GROUP OF TWENTY

FRAMEWORK FOR STRONG, SUSTAINABLE AND BALANCED GROWTH

REBALANCING, GROWTH, AND DEVELOPMENT: AN INTERCONNECTED AGENDA

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Main Messages

- The global economy has entered a risky phase that threatens to stall economic recovery in advanced economies. Weaker growth in these economies and financial turmoil also threaten growth in developing countries that has been an engine driving the global economy. These developments call for a renewed G20 focus on growth. Actions to address immediate risks to financial stability must be complemented by efforts to strengthen the foundations for global growth.
- Large and persistent imbalances—a major focus of G20 discussions for much of this year—must be addressed. But rebalancing would be difficult to achieve and sustain in a context of faltering growth. What is needed, fundamentally, is a strategy for growth—and job creation. Rebalancing must be framed as part of a broader G20 strategy to ensure strong and sustainable growth in the global economy. The strategy must fully engage developing countries that are an increasingly important source of demand for the global economy, accounting for as much as two-thirds of global growth in GDP and imports in the last five years. In an increasingly multipolar global economy, the goals of rebalancing, growth, and development are more and more interconnected. The agenda for these interconnected goals needs to be addressed in an integrated way.
- A pro-growth approach to rebalancing will have two key elements: a strong focus on structural reforms that remove barriers to growth and address the underlying drivers of unsustainable fiscal and external imbalances; and leveraging of developing country growth in supporting strong and more balanced global growth.
- In advanced economies, structural reforms must now move center stage. With macroeconomic policy space narrowing, structural reforms provide the main instrument to boost growth in the coming years, while also helping to reduce fiscal and external imbalances. Besides ongoing financial sector reforms, priorities include removal of barriers to investment, competition, and job creation that can yield quick gains in growth, and tax and expenditure reforms to underpin fiscal consolidation. Fiscal policy needs to strike an appropriate balance between medium-term consolidation and short-term support for growth. Even where the fiscal space is limited, the impact of fiscal policy can be enhanced by changing the structure of taxes and expenditures without necessarily changing the total amount of spending or the fiscal balance. The composition quality of fiscal response matters.
- In emerging economies, building on structural reforms that helped unleash their growth potential will be important to sustaining their growth momentum. Economies with large and persistent external imbalances need to step up reforms (of product and factor markets, social safety nets, exchange rate policies) to rebalance demand and facilitate related structural shifts. This paper includes a special focus on structural reforms in emerging market members of the G20.
- Stronger growth in developing countries would benefit global growth and rebalancing at the same time as it advances development and poverty reduction. Returns on quality infrastructure investment can be particularly high in developing countries. For many developing countries, however, long-term financing for investment remains a binding constraint. Boosting infrastructure investment in developing countries can produce win-win global outcomes.
- Successful rebalancing would allow more of the surplus global savings to support investment in developing countries, such as in critical infrastructure and human capital. While about three-quarters of developing countries are net importers of capital, in the aggregate emerging and developing economies have been net exporters of capital to advanced economies over the past decade—a cumulative current account surplus of $3.8 trillion (“capital flowing uphill”). Simulations show that a combination of fiscal consolidation in advanced economies and increase in infrastructure investment in developing countries could raise GDP in developing countries by about 25 percent and global GDP by 7 percent over a ten-year period and also significantly reduce global imbalances.

Introduction[1]

A major focus of work this year under the G20 Framework for Strong, Sustainable and Balanced Growth and related Mutual Assessment Process (MAP) has been the reduction of large and persistent external imbalances in the global economy that developed over the past decade. The imbalances declined during the current economic downturn but there is concern that, in the absence of corrective actions, they will rise again as the world economy recovers. The G20 has made progress in developing a framework for addressing these imbalances, with the effort now turning toward concrete measures that can form part of an action plan that the G20 Leaders can adopt at their summit in Cannes in November 2011.

Unsustainably large imbalances must be addressed. But in pursuing this rebalancing agenda, it will be important to maintain a focus on economic growth. Adjustment should not come at the expense of growth but rather promote growth, which is central to employment generation—an important concern given current high levels of unemployment in many countries. Rebalancing must be framed as part of a broader G20 agenda to ensure strong and sustainable growth in the global economy. The recent weakening of growth in the global economy, and increased risks about future prospects, reinforce the need for a stronger focus on growth.

Attention should focus on policies that remove barriers to growth and also facilitate structural and demand shifts that address imbalances. Structural reforms are key to achieving pro-growth rebalancing. From the outset, the MAP has included consideration of structural reforms alongside macrofinancial policies, but progress has been relatively limited so far. These reforms need to move center stage.

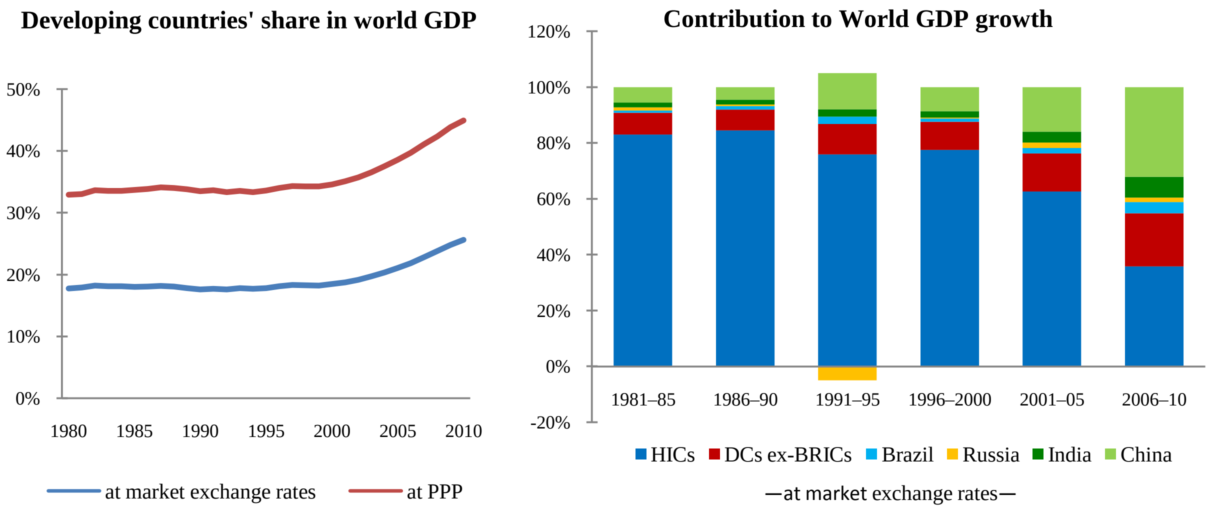
Also, rebalancing should be considered in a global context that factors in and leverages the role of developing countries in supporting strong and more balanced global growth. Growth in developing countries increasingly matters for global growth, and even more so in the present conjuncture of severe challenges to growth in advanced economies. Developing countries' demand is now a major driver of world trade. Stronger growth in developing countries would benefit global growth and rebalancing and advance development and poverty reduction at home. With the rising role of developing countries in an increasingly multipolar world economy, the goals of rebalancing, growth, and development are more and more interconnected. The agenda for these interconnected goals needs to be considered in an integrated way.

