COMMONWEALTH POLICY STUDIES UNIT: 6

2001 Commonwealth Finance Ministers' Meeting: Policy Brief

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Policy brief for the Commonwealth Finance Ministers' Meeting, 24-26 September, 2001, St Lucia

Executive summary
Poverty remains at the top of the agenda for this year's Finance Ministers' Meeting, whose formal theme is "Financing for Development." The slowdown in the world economy provides the backdrop for discussion of the continuing delays to debt relief, the need for fairer trade as well as freer trade, the channelling of funds for development, and also the requirement to make development a bottom-up process. With summit after summit of rich countries' leaders blockaded by demonstrations some see this meeting as a unique opportunity to alter the course of trade and economic thinking. However OECD attempts to crack down on what it calls "harmful tax competition" – in other words the offshore finance industries of small island states – suggest that hearts and minds in the North are far from changed yet. And the complacency surrounding reform to the international financial architecture will return to the centre of discussions, given the additional urgency arising from the fragile state of health in which the global economy finds itself.

1 Status, representation, recent meetings

Among the numerous periodical ministerial meetings within the Commonwealth system, the Finance Ministers' Meeting (FMM) stands somewhat apart. Its deliberations and conclusions may sit within the context of other Commonwealth ministerial gatherings; but even more than its counterparts it takes place in a broad continuum of wider international discussions concerning economics and finance.

The meeting – annual, unlike most Commonwealth ministerial gatherings, and more well-attended than most as well – immediately before the annual gatherings of the world's two key international financial institutions (IFIs), the International Bank for Reconstruction and Development (the World Bank) and the International Monetary Fund (IMF). That gives Commonwealth finance ministers the chance to thrash out key questions in a more collegiate forum ahead of time in a forum with a mix of a minority of industrialised countries and a large majority of developing states.

Out of the 54 member states, as many as 90% are likely to send ministers. This year, one state is suspended: Pakistan, thanks to the military dictatorship instituted in October 1999. Fiji's return to democracy after its coup in May 2000 means it has returned to the fold after suspension last year. The chair is traditionally held by the Finance Minister of the host nation: in this case the Prime Minister, Dr Kenny Anthony, who is also the Minister of Finance.

The scale and significance of FMMs means that playing host is a relatively expensive proposition in comparison with some ministerial meetings. That can be a heavy burden for the small islands which have hosted four of the last five, the exception being Canada in 1997. Two have been in British dependent territories (the Caymans in 1999 and Bermuda in 1996) and St Lucia makes this the third time in six years that ministers have headed for the Caribbean or the Gulf of Mexico. One was held in Mauritius, in 1997, and last year it was in Malta. But as is the norm at Commonwealth ministerial meetings, member states bear the brunt of the expense of their delegations, with just the head of state and spouse being supported by the host government.

2 Record for policy

The Commonwealth's position as the only international body whose membership includes both industrialised and developing states, with the latter in a majority, gives it a unique role in economic policy making. While decisions — reached, of course, by consensus rather than by vote — may not necessarily have a direct impact on global economic policy, the results of FMM deliberations not only have some support from two of the G8 countries (the UK and Canada) but a near-worldwide distribution of developing countries as well. Further weight comes from the presence of 10 Commonwealth members among the 41 countries in the Heavily Indebted Poor Countries (HIPC) initiative.

The meetings of 1998, in Ottawa, and the meeting in Mauritius the year before, provide good examples. Ottawa saw a statement on the chaos caused in the global economy by the Asian currency crisis of 1997. It called for root-and-branch reform of the regulation of international capital flows, and a supranational committee of all international financial institutions, to intervene when the balance of risk reached critical levels. The international community, the statement said, needed to rediscover the energy and commitment of the original Bretton Woods negotiators.

Since then, reform has ossified. 1999 brought an unequivocal call for concrete, deep-seated reform, bringing developing nations much closer to the heart of IFI decision-making. The establishment by the IFIs of the Financial Stability Forum, chaired by the UK's Gordon Brown, went some way towards answering the questions posed by the inequalities inherent in globalisation, it said. But the forum had to retain a "sense of urgency" and should work harder to bring developing countries into the decision-making process.

