

COMMONWEALTH POLICY STUDIES UNIT: 15

**2004 Commonwealth Finance Ministers' Meeting:
Policy Brief**

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Policy Brief for the Commonwealth Finance Ministers' Meeting, 28-30 September 2004, St Kitts and Nevis

Executive Summary

This year's Finance Ministers' Meeting will be influenced by a number of recurring themes. The outcome of Doha development round discussions at the WTO talks impact directly on the CFMM since many developing countries are still facing declining terms of trade. The issue of agricultural subsidy is still critical, as is market access, the policy orientation of the IFIs towards poverty and development and the challenge of attracting investment. The treatment of small states remains a concern. On the plus side, the world economy is looking more robust, with global growth at its highest level since 1999 and WTO talks are back on track after the breakdown at Cancun and WTO adjudication against EU sugar and US cotton subsidies, though there is a long way to go.

Executive Summary

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Authors, Commonwealth Policy Studies Unit, acknowledgements

1 Status, representation, recent meetings

The subjects of economics and finance appear to attract greater attention than others on the development agenda. Not least so among the numerous annual and biannual meetings of Commonwealth Ministers, of which the Finance Ministers Meeting (FMM) is among the most frequent, taking place as it does annually, and also the best attended. Topics for discussion are chosen with due regard to the many other meetings of international actors, with the deliberations of the World Bank/IMF meetings which follow soon after weighing heavily on items for consideration and discussion. No less significant for 2004 is movement at the World Trade Organisation (WTO) and its recent adjudications against US cotton and EU sugar subsidies.

The Commonwealth is unique among international bodies in that its 53-state membership comprises a majority of developing countries and yet has as members several significant international first world countries, including three OECD countries (Australia, Canada and Great Britain), two of which (Canada and the United Kingdom) are members of the G7. As such its representation of a united voice to the International Financial Institutions is of utmost importance as change will only be achieved through continued pressure to reform.

Currently there are 53 Commonwealth member states, following the withdrawal by Zimbabwe in 2003. The CFMMs took place in 2003 and 2002; however the 2001 meeting was called off due to the events on September 11th 2001 in New York.

St Kitts and Nevis are hosting this years meeting. Traditionally the Finance Minister of the host nation chairs the meetings. The honour falls this year to the Hon Denzil Douglas, who as well as Minister of Finance also fulfils the role of Prime Minister of St Kitts and Nevis.

Since 2002, at the initiative of Gordon Brown, civil society groups have had the opportunity to contribute in the form a single speech to the proceedings. This year will be no exception and consultations have taken place agreeing priority issues for the civil society groups.

2 Record for policy

The Commonwealth, because its membership straddles both industrialised and developing countries, has a unique voice in economic and development policy making. Its consensus-based decision making process may not directly affect global economic issues and policies, but with membership spanning G8 countries (UK and Canada), as well as 10 of the 41 LDCs involved in the HIPC initiative, the Commonwealth's membership affords a unique interface between developed and developing countries.

The best recent examples of policy success come from Ottawa, in 1998, and Mauritius in 1997. The financial meltdown caused by the Asian currency crisis of 1997 brought forth from Ottawa a call for root-and-branch reform of the regulation of international capital flows, and a supranational committee of all international financial institutions, to intervene when risk factors reach critical levels. Though the call for reform was

unequivocal, reform has stalled, and 1999 saw a renewed call for deep-seated reform, bringing developing nations much closer to the heart of IFI decision-making. The Financial Stability Forum, established by the IFIs and chaired by Gordon Brown, has to retain a “sense of urgency,” and should work harder to bring developing countries into the decision-making process. The Commonwealth, through numerous forums, continues to press for reform in IFIs, and that call for reform will likely need to be made for some time yet before IFIs reassess their strategies and behaviours.

In 2000, Malta’s meeting reiterated the need for progress. Developing countries felt that their richer neighbours were ignoring the continuing troubles of the South as long as a United States consumer boom, and some Bretton Woods firefighting, kept the North comfortably afloat. In that regard, the developing world is still waiting for the Doha development round to emerge as a true development round.