Growth in a Multipolar Global Economy

The acceleration of growth in developing countries since the 1990s has produced a significant increase in their relative size in the global economy. Developing countries have emerged as a strong demand pole for the global economy. They now account for about 28 percent of world GDP at market exchange rates and 45 percent at purchasing power parity. As developing countries are growing at a much faster rate than high-income countries, their share in global growth is even higher. It was about one-half in 2010 (at market exchange rates). For the last five-years, as high-income countries experienced a drop in GDP as a result of the global financial crisis while developing countries' growth showed more resilience, the latter's contribution to global growth was as high as 65 percent. While much of the rise in developing countries' share in world growth owes to a few large emerging economies, the share of other developing countries has risen as well. Better policies have improved growth performance across a broad range of middle- and low-income countries. In the last five years, developing countries other than Brazil, Russia, India, and China (BRICs) contributed almost 20 percent of global growth (Figure 1).

[1] The report was prepared by a staff team from the World Bank's Development Economics Vice Presidency, led by Zia Qureshi and comprising Dilek Aykut, Andrew Burns, Jamus Lim, Ha Nguyen, David Rosenblatt, Theo van Rensburg, and James Trevino, and with inputs from Bank country teams for G20 member countries.

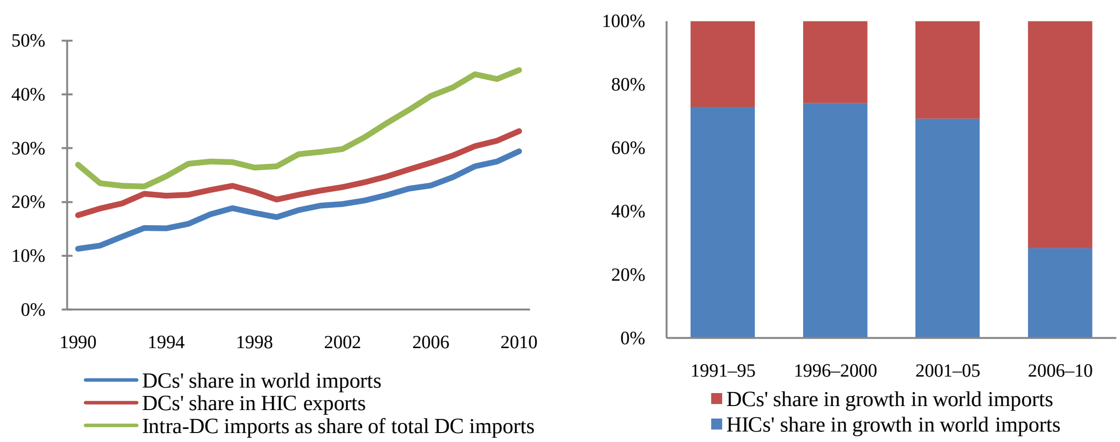
Figure 1: An increasingly multipolar pattern of global growth



Source: WDI database.

Can growth in developing countries help spur growth in high-income countries and facilitate rebalancing? One key channel is through trade as developing countries provide important new sources of growth in global demand. Developing countries' share in world trade has risen at an even faster rate than their share in world GDP. They now account for 30 percent of world imports. Their share in world import growth is higher still, exceeding 70 percent in the last five years. More than one-third of high-income country exports now go to developing countries (Figure 2).

Figure 2: Developing countries' rising role in world trade



Note: DCs = developing countries; HICs = high-income countries
Source: WITS, IMF DOTS.

Can increased linkages between developing countries help spur and sustain growth in the developing world, with positive spillovers to high-income countries? South-South trade has expanded rapidly. South-South imports have risen from about 23 percent of developing country imports in the early 1990s to 45 percent today (Figure 2). South-South financial linkages have grown as well: more than one-third of foreign direct investment into developing countries now originates in other developing countries. The significance and implications of the growing South-South linkages extend beyond direct trade and finance links. As the rapidly growing major emerging markets, notably China, upgrade from labor-intensive manufacturing to more sophisticated products, they create opportunities for growth and job creation in lower-income countries.[2]

Looking ahead, growth in developing countries will be a key determinant of global growth, as growth in advanced economies is expected to continue to face strong headwinds in the wake of the financial crisis (Figure 3). More than one-half of global growth in the next three years is expected to emanate from developing countries. The much faster growth projected for developing countries—more than twice as fast as in advanced economies—mainly reflects faster growing domestic demand. In 2011, for example, domestic demand growth in developing countries is projected to surpass GDP growth by about 0.4 percentage points. In contrast, in advanced economies, GDP growth is projected to exceed domestic demand growth by 0.15 percentage points.

Figure 3: Medium-term outlook for global growth

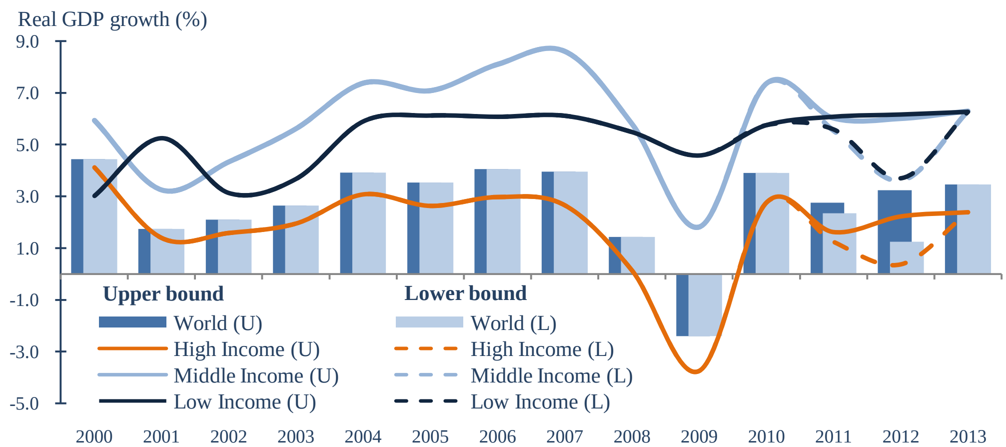


Table 1: Growth prospects by country income group and region[3]
(% per annum; MER-based weights)