Last year's message indicated little change. IFI firefighting and the US's continuing consumer-led boom, it was widely felt, had patched things up sufficiently to allow financial markets in the industrialised countries to go on generally as they had before, despite persisting collateral damage to some developing economies.

There remained, the 2000 communique noted, little practical movement on reform of the IFIs, while progress on debt reduction and the opening of trade barriers affecting developing countries was patchy at best. Increasing US pressure to clip the wings of the IMF in particular – now brought into sharp relief by a new US cabinet including several of the key proponents of radical surgery – lay behind a call for proper financial support of the Fund's activities.

New to the menu in 2000 was the question of what has come to be dubbed "harmful tax practices" and has developed into the centre of a row which has set the smallest of states in a head-on clash with the largest. An initiative by the Organisation for Economic Co-operation and Development to clamp down on tax evasion was seen by many as crossing the line into imposing limitations on the offshore finance industries of small, mostly island states, as much to cripple the competition as to attack tax dodging per se. The threat of sanctions on non-members on a "blacklist" of 35 (over half of which are in the Commonwealth) who chose not to comply was taken as the final straw.

Debt refinancing and forgiveness has continued to top the agenda for a majority of Commonwealth countries, and therefore a staple of FMM agendas. During 1997's Mauritius FMM, the snail's pace at which the HIPC programme was proceeding was of great concern.

The outcome was the Mauritius Mandate: a demand that the Paris Club of donors and those responsible for administering the HIPC initiative ensure that, by the year 2000, all HIPC countries should at least have embarked upon the process of examining and rescheduling debt. By the same deadline, 75% of the countries should have been able to settle the terms for forgiveness and repayment. It also urged HIPC assistance for additional categories of debt — that owed to multilateral bodies, as well as bilateral debt, for instance — which had been omitted from its terms of reference.

In 1998 the snail's pace of progress with the Mauritius Mandate, unsurprising though it may be, triggered a call for its extension beyond the end of 1999. That year, Ministers welcomed the greater emphasis on poverty reduction which the G8 nations agreed in their summer summit in Köln that year, but set a 2015 target for achieving this aim. They stressed that with time ticking by, sustainability was a key issue. They also reminded the Bank and the Fund that debt relief should not replace Official Development Assistance (ODA).

3 Agenda for 2001

The current draft agenda, which will be confirmed or amended on the eve of the conference, is as follows:

1. **Current world economic situation and prospects**
   Examination of the performance of the global economy in the year since the last meeting, and discussion of a Commonwealth Secretariat briefing on the prospects for the future. Key issues include:
   • The new WTO trade round which could start in November in Doha, Qatar
   • Co-operation with World Bank and IMF
   • Debt, the HIPC initiative and the Mauritius Mandate, with input from the Commonwealth HIPC Ministers' Forum

2. **Special theme:Finance for development**
   Intended to map out possible input to the United Nations International Conference on Financing for Development, scheduled for March 2002 in Monterrey, Mexico.
   • Collaborating on individual countries' planned proposals for the conference, and examining how they can best be presented
   • Looking for ways to link financing for development and individual countries' internationally agreed development targets
   • Determining ways of reinvigorating official development assistance (ODA) flow and directing it better towards those countries most in need – particularly the smaller ones and those with severely limited savings
   • Examining the problem of persuading private capital to flow to countries off the normal beaten track

3. **Small states**
   A review of the implementation of the recent joint Commonwealth Secretariat/World Bank Task Force on Small States which looked at ways of integrating small states safely and securely into the global economy, together with specific issues which are affecting those nations with a population below 1.5m. Including:
   • Practical application of the vulnerability index which arose from the task force
   • Exposure to commodity markets and dependence on a narrow range of exports, as well as exposure to volatile capital flows
   • Strengthening the ability of small states to gain fair representation in international fora, particularly with respect to the global trade regime
   • The OECD's harmful tax competition project, which disproportionately affects small states, and progress in the Malta Initiative intended to rectify its deficiencies