Also on the menu in 2000 was the Organisation for Economic Co-operation and Development’s so-called “harmful tax practices” initiative. Ostensibly designed to close loopholes that encouraged widespread tax avoidance, its potentially disproportionate effect on small island states, who suspected the real aim was to kneecap the opposition to European and US financial services, caused a backlash led by Commonwealth members. The result: most of the targets have signed up on condition that substantive changes can only happen in lockstep with the “rich nations’ club” at the OECD. That is looking unlikely, since the Swiss have secured agreements with the EU excluding them from compulsory information exchange, the proposal at the heart of the HTP initiative. Nonetheless several legislative reforms have taken place in Caricom countries to curb the worst excesses of illegal money laundering. Improved governance in off-shore banking practices has therefore taken place and developing countries have met their developed counterparts halfway.

The other perennial item on the agenda was put there in 1997 in Mauritius: the acceleration of debt refinancing and forgiveness for a majority of Commonwealth countries. The communiqué that year made clear that the snail’s pace at which the Heavily Indebted Poor Countries (HIPC) programme was proceeding, was of great concern. These concerns are no less valid for 2004, especially as the introduction of HIPCII in 1999 has not vastly improved the situation, with measures of debt sustainability and, indeed, continued loan conditionality through the PRGF/PRSP remaining a core issue.

Since the signing of the Mauritius Mandate progress has been slow, and successive CFMMs have sustained the push for more action and more money. Securing change is a slow business and the terms under which debt is seen as sustainable need to be examined as the terms of the Enhanced HIPC still show bias towards lenders.

Finally, the Commonwealth’s position as a key international organisation for small states of fewer than 1.5m people to have a voice, has led to a concerted effort to examine and find solutions for the precarious social and economic situation some such countries confront. The late 1990s saw a joint Commonwealth Secretariat-World Bank task force

tackle the issue, and from 2000 onwards successive meetings have examined the outcomes and set in train work to implement possible ways forward. Much research has been conducted and advice has been given although the policy debate still centres around whether small states should be identified separately from other developing countries and treated as special cases in the WTO, World Bank and IMF, precisely as many of them soon face precarious graduation from IMF programmes. By definition, small states find representation at and lobbying of the IFIs harder than big states.

3 Agenda for 2004

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

1 Election of Chairperson

2 Adoption of agenda

3 Current world economic situation and prospects

*Review of IMF/World Bank Issues

*Commonwealth Secretariat report on monitoring donor support behind country-owned Poverty Reduction Strategy in Tanzania

*Chair's Report on HIPC Ministers' Forum

4 Small states issues

*Progress in Implementation of the recommendations of the Commonwealth Secretariat/World Bank Task Force report, "Small States: Meeting the Challenges in the Global Economy".

*Preparations for Mauritius international meeting on the review of the Barbados Programme of Action for the sustainable development of SIDS.

5

Report from Chair of Senior Finance Officials on their technical theme discussion (Strengthening the investment climate in Commonwealth developing countries)

*Presentation by IFC on Investment Climate

6 Commonwealth development cooperation issues (including CFTC pledging)

- Promoting investment into economies with "endowed" handicaps

- Progress report on Commonwealth Private Investment Initiative
- Progress report on Caribbean Investment Fund

7 Special theme: Capacity of International Financial Institutions to support trade liberalisation in low income and vulnerable countries

Presentation by: Professor Joseph Stiglitz
Civil Society
Commonwealth Business Council

8 Adoption of communiqué

**9 Venue of 2005 meeting
Any other business**

Closure of meeting

Press Conference shortly after close of meeting

4 Comments on numbered agenda items

3 Following the shocks of 9/11 and SARS in 2001 and 2002, global economic conditions have improved and recovery appears to be underway, though it is patchy and by no means evenly distributed. High oil prices remain a concern and they seem likely to remain high while unrest continues in Iraq. Industrial production has picked up sharply, accompanied by a strong rebound in global trade. Consumer confidence is strengthening, with positive investment growth in almost all regions. Annualised global GDP growth averaged nearly 6 percent for the latter half of 2003, the highest since late 1999. Growth has been determined by a surge in consumption in the United States due to the impact of tax cuts and mortgage refinancing, and the rebound from the slowdown related to Severe Acute Respiratory Syndrome (SARS) in Asia. Signs are that global GDP growth has remained solid into 2004. The industrialised Commonwealth countries fare well, with the UK buoyed by strong consumer spending from cheap money, though recent rate rises may yet dampen that.