	2006 – 2008	2009	2010	2011	2012	2013
World	3.1	-2.4	3.9	2.4 to 2.8	1.2 to 3.2	3.5
High-Income Countries	1.9	-3.7	2.8	1.2 to 1.6	0.4 to 2.2	2.4
Developing Countries	7.5	1.9	7.3	5.5 to 6.0	3.6 to 6.0	6.3
Middle Income Countries	7.5	1.8	7.4	5.5 to 6.0	3.6 to 6.0	6.3
Of which: G20 Members	8.0	2.4	8.3	6.3 to 6.8	3.9 to 6.6	6.8
Low Income Countries	5.9	4.6	5.8	5.6 to 6.1	3.7 to 6.2	6.3
East Asia & Pacific	10.6	7.4	9.6	7.7 to 8.3	4.9 to 7.9	8.1
Europe & Central Asia	6.5	-6.6	5.1	4.0 to 4.5	1.8 to 4.4	4.6
Latin America & Caribbean	5.0	-2.1	6.0	4.0 to 4.4	2.2 to 4.1	4.2
Middle East and North Africa	4.9	3.1	3.0	0.5 to 0.8	1.2 to 2.7	3.7
South Asia	8.0	6.2	9.3	6.8 to 7.2	5.8 to 7.6	7.9
Sub-Saharan Africa	6.0	2.0	4.8	4.8 to 5.0	4.4 to 5.7	5.7

Source (Figure 3 and Table 1): World Bank staff estimates and projections.

[2] As wages rise and China moves up the value chain, it may shed as many as 85 million manufacturing jobs. This is a much bigger jobs and growth opportunity for lower-income countries than was the case when Japan and Korea underwent a similar transition. At corresponding stages of their development, Japan had 9.7 million workers in similar manufacturing jobs (1960) and Korea 2.3 million (1982). See Lin, Justin Yifu. 2011. *From Flying Gees to Leading Dragons: New Opportunities and Strategies for Structural Transformation in Developing Countries.* WIDER Annual Lecture 15. Helsinki,

[3] Reflecting current high uncertainty in the outlook, forecasts for 2011-12 are presented as a range, with upper and lower bounds.

Increased Risks in Growth Outlook

Recent developments have increased risks and uncertainty in the global economy. The accentuation of sovereign debt problems in several advanced economies, renewed stress in the still fragile banking sector, the slowing of economic recovery in the U.S. and Europe, and turmoil in financial markets have significantly increased downside risks to global growth. These developments are beginning to impact developing countries as well through increases in risk premia on sovereign debt, lower and more volatile capital inflows, and pressures on currencies and in stock markets, which could slow growth in economies that have been an important engine driving global growth.

How these developments will affect global growth will depend importantly on how they affect investor and consumer confidence in both advanced and developing economies. Assuming these confidence effects remain contained, global growth will slow but could still approach the upper bound of the forecast range for 2011-12 shown in Table 1. Developing country growth, while lower, could still reach a healthy 6 percent. However, if the debt stress and slowing of recovery in advanced economies trigger a deeper crisis of confidence, and absent an effective policy response, the decline in growth in advanced economies could be sharper with more serious effects on growth in developing countries. Global growth in 2011-12 in that scenario could be close to the lower bound of the forecast range in Table 1. Developing country growth could be on average 2-2.5 percentage points lower. Such an outcome would have serious knock-on effects on social outcomes and carries the risk of triggering secondary crises in developing countries. How the current policy challenges in advanced economies are managed has important implications not just for these economies but for the developing world as well.

Rebalancing with Growth

The increased concerns about global growth prospects call for a renewed focus on growth. Reduction of large and persistent external imbalances is important for long-run sustainable growth. Countries must eventually correct persistent imbalances between domestic and external demand. But how rebalancing is approached matters. Quick fixes or beggar-thy-neighbor policies that undermine growth and end up hurting all must be eschewed. The focus ought to be on correction of underlying structural distortions that cause imbalances and also obstruct sustainable growth. In the current context, structural reforms that deliver quick gains in growth are at a premium. Credible action on longer-term structural reforms also can spur growth in the short run by boosting market confidence. The approach to rebalancing must also fully engage the potential win-win linkages between advanced and developing countries in an increasingly multipolar global economy. A growth-oriented approach to rebalancing will have two key elements:

- a strong focus on structural reforms that address the underlying, fundamental drivers of the imbalances and also remove barriers to growth; and
- leveraging of the role of developing countries in supporting strong and balanced global growth.

Placing a Stronger Emphasis on Structural Reforms

All external imbalances are not bad: some reflect the normal workings of globalization, market-driven differences in saving and investment performance and competitiveness, business cycles, and differences in stages of development that may not be a threat to the global economy. Some reflect economies' fundamental structural characteristics, such as a heavy reliance on commodity trade. It is the large and persistent imbalances that arise from policy distortions and structural deficiencies—product and factor market distortions, financial market failures, biases in tax and expenditure policies, deficiencies in social policies, and distortions in external sector (trade, investment, exchange rate) policies that affect saving and investment performance and competitiveness—that should be the focus of attention.

Many of the structural and policy distortions that produce sub-optimal saving and investment outcomes that underlie external imbalances also impede sustainable long-run growth. Addressing these distortions would help reduce the imbalances in a durable way and also enhance growth. For example, in external deficit countries, productivity enhancing measures to improve export competitiveness would contribute to external rebalancing and boost growth. Reform of the tax and social protection systems can raise domestic saving and reduce the external deficit while improving fiscal sustainability and longer-term growth prospects. Education and health care efficiency gains can have similar effects. Improved energy efficiency benefits both the external balance and sustainable growth in countries dependent on energy imports. In external surplus countries, competition policy reforms, including removal of trade and investment barriers, can raise investment, reduce the external surplus, and bolster growth. Allowing exchange rates to be market determined can reduce distortions in the allocation of resources and provide an incentive to enhance productivity. Financial sector reform that eases borrowing constraints can raise consumption and investment, lower the external surplus, and boost growth. Development of service sectors and infrastructure upgrading can be pro-rebalancing and pro-growth. A strengthening of social safety nets can help reduce external imbalance by reducing precautionary saving. Much of the rebalancing agenda is in fact one of longstanding domestic structural reform brought into sharper focus by the crisis.