4. **Commonwealth Gender Budget Initiative**
   The Initiative, which has grown from a pilot project in Sri Lanka, is intended to embed awareness of the effect of policy on both genders in the policy making process, and move away from the assumption – rarely challenged, not least for

reasons of administrative convenience – that policy is gender neutral until proven otherwise.
• Progress in Sri Lanka, where the lessons learned from the initiative is now being integrated into mainstream policy making
• South Africa, where the government has decided to implement the same kind of studies potentially leading to policy changes
• How to implement the Initiative in other Commonwealth countries

5. **Commonwealth Private Investment Initiative**
Review of the performance of the CPII, which now includes four funds, one for each of the Caribbean,. Africa, the Pacific region and South Asia. Including:
• Progress in lending activities and status of projects currently under way, particularly the Commonwealth Africa Investment Fund (Comafin) which has now completed its investment programme
• Looking forward, whether and how the CPII can be improved and expanded

6. **Commonwealth Fund for Technical Co-operation**
Review of the performance of the CFTC, its activities, its overall funding level, and the opportunity for finance ministers to make their pledges for 2001/2 known.

7. **Other issues**
• Debt conditionality: officials will meet to discuss the strings attached to IFI and other loans, and how to ensure that the conditions do not get in the way of achieving the aims of the loan programme itself, to feed into the ongoing review undertaken by the Bank and the Fund.

8. **Any other business**
Including:
• Papers for information
• Communiqué
• Acknowledgements
• Next meeting

4 Comments on numbered agenda items

1 Early last year, the "new economy" boom was at its height. Stock exchanges were breaking records and the more optimistic commentators were lauding the so-called "new paradigm" to the skies.

It didn't last. Once 2001 was under way it became evident that the huge sums invested in startup companies and new technologies in the West were about to evaporate as company after company registered a sharp slowdown in their markets and thus their earnings.

From the US, the downturn spread to Europe, while Japan remained mired in its decade-long bad debt-fuelled deflation. Hopes of a second-half recovery in 2001 have been dashed. And the effects will exacerbate developing countries' problems, as recent experience in Brazil and Argentina is demonstrating.

The recent G8 summit in Genoa's "Millennium Africa Plan", though woefully short on specifics, shows that the richest countries are somewhat aware of the imbalance. But ministers will want more precision and more commitment: evidence that any measures taken, on this or, for instance, on battling HIV/AIDS, are not just a gesture.

Some ministers are likely to point out the way the urgency felt with reference to constructing a more water-tight international financial architecture following the 1997 Asian crisis has dwindled. US pressure for IMF reform, which is mostly about curtailing the organisation's funding and freedom to move rather than opening up its workings, is the only significant movement.

Also up for debate is the ongoing question of how to speed the process of debt relief. The HIPC initiative is still moving at a snail's pace, with only a fraction of the $100bn funding promised at the G8 meeting in Köln in 1999 in place.

According to some in the developing world, the practices which govern the process can sometimes actively militate against achieving the goals of poverty reduction. Poverty Reduction Strategy Papers (PRSPs) – a condition of faster relief – can be so complex and taxing to generate that the IFIs end up largely writing them for themselves; little different than the traditional imposed approach so criticised in the past.

A consultation process is under way to see whether the impediments can be lifted and the process simplified, to concentrate resources on front line poverty reduction. The stated emphasis is on furthering "country ownership" – indigenous control over the development process. Ministers from the developing world will want to know from their richer colleagues the extent of their commitment to this change.

World trade is also, again, a key theme. The protests which began at the abortive WTO summit in Seattle in 1999 and have followed statesmen from country to country, have given new life to the debate about the fruits of globalisation, the distribution of spoils between rich and poor.

