however, the evolution of the world economy, with many emerging economies coming into play, has been such that, despite the Group's recommendations of caution at times of global imbalances, its influence in ensuring action to adjust such imbalances has become rather limited, especially in relation to the broader scope of the current problem. The Group could explore further possibilities for expanding cooperation, bringing more stability to world financial markets and strengthening international macroeconomic coordination towards that goal.

2. Regional macroeconomic policy coordination

56. There remains much room for improvement in international economic cooperation and, although work has started, it will take some time for the system to be able to work effectively. In the meantime, as past financial crises have shown, international mechanisms have not been effective and the affected countries have had to undergo major adjustments with tremendous costs, including disruption to their efforts to reduce poverty. Given the regional nature of these financial crises, there is renewed interest in the potential role of regional macroeconomic policy coordination.

57. Historically, there have been several attempts at such regional cooperation. The European Union provides a successful example of, on the one hand, full trade integration through the creation of the European Single Market and, on the other, macroeconomic and financial cooperation in its most developed form through the formation of the European Economic and Monetary Union (EMU). Throughout this process, particular emphasis was given to the development of strong institutions and

exchange-rate stability, which were considered the best way to foster trade integration. Later on, explicit convergence criteria, in the form of targets regarding inflation, long-term interest rates, national budget deficits, public debt and exchange rates (the Maastricht criteria), were established for candidate countries wishing to join EMU.

58. For developing countries, as for the European Union, one of the major incentives to engage in macroeconomic cooperation is the link between trade and macroeconomic cooperation. At the same time, developing countries have two further reasons for cooperation: to build stronger walls of defence against financial crises and to avoid “race to the bottom” or “beggar-thy-neighbour” competition among export-oriented economies.

59. While there is strong regional cooperation in development financing, notably through multilateral development banks, progress in regional macroeconomic and related financial cooperation has been limited so far. The existing initiatives have three basic components: macroeconomic policy dialogue and, ultimately, policy surveillance and consultation; liquidity support during crises; and exchange rate coordination.

60. With respect to the last objective, since the magnitude of shocks tends to be larger in developing countries, there is a tendency to eliminate or postpone exchange-rate coordination, with the exception of a few examples of monetary unions. Among them, the formal commitment to form a monetary union of the Gulf Cooperation Council and the Caribbean Community stand out, although there has not been much progress. Existing currency unions, such as the franc zone of sub-Saharan Africa, the West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Union, demonstrate the difficulties of such arrangements in the face of financial and political crises. In 2000, five members of the larger Economic Community of West African States (ECOWAS) agreed to create a West African Monetary Zone and merge this zone with the existing WAEMU in December 2005, but this was later postponed until December 2009. The experience with the franc zone shows that price stability among its member States was better than for neighbours in the region, but it performed only as a weak external mechanism of constraint and could not avoid banking crises in the 1980s or a 50 per cent devaluation of the CFA franc in 1994.

61. In the case of currency unions, one of the few success stories in the developing world is the Eastern Caribbean Currency Union (ECCU), which consists of very small economies with well-developed domestic banking systems. The quasi-currency board, pegging the United States dollar, is backed with a large effective reserve cover. The broader Caribbean Community committed itself to create a monetary union in 1990, but has not made significant progress.

62. The three major integration processes in Latin America — MERCOSUR, the Andean Community and the Central American Common Market — provide examples of mechanisms for macroeconomic policy dialogue. These initiatives have agreed on Maastricht-type criteria for economic convergence. Although intraregional trade is still limited and the integration of domestic financial markets has not progressed, these countries have experienced major negative spillover effects from the macroeconomic policies of neighbouring countries. This was particularly the case for MERCOSUR in the late 1990s. More explicit coordination

mechanisms, such as exchange-rate coordination and consultations in times of crises, could have helped to prevent those effects from becoming externalized.

63. In terms of liquidity financing, the Latin American Reserve Fund provides an important incentive for macroeconomic cooperation and shows that even a modest fund can contribute to balance-of-payments financing by providing countercyclical disbursements. In addition, such a mechanism can help to manage trade shocks and even mitigate the negative effects of abrupt reversals of capital flows.

64. The most developed initiative of this nature, following the Asian crisis, is the Chiang Mai Initiative, agreed in 2000 by the countries of the Association of Southeast Asian Nations (ASEAN) and China, Japan and the Republic of Korea. The member countries committed themselves to bilateral swap arrangements among their central banks in time of crises, currently amounting to $80 billion with 16 bilateral swap arrangements among eight countries. They also agreed on more explicit forms of policy dialogue, and a surveillance mechanism is being designed. The Initiative intends to play the complementary role to the services provided by IMF by linking the arrangements to the IMF programme. At the meeting that took place in early May 2007, finance ministers of the member States agreed to pool part of their foreign reserves and establish a multilateral currency-swap scheme. This reserve pooling arrangement will be self-managed, governed by a single contractual arrangement. With the integration of explicit policy coordination and exchange-rate stabilization, this initiative could evolve into a full-fledged monetary system.

65. Under the current international financial system, only a few specialized multilateral agencies provide the necessary services of liquidity provision and development financing, macroeconomic surveillance and consultation, and peer review of prudential regulation. Although experience is limited, the foregoing initiatives demonstrate that such arrangements can play an important role in strengthening the international financial architecture. As intraregional trade and investment flows have deepened the macroeconomic linkages among neighbouring countries, more explicit mechanisms for regional macroeconomic cooperation could limit the spillover effects of national policies. While IMF should continue to play a central role at the global level, its services could be enhanced through a network of institutions which provide those services at the regional level. In addition, regional funds could provide effective rescue mechanisms in the case of smaller and more local financial crises.