The OECD's *Going for Growth* report estimates that fiscal tightening to stabilize debt-to-GDP ratios in OECD countries by 2025 could reduce global imbalances by about one-sixth. Global imbalances could decline by twice as much if China, Germany and Japan were to deregulate their product markets and China were to liberalize its financial markets and raise public health spending—with these structural reforms also contributing to better growth and social outcomes.[4]

MAP submissions from G20 members cover a range of structural reforms to promote stronger and sustainable growth and address the underlying drivers of external imbalances: tax and expenditure reforms; removal of barriers to competition, domestic and external; financial sector reform; labor market reform; reform of social protection; and sectoral reforms, including in infrastructure, education and health. On rebalancing, members' submissions cover not only policies to address external imbalances but also internal imbalances such as income and regional inequalities and poverty. Policy actions and commitments set out in earlier MAP submissions are encouraging but, in general, the structural reform plans would benefit from a higher level of ambition and specificity. The more recent effort within the G20 to strengthen structural reforms and specify plans and priorities more concretely is therefore welcome.

In advanced economies, policy action since the start of the crisis has had a strong focus on macroeconomic policies and financial sector reform. Progress on structural reforms, other than in financial sector regulation, has been relatively limited. Even in the financial sector, there is much that remains to be done, with the remaining agenda given added urgency by recent developments in the Eurozone. With macroeconomic policy space approaching its limits in many advanced economies, structural reforms provide the main policy instrument to boost growth in the coming years, while also providing important co-benefits in helping to reduce imbalances. While priorities vary across countries, key areas of reform include labor market reform to improve labor utilization and productivity, reform of the tax system and social protection, removal of barriers to investment and competition (especially in network and service industries), reduction of producer support for agriculture and energy subsidies, upgrading of infrastructure, and improvement of programs in education and health. Pro-growth structural reforms would help mitigate the potential negative short-term impact on growth of the fiscal consolidation needed in many of these economies. In countries that have the fiscal space, upgrading of infrastructure would both promote growth and spur demand in the short run. Structural reforms are also a critical element in addressing current concerns about "jobless" growth.

[4] OECD. 2011. *Going for Growth, 2011: Economic Policy Reforms.* Paris.

In emerging economies, progress on structural reforms over the past couple of decades has been instrumental in unleashing their growth potential. But many challenges remain. Continued progress on structural reforms will be important to sustain these economies' growth momentum—and the vital contribution they are now making to supporting global growth. In economies with large and persistent external imbalances, structural reforms would help with rebalancing.

Nine G20 members are emerging economies. The World Bank has an active dialogue on structural reforms with these middle-income countries. Bank country teams have reviewed their MAP submissions and prepared summary assessments of recent actions and future priorities.[5] These are set out in Table 2, organized by the three dimensions of the G20 Framework for Strong, Sustainable and Balanced Growth.[6]

Emerging market members of the G20 are engaged in structural reforms across the three dimensions of the growth framework, as indicated in Table 2. However, as their MAP submissions note, a substantial agenda lies ahead. Key structural reform priorities in the forward agenda include the following:

Strong growth: regulatory reform to reduce barriers to investment and competition (China, India, Indonesia, Mexico, Russia, South Africa); labor market reform (Argentina, Mexico, South Africa, Turkey); reform of state-owned enterprises, privatization (China, Russia, Turkey); financial/capital market development (Argentina, Brazil, China, India, Turkey); strengthening of infrastructure, including regulatory framework for private participation (practically all nine countries); and competition in network industries (Mexico, South Africa).

Sustainable growth: tax and expenditure, including subsidies, reform for fiscal sustainability (Argentina, Brazil, India, Indonesia, Mexico); intergovernmental fiscal system reform (China, Indonesia); efficiency of public administration (Indonesia, Russia); health/pension system reform (Mexico, Russia, Turkey); education quality/skills development (practically all nine countries); innovation/R&D (Argentina, China, Indonesia, Russia); energy efficiency/renewable energy (Brazil, China, India, Indonesia, Mexico, South Africa, Turkey); sustainable agriculture and control of deforestation (Argentina, Brazil, Indonesia); and water resource management (Argentina, India, Turkey).

Balanced growth: reduction of trade barriers (Argentina, India, Russia, South Africa); liberalization of the services sector (China, India); exchange rate flexibility (China); reform of social safety nets (practically all nine countries, in most cases motivated by reduction of poverty and inequality and protection of the poor and vulnerable against shocks but in some, notably China, with a focus on external balance as well); expansion of social spending–education, health (China); reduction of regional disparities (Argentina, Brazil, China, South Africa); and emphasis on raising domestic saving in tax, social security, and financial sector–financial literacy, saving instruments–reforms (Brazil, South Africa, Turkey).[7]

[5] The focus here on these nine countries complements OECD work on structural reforms that also covers advanced economies. See OECD. 2011. *Pursuing Strong, Sustainable and Balanced Growth: Taking Stock of Structural Reform Commitments.* Paris.

[6] Inevitably, there is some arbitrariness in assigning individual structural reforms to one or another of these dimensions as many reforms, as noted above, cut across them in terms of their full impact. Still, it is useful to see the alignment of reforms with these growth objectives. Structural reform actions aimed primarily at boosting growth in the short to medium term (such as infrastructure investment and many product and factor market reforms affecting the investment climate) are placed in the first column. Actions aimed primarily at promoting longer-term sustainability of growth, such as actions that affect long-term fiscal/debt sustainability (fiscal measures of a structural nature), long-term productivity growth and structural change (e.g., innovation, skill upgrading, or institutional framework reform), and environmental sustainability, are placed in the second column. Actions with a primary focus on addressing growth imbalances, including external imbalances as well as internal imbalances such as a highly unequal pattern of growth, are placed in the third column.

[7] Countries identified here in parentheses are those where the indicated reforms are highlighted as particularly important priorities in their reform programs at present but are not the only ones where further actions in these reform areas are needed.

Table 2: G20 Emerging Economies
Priorities in Structural Reform for Strong, Sustainable and Balanced Growth