The rolling street demonstrations have helped catalyse a need among the richer nations at least to appear to adopt a more broad-based approach to trade. The victory of South Africa against 39 drug companies trying to block WTO rights to suspend patents in a health emergency, for instance, has also played a huge part.

Plans are afoot for a fresh round in Doha, Qatar. Whether or not it takes place, recent months have seen a resurgence of collaboration between developing states in an attempt to generate a united front.

The recent meeting of least developed countries (LDCs) in Zanzibar in July, looked at ways of reversing or mitigating the consistent recent experience of finding developed countries exploiting loopholes while closing those which favour the poor, in the hope of halting the European Union's ambitious agenda of further talks on services and the US insistence on intellectual property.

It is also seen as vital to club together to avoid the heavy pressure from developed countries – mostly conveyed in the corridors rather than the committee rooms of negotiations – to back off and accept the terms of the new round. Both offers and threats tend to accompany such "quiet words".

2. Ahead of the UN Conference on Financing Development, the FMM presents a perfect opportunity to work through questions dogging the development field – some perennial, some more fresh.

Among them is the question of overseas development assistance (ODA), which – bar a handful of countries, notably in Scandinavia – represents one of the more notably missed economic promises of the last few decades. Most developed countries would have to work to reach half the 0.7% of GDP recommended, and the US contributes barely a quarter of that.

And the aid is very poorly targeted, with more than 90% going to just ten countries and the rest left largely out in the cold. Private investment capital has been seen as the panacea, but without official assistance to prime the pump and investment guarantees which work for the country and the project, not simply for the companies concerned, many Commonwealth states are left struggling.

Countries with low savings are especially at risk, and capital liberalisation is no use to them. IFIs should work more effectively to encourage appropriate investment and to create the environment in which it could flow, while leaving ultimate ownership in the hands of the country concerned.

It is clear that without increased ODA to serve as part of the loan and funding underwriting process, funding will continue to be hard to find. The global economic slowdown could paradoxically encourage emerging market investment, but not without support and infrastructure to make the money work. If the converse is also true – that the slowdown means risk and return on investment will be scrutinised even more closely than before – the imperative remains the same.

3 The findings of a joint Commonwealth-World Bank taskforce on the unique problems of small states with a population under 1.5m, including a limited range of exports often based on commodities, debt problems and low GDP, have now been public for some time. The taskforce's remit has been to examine how small states are affected disproportionately by the imbalance developing countries experience between their ability to affect the outside world and their susceptibility to it. Out of 54 member states, 30 count as small states, which was why the Secretariat's lobbying brought the taskforce into being in the first place.

Its answer was to create a vulnerability index, to quantify small states' exposure to external shocks and to the daily workings of the global market. Progress in its integration into day-to-day policymaking is up for discussion now.

But more pressing is the Organisation for Economic Co-operation and Development's crackdown on "harmful tax competition", defined by the OECD as existing when tax regimes "are tailored to erode the tax base of other countries", facilitating the avoidance of other countries' taxes. About half the 35 "blacklisted" jurisdictions threatened with "defensive measures" by the end of July 2001 are within the Commonwealth.

Initially there appeared little problem with the OECD's proposals. Tax havens can present individuals and companies with a way of avoiding or evading tax in their home countries. Oxfam estimates that by permitting corporate and individual tax avoidance, easing corrupt money flows, and smoothing capital flight, the cost to poorer countries is as much as $50,000M. Havens also force poorer countries into a "race to the bottom" of ever-lower tax rates for foreign investors.

But small states, which dominate the blacklist, pushed back. While the record of some is far from unblemished, many are justifiably seen as "clean", with a reluctance always to share information when asked the worst accusation that could be levelled. Barbados is one example, and it was that country's Prime Minister, Owen Arthur, who took the lead in putting the other side of the story.

Setting up as an offshore financial centre, they argued, is one of the few avenues open for earning foreign exchange, yet capacity constraints may militate against regulation of the quality immediately required by the OECD. They suspect the OECD and organisations like it concentrate too much on small jurisdictions, and not enough on larger nations: in this case, particularly the UK. Six UK jurisdictions — Jersey, Guernsey, Gibraltar, the British Virgin Islands, Montserrat and the Turks and Caicos Islands — made it into the OECD hall of shame.