3. International development cooperation[7]

66. Official development assistance constitutes an important source of financial resources for developing countries, in particular for low-income developing countries. Although the relationship is not straightforward, aid has been a contributing factor in long-term development in many countries. Well-targeted programmes supported by aid, particularly in the area of infrastructure, education and health, can assist low-income countries in improving economic growth and making progress on poverty reduction.

[7] The role of global partnership for the reduction of poverty and hunger is elaborated on in the report of the Secretary-General entitled “Strengthening efforts to eradicate poverty and hunger, including through the global partnership for development”, also submitted to the Council at its current session.

67. The aim of such assistance is to achieve a certain threshold level of infrastructure and human development through targeted public investment, after which the combined effect of economies of scale, complementarities and linkages is expected to generate self-sustaining growth, with private investment taking the lead. In order for aid to work effectively, it is necessary to channel such resources efficiently in the context of each country. At the same time, Governments of recipient countries should have the administrative capacity necessary to manage productive assets and resources in a way that generates cumulative improvements in income and productivity.

68. In recent years, there have been major commitments made by developed countries to increase their ODA. According to the recent estimates by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD),[8] however, substantial efforts need to be made in order to meet the commitments made at the Gleneagles Summit of the Group of Eight and the 2005 World Summit: to increase aid by $50 billion in real terms between 2004 and 2010 and to double aid to Africa over the same period. In order to fulfil the current aid pledges, the core development programmes will have to increase in the coming four years at triple the rate of the current 4 per cent per annum, considering that debt relief and humanitarian aid are likely to decline. For Africa, they have barely increased since 2004, pointing to the urgent need for donors to accelerate their efforts. Effective follow-up and monitoring are needed to ensure fulfilment of those commitments. In addition, the macroeconomic policies of developed countries, including those relating to trade and foreign investment, need to be consistent with their aid policies to avoid unintended negative consequences for developing countries' efforts to implement the United Nations development agenda, including achievement of the Millennium Development Goals.

69. Stable aid flows to individual countries are required to facilitate the consistent implementation of national development strategies. The stability of aid could be improved through multi-annual agreements or multi-year predictability, with aid being channelled through national budgets. Multi-annual programming should ensure the continuous implementation of national development strategies and should give recipient countries more fiscal leeway, which could be used either for counter-cyclical measures or for development purposes, as circumstances dictate. An additional element of this multi-annual programming could take the form of financial insurance to cover macroeconomic risks, including the possibility of commodity price collapses or an aid shortfall.

IV. Conclusions and recommendations

70. **There are four key areas that are important for ensuring that sustained economic growth is pro-poor and leads to the realization of the internationally agreed development goals. First, macroeconomic policies should be broad-based in their approach. The starting point for such an approach is the adoption of a long-term, comprehensive development policy or national development strategy. Secondly, these long-term strategies should integrate**

[8] Statement by the Secretary-General of OECD and the Chairman of the OECD Development Assistance Committee at the meeting of the Development Committee of the World Bank and IMF in Washington, D.C., on 5 April 2007.

short-term counter-cyclical policies, which act as a buffer against business cycles and create fiscal space. Thirdly, such long-term strategies and macroeconomic policies need to be supported by predictable financial flows. Finally, macroeconomic policy coordination at the international and regional levels is essential for supporting the efforts of developing countries to achieve pro-poor sustained economic growth at the national level. There is a need not only for improving the existing mechanisms, but also for devising new ones.

71. **To pursue sustained economic growth that is pro-poor, the following measures should be considered:**

(a) **Countries should employ a broad-based and balanced approach to macroeconomic policies, including by developing and implementing national development strategies as envisioned at the 2005 World Summit;**

(b) **Concrete steps should be taken to build institutional capacities in developing countries. In supporting developing countries, international development partners, including the United Nations system, should work together to tailor their support for building institutional capacity to the specific needs of each country;**

(c) **There is a need to increase access to low-cost financing by developing countries in order to meet their investment needs for infrastructure and human development. Measures should include the development of insurance markets, as these can contribute to providing protection against the effects of fluctuations in exchange rates, interest rates and commodity prices;**

(d) **The international coordination of macroeconomic policies needs to be strengthened to improve the stability and efficiency of the global economy. The role of IMF in promoting multilateral consultations and in acting as a mediator needs to be strengthened, including by improving its governance structure;**

(e) **The central global role of IMF should be supplemented by regional coordination mechanisms and regional reserve funds;**

(f) **In order to prevent major global payments imbalances, a new, supranational currency based on the Special Drawing Rights should be considered in the long run. As a more immediate solution, an officially backed multi-currency reserve system could be promoted;**

(g) **Better follow-up and monitoring are required in order to ensure the fulfilment of the commitments made regarding official development assistance;**

(h) **The Economic and Social Council should promote refinement of the concept of “pro-poor growth” and the identification and implementation of measures to promote such growth in a sustained manner;**

(i) **The Council should also facilitate the sharing of experiences in promoting pro-poor sustained economic growth at the national level and within the United Nations system. Such sharing of experiences could take place through the annual ministerial review.**