Strong	Sustainable	Balanced
Argentina		
Key recent actions - Major program of infrastructure investment and institutional strengthening in highways and urban transport and energy. - Investments to raise productivity of small and medium size agricultural producers. - Labor market reform covering skill development, unemployment benefits, job search, and incentives to formalize. *Priority additional actions* - Strengthen financial system to improve access to long-term capital and SME financing. - Lower the cost of hiring, particularly the young and for SMEs.	*Key recent actions* - Increased investment in school infrastructure and new technologies for students and teachers. - Matanza Riachuelo River Basin clean-up and forest and community development carbon finance projects. *Priority additional actions* - Improve access to secondary education and raise quality at all levels. Improve links between tertiary and technical education and labor market. - Improve financing and incentives for innovation, R&D. - Improve fiscal sustainability through tax reform and containment of utility subsidies. - Improve water resource management, flood control, and disaster risk management.	*Key recent actions* - Increased transport and water investments in the poorer Norte Grande region. - Improved universal child allowance safety net program. - *Plan Nacer* aimed at reducing infant and maternal mortality. - Cost-free savings accounts for low-income households. *Priority additional actions* - Reduce nontariff trade barriers. - Reduce logistics costs, especially in Norte Grande (road network, Belgrano Cargas railway). - Increase access to early childhood development programs, especially in poor regions.
Brazil		
Key recent actions - Competitiveness Development Policy with renewed focus on private investment, productivity, and R&D. - Simplified regulation and tax regime for promotion and formalization of MSMEs. - Increased infrastructure investment (urban development, transport/logistics, water, energy) under Growth Acceleration Plan (PAC2). *Priority additional actions* - Strengthen institutional framework for PPPs in infrastructure. - Improve procedures and capacity to raise quality of public investment in PAC2. - Develop domestic capital market.	*Key recent actions* - Ten-Year Energy Plan with focus on renewable energy and energy efficiency. - Compulsory schooling at age six. - National Climate Change Action Plan. National Solid Waste Management Law. *Priority additional actions* - Enhance fiscal sustainability through better control of current spending. - Scale up promising reforms at state and local levels to raise quality of secondary education. - Continue improving environmental management: institutional mandates and capacities, use of economic instruments, licensing processes, social participation. - Develop incentive and financing schemes for modernization of agriculture with reduced deforestation. - Develop a nationally coordinated disaster risk management strategy.	*Key recent actions* - *Brazil sem Miseria* program for poverty eradication with three pillars: income transfers, productive inclusion, and access to public services. - National Program to Access Technical Education and Employment for low-income students and workers. *ReUni* program to expand slots for poor students in federal universities. - Expanded *Minha Casa Minha Vida* and *Luz para Todos* programs for low-income housing and electricity. *Priority additional actions* - Develop integrated health care networks, improving governance and quality of basic health programs. - Improve coverage and quality of early childhood development for poor students/areas. - Implement social security, and tax, reforms to boost domestic saving.
China		
Key recent actions - Issuance of regulations to boost private investment. - More open and transparent market access for private and foreign investors in service industry. - Personal income tax (PIT) threshold raised. *Priority additional actions* - Revisit SOE role in sectors to further open opportunities for private sector. Increase competition in sheltered sectors, including services; strengthen anti-monopoly law. - Complement higher PIT threshold with reduction of social security charges to further boost disposable incomes. - Remove barriers to urbanization through reform of *Hukou* registration and entitlement system and land reform.	*Key recent actions* - Strategic focus on upgrading industrial structure, moving up value chain, and stimulating innovation. - 12th Five-Year Plan commitments on reducing energy intensity and environmental impact of growth, backed by targets. *Priority additional actions* - Bring on budget all forms of fiscal revenues and expenditures. Reform intergovernmental fiscal system to improve fiscal sustainability and reduce regional inequalities. - Improve education quality through expanded cycle of general education running from pre-primary to senior secondary school. - Increase environmental public investment and use of pricing and taxation to internalize environmental costs.	*Key recent actions* - 12th Five-Year Plan aims to rebalance growth pattern more toward consumption, services, and domestic demand. - Increased government spending on health, education, and social safety net. - Scaling up of social housing. - Regional rebalancing through more public investment in less advanced central and western regions and rural infrastructure. *Priority additional actions* - Continue reforms to rebalance growth, which calls for action on several fronts including: pricing and taxation of inputs into industry; SOE dividend policy and corporate governance; financial sector reform to price capital better and increase access for services sector and SMEs; expansion of social spending; and

Strong	Sustainable	Balanced
		exchange rate reform. - Develop rules-based financing arrangements for sustainable scale-up of social housing.
India *Key recent actions* - Creation of infrastructure finance companies. - Enhanced transparency of loan pricing by banks. *Priority additional actions* - Further improve financial system's ability to provide long-term infrastructure financing. Develop corporate bond market. Improve regulatory framework for private participation in infrastructure. - Open economy further to FDI including in services (retail, insurance). Reduce administrative burdens on private enterprise. - Improve land acquisition policies.	*Key recent actions* - Revenue and spending measures to enhance fiscal sustainability, including reduction of subsidies (petrol, fertilizer). - Stronger approach to environmental sustainability: clean-up of Ganges basin; increased focus on renewable energy. *Priority additional actions* - Spell out concrete actions for medium-term fiscal consolidation. - Improve pricing of natural resources (energy, water). - Increase focus in education on raising quality.	*Key recent actions* - Unique identity cards to help with improved safety net targeting. - Planned Food Security Act to improve nutrition for the poor. - Right of Children to Free and Compulsory Education Act. - Rural development programs: Mahatma Gandhi Rural Employment Guarantee, National Rural Health Mission, Bharat Nirman scheme for rural infrastructure. *Priority additional actions* - Further improve social inclusion service delivery and efficiency of spending. - Improve delivery of basic urban services to cope with rapid urbanization.
Indonesia *Key recent actions* - Business environment reforms: negative investment list, one-stop-shop services. - Land acquisition and guarantee laws to streamline large infrastructure projects. - Presidential decree on food production. Set up of credit financing for food security and energy programs *Priority additional actions* - Continue improvement of legal certainty, simplification, and harmonization of business regulations. - Improve SME access to finance and simplify tax procedures. - Improve regulatory framework for infrastructure. Improve financing of urban infrastructure. - Reform severance system and SJSN pension program for workers.	*Key recent actions* - Five-year plan RPJMN envisions reduction in energy subsidies. - Revision of laws for civil service management and subnational spending. - National Innovation Commission. - Forestry moratorium and move toward pay-for performance in deforestation. *Priority additional actions* - Improve fiscal sustainability by substantially reducing energy subsidies and continuing reform of PFM and intergovernmental transfers. - Scale up competitive funding for innovation. Increase emphasis on education quality. - Promote gas and geothermal energy exploration by removing domestic price restrictions and opening access.	*Key recent actions* - Creating a national unified registry of poor households to improve social assistance targeting. - Pilot for demand-driven training for unemployed youth. National youth employment strategy under preparation. *Priority additional actions* - Develop an overall social safety net strategy and implement reforms of programs that can be scaled up. - Pilot and scale up a skills-development training program, and provide social assistance that targets youth and informal workers. - Strengthen food security for the poor and vulnerable.
Mexico *Key recent actions* - Review process to reform burdensome business regulations. - Amendments to Competition Law to strengthen competition enforcement. - Increased public investment in infrastructure. - Enhanced competition in telecommunications. *Priority additional actions* - Reform labor legislation to facilitate more flexible contracting, reduce cost of ending contracts, expedite dispute resolution, and encourage training. - Broaden scope of regulatory review process. - Strengthen resources and capacity of Federal Competition Commission.	*Key recent actions* - Fiscal consolidation program, including raising of non-oil tax revenues. - Financial Stability Board to improve coordination across financial authorities and risk management. - Adoption of a Special Program for Climate Change, including sector-specific emission targets. *Priority additional actions* - Prepare further tax reform. Increase incentives and scope for revenue mobilization at subnational level. - Better align domestic energy prices with international prices. - Complete transition to a defined contribution pension system. - Improve quality of public education, with a focus on teacher quality.	*Key recent actions* - Unilateral MFN tariff reduction program for non-agricultural products. Electronic Single Trade Window for compliance with all trade regulations. - Expanded health insurance coverage through *Seguro Popular*. - Expanded income support to the poor through *Oportunidades* CCT program. - Furthering financial inclusion: banking service provision through third parties and mobile phones. *Priority additional actions* - Design a broad-based strategy, including review of social security services, to reduce informality. - Integrate provision of health care services among different public sector providers.