The OECD agreed late in 2000 to discussions with the nay-sayers, which the Commonwealth Secretariat helped to bring about. For months there was little progress, not least due to evidence that the OECD had no intention of compromising its stance an inch. But in May 2001 new US Treasury Secretary Paul O'Neill made it clear that while information sharing was a laudable goal, several other of the more invasive demands of the OECD were unacceptable to the US: not least the July deadline.

The intervention saw the date pushed back to November, and the chance of some meeting of minds seems to have risen despite continuing pressure within the OECD from the UK and Australia in particular to press on. Still, Commonwealth states should recognise that the US position is based on a doctrinaire low-tax policy. They should remember that whatever vocal support for small states may come, the rights and livelihoods of small states are nowhere near the forefront of US thinking.

Ministers will want to know how the OECD will proceed, and what will happen in November. Once agreement has been attained – and many among the listed jurisdictions have made it clear that they have no trouble with bettering the way they exchange information with other jurisdictions, for instance – the assistance with regulation and capacity-building the OECD offers will have to be concrete and committed.

4. The impact of gender imbalance on the development process has been documented in more studies than one could comfortably count. When care is taken, for example, to

ensure that education and other public goods do not remain a male preserve, the result has been a solid, and rapid, upsurge in the pace of development.

This experience, along with others along similar lines, is the catalyst for programmes such as the Commonwealth Gender Budget Initiative. Its aim is to embed in the process of public policymaking, and particularly in decisions concerning the allotment of government resources, the habit of examining policy for its effects on both genders, moving from an assumption that decisions are gender neutral unless glaring proof exists to the contrary to an awareness that policy needs to be tested against this yardstick as a matter of course.

The pilot programme has taken place in Sri Lanka, and the test phase is complete. Its success can be seen in the fact that despite the ongoing budgetary difficulties engendered by almost two decades of conflict with Tamil Tiger separatists, the government has resolved to incorporate the lessons of the CGBI into the mainstream of budget and policy preparation.

South Africa is looking at the possibility of following suit, and the test at this year's FMM will be to see if there are any more takers. Arguments must be made for the availability of resources – technical assistance from the Secretariat and other sources made the Sri Lanka experiment possible – if the project is not to fade.

Ministers should remember, though, that unfortunately this is a new area of activity not only for developing countries; their industrialised cousins are in some cases new to the game as well. The UK government, for example, developed a Women's Unit with a brief to examine policy for its inadvertent effects within the 1997-2001 term of the present government, and its effects are thus far limited. But that is largely a measure of limited political will. There is little to stop other countries from gaining real developmental benefits – with, it goes without saying, the proper support.

5. That investment flows to developing countries are severely skewed is hardly news. A handful of countries garner the vast proportion – figures suggest more than nine-tenths – while the others, lacking resources, security, geographical position, legal and financial structures corporations deem suitable to their needs, languish.

Faced with this situation, and the ongoing downward spiral in Official Development Assistance, the four-year-old Commonwealth Private Investment Initiative (CPII) has taken on a growing importance. The CPII, which generates private sector funds to be invested on a regional basis, will be called upon to extend the range of its activities.

Input is likely to be solicited from the Commonwealth Business Council, in its third year of observer status at the FMM.

Much of their resources to date are now committed, and all four regional funds are now up and running: one each for Africa, the Pacific, South Asia and the Caribbean. The first of these, the Commonwealth African Investment Fund (Comafin) has completed its investment programme, and reports on its progress will form the centrepiece of discussions. Among the most important things to be learned from its experience are how it has distributed its resources geographically, what stumbling blocks has it encountered, and where, in an increasingly difficult world economy, are the best prospects for further fundraising.

The experience in Africa is particularly important since the recent economic experience in much of Commonwealth Africa has been one of decline. How the CPII has fared there is a definite test of its robustness and rigour.