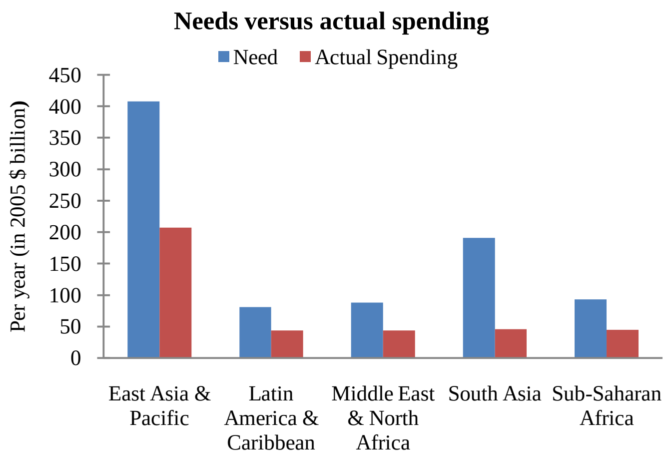
Strong	Sustainable	Balanced
Russia		
Key recent actions - Improvements in fiscal management: countercyclical use of oil windfalls and saving for future generations; medium-term fiscal adjustment framework, including broadening of non-oil tax base; improved budget transparency. - SOE privatization program aimed at reducing state control and attracting private capital and technology. - Banking sector strengthening, including transparency of bank ownership. *Priority additional actions* - Implement privatization program and explore further scope for PPPs. - Complete high-impact infrastructure projects and improve connectivity between centers of economic activity. - Ease regulatory burden on SMEs to spur entrepreneurship and competition.	*Key recent actions* - Strengthening incentives for innovation; a new innovation center in Skolkovo near Moscow. - Strategy for higher education reform and actions to strengthen preschool education. - Measures to reduce corruption, including financial disclosure by public officials. - Adoption of an energy efficiency law. *Priority additional actions* - Implement more concrete actions to raise efficiency of public expenditures, with a focus on social sectors (health finance, pensions). - Pursue agenda to curb corruption and improve public procurement.	*Key recent actions* - Actions to improve unemployment benefits. - Adoption of program to curb non-communicable diseases. *Priority additional actions* - Complete the process of Russia's accession to WTO. - Strengthen social safety net for poor and vulnerable groups and improve targeting. - Advance ongoing work on long-term development of pension system.
South Africa		
Key recent actions - Major public infrastructure investment program, with focus on energy and transport and logistics. - Amendments to Companies Act to simplify registration and improve framework for reorganization and insolvency. - Tax incentives to labor-intensive investments and worker training. *Priority additional actions* - Reform wage bargaining system as part of strategy to reduce high unemployment. - Improve access to finance for SMEs and underserved areas. - Reform electricity pricing and regulation to encourage private investment. - Open the market for mobile telephony.	*Key recent actions* - Adoption of National Skills Development Strategy, with increased allocations to education and training. - Adoption of Long-Term Mitigation Scenarios backed by an Integrated Resource Plan. Carbon emissions tax imposed on new vehicle sales, with a broader tax under consideration. *Priority additional actions* - Raise education quality, including by strengthening accountability at school level. - Strengthen competition policy to address high industrial concentration.	*Key recent actions* - Expanded public works program. - Jobs Fund with a focus on young workers. Proposed youth wage subsidy. - National Health Insurance system under consideration to expand coverage. - Process to design comprehensive social security reform to raise national saving. *Priority additional actions* - Improve implementation of the means-tested Child Support Grants. - Better link the poor in remote areas to economic hubs: clarify mandates for municipal infrastructure; consider well-targeted transport subsidy. - Reduce high trade tariff dispersion. Reduce nontariff barriers to deepen regional integration.
Turkey		
Key recent actions - Labor market reforms to reduce non-wage labor costs and disincentives to part-time work. - Adoption of an informality strategy and action plan. - Enactment of Commercial Code, Code of Obligations, and Civil Procedures Law. *Priority additional actions* - Implement planned Employment Strategy to improve labor market flexibility and worker protection and strengthen links between vocational education and jobs. - Promote financial intermediation by improving corporate governance and capital markets law. - Amend electricity and gas market legislation and complete institutional reform of key SOEs (BOTAS, TEIAS).	*Key recent actions* - A new Court of Accounts Law to improve public financial management. - Amendment of Renewable Energy Law to enhance investor incentives. - Launch of a modern power exchange and implementation of a program of distribution and generation privatization. - Development of National Climate Change Strategy - being translated into an Action Plan. *Priority additional actions* - Contain pension and health care spending for long-term fiscal sustainability. - Improve learning outcomes by raising teaching quality and strengthening systems for financing and ensuring quality education. - Further improve energy efficiency. Develop watershed management strategy for sustainable hydro development, irrigation, and flood control.	*Key recent actions* - Launch of program to achieve universal preschool education among 5-year olds by 2014. - Improved access to health services through universal health insurance reform and rollout of family medicine model. *Priority additional actions* - Consolidate reforms to build an integrated social assistance system that protects the poor and provides productive opportunities. - Expand skill upgrading opportunities for the low skilled, particularly youth and women. - Promote domestic saving – including by increasing financial literacy, introducing new saving instruments, and expanding private pensions.