6 Discussion of development co-operation will follow broadly the same lines as last year. It will centre again on the small resources of the Commonwealth's main organ for offering development assistance, the Commonwealth Fund for Technical Co-operation (CFTC). The CFTC pays for hundreds of advisers each year to spend time in member states on missions mostly devoted to "capacity building": assisting with public and private sector economic and financial reform. But contributions to the CFTC have consistently failed to keep pace with need over recent years, although the last twelve months have seen a concerted push from the Secretariat and some governments to boost pledges. Once again efforts will be made to twist the arms of Canada, Australia, New Zealand and the richer developing countries. Under the funding formula each country has to make some contribution to receive a benefit, and as the UK has agreed to pay 30% of what the CFTC actually receives, every extra £ from other countries has a multiplier effect.

However it can be unfortunate that the CFTC's finances are denominated in sterling, and the weakness of the euro and the yen have seen the pound gain in strength. Sterling has recently started backing off – but the dollar, thanks to the downturn, is following suit, and few place much confidence in the strength of the euro. The strong pound is unlikely to cease being an issue any time soon.

7. For the last few months, both the World Bank and the IMF have been engaged in a review of debt conditionality: the riders attached to loans setting targets and dictating priorities. In a series of meetings around the world – one at the Commonwealth Secretariat – with ministers, academics, NGOs and other interested parties it has become clear that too often the riders get in the way of the aims of the programme itself.

Sometimes they can appear almost 'off the peg', with not enough attention paid to the specific circumstances of the country concerned. Sometimes the level of prescriptiveness and the depth of detail of the plans mean that micromanagement to meet preordained targets can become more urgent that responding to real need in a sufficiently dynamic manner.

Officials are tasked this year to examine the evidence and determine progress on making conditionality work. Even though the review will not be presented in full to the Bank and Fund boards till April, the September meetings will include progress reports, and Commonwealth input is important to making sure the programme does not lose sight of the urgency of reform.

5 Interactions with other bodies

The makeup of the Commonwealth and its explicit focus on development means the FMM is always popular with interest groups and other bodies. Aside from the World

Bank, which this year is again involved through its involvement in the Small States project, a raft of Commonwealth bodies including the Commonwealth Development Corporation, the Commonwealth Investment Guarantee Corporation, the Commonwealth Business Council and the Commonwealth of Learning, and other international representative bodies including La Francophonie (with which the Commonwealth Secretariat is actively building a working relationship), the importance of HIPC and debt relief is likely to attract interest from a number of lobby groups

6. Other issues

Perhaps the biggest economic issue facing much of the Commonwealth is missing from the formal agenda, partly because it is as much a health issue as one of economic development. The rapidly-growing incidence of HIV and Aids that threatens – in some countries – more than a quarter of the working-age population is a huge economic threat, and is already eating into the competitiveness and attractiveness of numerous states as destinations for investment. Not to mention, of course, the massive weight on health budgets of caring for so many people, exacerbated as medical professionals themselves succumb.

The danger is huge and right in front of our eyes. Yet the UN's call for a global fund of up to $10bn for research and financial support met with a miserly response from the developed world as barely a tenth of that sum was promised. In any case, the threat of ever-stronger patent protection by large corporations – despite the seminal court victory in South Africa – remains strong, and its continuation is part of the price tag the US and other G8 countries have set on even their limited support to date.

Ministers may wish to stress throughout the meeting the centrality of the HIV explosion to economic policy-making. They may also pay close attention to Brazil, thus far one of the few HIV success stories – relatively speaking – of the Southern Hemisphere. Its dedication to treating all on the basis of need, and its willingness to bypass bans on generic drugs – entirely in line, it should be said, with its prerogatives under WTO and other rules, despite US efforts to claim the contrary – contain lessons that need be learned. Developed countries need constant reminders that if massive and immediate need conflicts with comfortable G8 policy making, the latter, not the former, must give way.

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