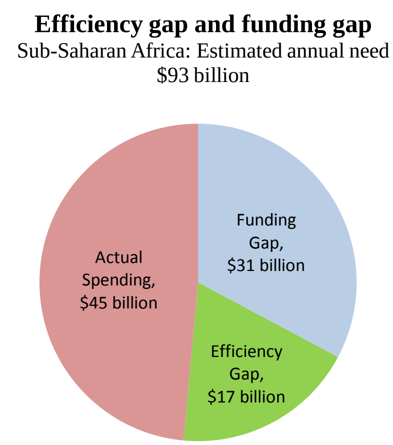
Leveraging Developing Country Growth

With their superior growth performance and prospects and rising role in the global economy, developing countries can be an important source of growth in demand to support the rebalancing of global growth. Developing countries possess a large potential for future growth. Investments in key infrastructure and human capital promise high returns. However, many countries, especially lower-income countries with limited access to private capital markets, face a financing constraint in capturing these opportunities. This applies in particular to infrastructure that often requires large and lumpy investments and long-term finance that even countries with better access to capital markets may find difficult to raise. Supporting investment and reforms that remove barriers to stronger and more broadly based growth in developing countries would be a global win-win. It would support development and poverty reduction in these countries. It would also contribute to stronger and more balanced growth at the global level by creating new markets and investment opportunities and more sources of growth in global demand.

Returns to infrastructure investment can be particularly high in developing countries where the infrastructure stock is typically low. It is estimated that if Sub-Saharan Africa's infrastructure were to increase to the level of Korea's, its growth rate could rise by 2.7 percentage points. Similarly, if Latin America could have the same level of infrastructure as East Asia's middle-income countries, its growth rate could rise by 2 percentage points.[8] Infrastructure gaps are large across the developing world. Infrastructure investment and maintenance needs in developing countries in the medium term are estimated at more than $1.2 trillion annually. Actual spending is only close to half that level. Some of the estimated financing need can be reduced through improved efficiency, as for example in Africa (Figure 4). Many developing countries have in recent years undertaken important reforms to improve the efficiency and development effectiveness of their investment programs. This effort needs to continue, as potential returns from infrastructure investment can only be fully reaped with attention to quality in project preparation, implementation, and maintenance. Even with improved efficiency, however, a large financing gap remains.

Figure 4: Infrastructure investment in developing countries



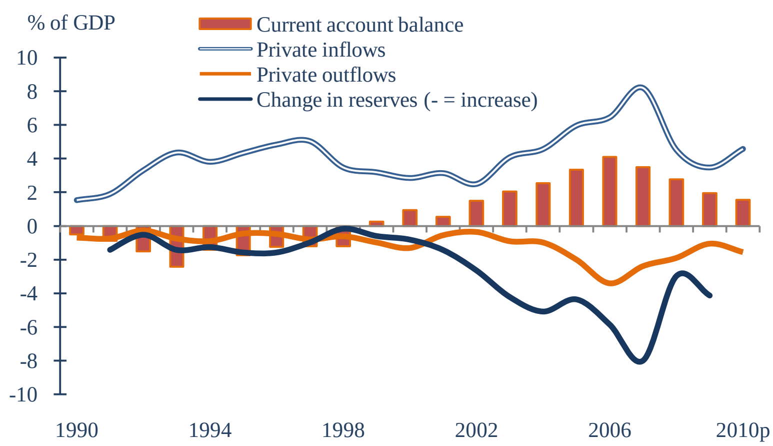


Note: Figures include investment and O&M spending. Data are not available for Europe and Central Asia.
Source: Supporting Infrastructure Development in Low-Income Countries. Interim Report to the G20 by the MDB Working Group on Infrastructure. June 2011.

[8] See Calderón, César and Luis Servén. 2010. "Infrastructure and Economic Development in Sub-Saharan Africa." *Journal of African Economies*, Vol. 19; and Calderón, César and Luis Servén. 2011. "Infrastructure in Latin America." *Policy Research Working Paper* 5317. The World Bank, Washington, DC.

About three-quarters of developing countries are net importers of capital. However, in the aggregate, developing countries have been net exporters of capital to advanced economies in the past decade – a phenomenon sometimes referred to as "capital flowing uphill" (Figure 5). This has largely reflected surpluses of saving over investment in a few large countries, notably China and oil and mineral exporters. In the 2000-10 period, emerging and other developing economies ran an average current account surplus of 2.6 percent of GDP. This translates into a cumulative current account surplus of $3.8 trillion, implying a sizable net outflow of capital to advanced economies.[9] Much of this took the form of accumulation of reserves by purchasing advanced economy sovereign debt. Successful rebalancing through fiscal consolidation in advanced economies would allow more of the surplus global savings to support investment and growth in developing countries, which in turn would generate more import demand and reinforce global rebalancing and growth. Investment in infrastructure in developing countries can play a key role in capturing these positive linkages, as illustrated by simulation results presented below.[10]

Figure 5: Developing countries' balance of payments: capital flowing uphill



Source: IMF BOP Statistics; World Bank staff estimates

Figure 6 shows the results of a simulation that combines an increase in infrastructure investment in developing countries with fiscal adjustment in high-income countries to illustrate the win-win implications of a policy mix that responds to the need for fiscal consolidation in major advanced economies and the ongoing need for more infrastructure investment in developing countries to support growth.[11] Fiscal consolidation in high-income countries in this simulation follows the size and time path of the reduction in fiscal deficits calculated by the IMF to bring down their ratio of government debt to GDP to 60 percent by 2030.[12] The cuts in fiscal deficits are assumed to be matched by an equivalent increase in infrastructure investment in developing countries.[13]

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[9] Using IMF definition of emerging and other developing economies.

[10] Simulations reported here were carried out using the G-cubed model, a dynamic intertemporal general equilibrium model of the world economy. The model has been used in the past to analyze a range of global economic issues. Full details of the model can be found at www.gcubed.com.

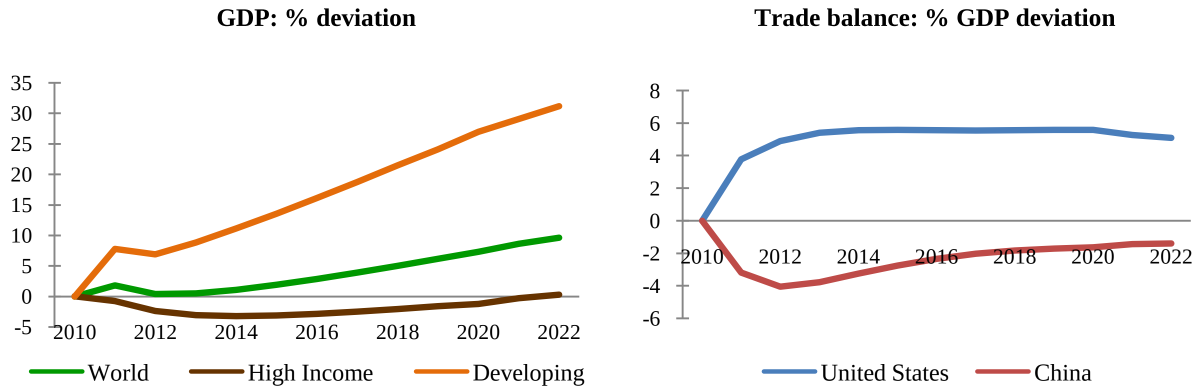
[11] Simulations on infrastructure spending are based on the finding of a recent study, utilizing panel data for 88 countries, that output rises by 0.8 percent for every 10 percent increase in infrastructure stock: see Calderón, César, Enrique Moral-Benito and Luis Servén. 2011. "Is Infrastructure Capital Productive? A Dynamic Heterogeneous Approach." *Policy Research Working Paper* 5682. The World Bank, Washington, DC. Note that the results of this study are based on actual data on productivity returns to infrastructure investment in these countries, not on optimistic assumptions about theoretical returns given infrastructure and productivity gaps.

[12] IMF. April 2011. *Fiscal Monitor: Shifting Gears - Tackling Challenges on the Road to Fiscal Adjustment.* Washington, DC.

[13] In this scenario, global savings released by a reduction in high-income country fiscal deficits are assumed to be apportioned to investment in developing countries other than China, a country with a large saving surplus.

Figure 6: Scenario with fiscal consolidation and infrastructure investment

Fiscal adjustment in HICs with an offsetting increase in infrastructure investment in DCs



Source: Simulations with G-cubed model. All results are expressed as percent deviations from baseline.

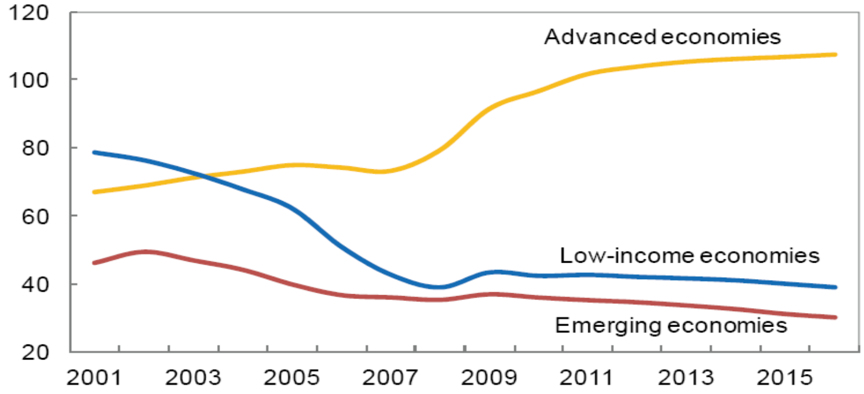
GDP in developing countries rises by more than 25 percent and world GDP rises by more than 7 percent over a ten-year period. A higher stock of infrastructure capital raises private sector productivity. Increased returns to private capital both boost domestic private investment and attract more capital from abroad. GDP in high-income countries dips initially because of the fiscal adjustment but recovers later both because of the positive medium-term effects of successful fiscal consolidation and positive spillovers from higher investment and growth in developing countries. The short-term drop in GDP in high-income countries can be averted if fiscal consolidation is complemented by growth-enhancing structural reforms (including improvement of the structure of taxes and spending to enhance the impetus to growth from a given level of public spending and fiscal balance). Global trade balances improve, both because of fiscal consolidation in advanced economies and higher investment and growth in developing countries. This is illustrated in the chart by the outcome for two countries with sizable imbalances: U.S. and China.

The scenario illustrates the win-win possibilities for global growth and rebalancing from an unwinding of the pattern of capital flowing uphill, by means of fiscal consolidation in high-income countries and redirection of global savings from financing imbalances in these countries to financing investment in developing countries. A variant of the scenario would combine increased investment in infrastructure in developing countries with more investment in human capital that also offers high returns in developing countries, or model a mix including increased private investment in directly productive activities. Another variant of the scenario would include an increase in investment in both developing and advanced economies. Fiscal consolidation would create more fiscal space for increase in growth-enhancing investment in advanced economies, such as in infrastructure upgrading. Quality infrastructure investment that boosts growth can pay for itself in the medium term.[14]

It will be important to ensure that the additional financing that developing countries take on for investment is in amounts and on terms that are consistent with their macroeconomic and debt sustainability. Improved macroeconomic and debt management, and stronger growth, have enabled developing countries to significantly lower their debt burden in the past decade (Figure 7). For a number of low-income countries, debt relief also has helped. The improved debt profile creates more room for boosting investment, but that will need to be carefully managed in light of specific country circumstances.

[14] The above scenario is presented for illustrative purposes only, to analyze potential results from some policy shifts at the global level. Specific circumstances of course differ across countries and must inform actual policies at the country level.

Figure 7: General government gross debt ratios
(% of GDP, 2009 PPP-GDP weighted average)



Source: IMF Fiscal Monitor, WEO.

Financing for Investment and Growth

The foregoing suggests a potentially virtuous circle between financing for development—for investment in critical infrastructure and human capital in developing countries—and global growth and rebalancing. Several emerging markets have experienced strong surges in private capital inflows, especially short-term portfolio inflows. But for many developing countries, longer-term financing for investment remains a binding constraint. Successful fiscal consolidation in high-income countries would open more space for flow of global savings to developing countries. Converting this opportunity into increased financing for growth-enhancing investments will require complementary actions by the international community.

In infrastructure, investors in the past have been reluctant to invest in developing countries because of perceived risks, capacity constraints on project preparation and implementation, and the long-term nature of infrastructure investments. Going forward, private capital flows and public-private partnerships will need to play an increased role in boosting infrastructure investment. This calls for strengthening risk mitigation guarantee mechanisms and exploring innovative partnerships that leverage private capital.[15] Multilateral institutions will have a key role to play in providing financing, catalyzing private investment through guarantees and partnerships, and helping to improve regulatory and institutional frameworks for investment in developing countries and build project preparation and implementation capacities (at the country level and for regional projects). Sovereign wealth funds and South-South investments can provide more finance and partnership possibilities. Additional funding can come from climate finance for qualifying infrastructure projects.

Work underway in the G20 Development Working Group on the infrastructure pillar will provide important support to this agenda. Also relevant in this context are the G20 work streams addressing the development of capital markets and domestic resource mobilization in developing countries.

[15] Even in high-income countries with more developed capital markets, the risk and long-gestation characteristics of infrastructure investments have prompted governments to consider guarantees and other public-private partnerships to boost private financing. Recent examples are President Obama's call for an Infrastructure Bank in the U.S. and the European 2020 Project Bond Initiative.