Growth, for all its increases, remains uneven. Given the strength of growth in China, the upturn is most rapid in emerging Asia with growth in demand growth picking up substantially. Asia's exports are being supported by the rebound in the information technology sector as well as depreciating exchange rates. Exchange market developments have been dominated by record and sustained weakness of the US dollar, driven primarily by concerns over the sustainability of the US current account. Against that, the Euro zone continues to falter, with consumption still largely weak and low interest rates not yet stimulating recovery in demand.

As far as the developing world is concerned, some growth is evident across Africa, though the challenge remains in translating that growth into meaningful levels of poverty

reduction, and growth continues to be informed by concerns over widespread vulnerability to conflict: the continuing conflict in Côte d'Ivoire will continue to hamper growth and stability in west Africa, for example, and conflict in northern Uganda retards its otherwise impressive achievements. Security concerns, then, are inextricably linked with economic issues.

For all the positive signs of economic improvement on a broadly global basis, the need remains for developing countries to benefit from increased aid, more effective debt relief, reliable means of protecting them against exogenous shocks, investment and better access to developed markets. In many ways, the concerns of developing countries remain the same. Developing countries' debt burden still generates a net capital outflow to the developed world, and though HIPC provides some relief, it is not at a level that is able to reverse that trend. Commodity prices, with the notable exception of oil, remain depressed with the result that terms of trade of many poor countries, particularly those in sub-Saharan Africa, continue to deteriorate, underlining the need for improved HIPC relief for the poorest Commonwealth members.

While talks are now underway again within the WTO, there is still much work to be done to eliminate subsidy and improve market access, though recent WTO adjudications against the US and EU are encouraging signs.

But the key message remains stark: until coherent measures are put in place that address the ability of developing countries to reverse declines in terms of trade, growth, however welcome, will not be able to deliver the benefits in welfare that are expected of it.

Concerns remain over the World Bank's record on poverty alleviation, both with regard to its lending generally and particularly with regard to its involvement with extractive industries through the IFC. Some improvements have been noted in terms of requirements for increased levels of transparency, but for all that there is little or no evidence that energy projects, for example, have a positive effect on poverty, even if investment and export earnings are positive in terms of overall macro-economic performance. The publication of the Extractive Industries Review (EIR) highlights many concerns over the Bank's operations and record.

The World Bank's response to the EIR has been mixed at best and indifferent at worst. The World Bank seems unable to bridge the gap between critical self-appraisal and effective institutional change. It is encouraging however that the UK, as a major stakeholder, has called for the Bank to orient its efforts more closely to alleviating poverty, with less attention to be given to funding oil-based projects and more attention to be given to inclusive, sustainable development, a critical issue when one considers the livelihood and environmental impact that oil extraction has had in Nigeria.

Concerns over the IFIs' activities have led civil society to express concerns that the IFI's activity is gradually expanding to include input over micro-economic issues as well as macro ones: given the review process involved in the IMF's PRSPs, for example,

expansion into the assessment and control of micro issues is perhaps inevitable, though not necessarily welcome.

Widespread concerns over the potential for developing countries to lose control over micro policy and poverty alleviation policies appear in part at least to be justified. The structure of the PRSP implies that the IMF and the World Bank, through Joint Staff Assessments and approval of PRSP in Washington of locally formulated policies, undermine local ownership of MDGs. A potential consequence is that the management of the PRSP seems to undermine efforts, promoted by the UN, to ensure that developing countries have and maintain through the PRSP some degree of ownership over the MDGs.

That said, the resumed WTO discussions represent a useful step forward for negotiations on trade issues and recent arbitral decisions on the illegality of US cotton subsidies perhaps begin to signal the end of subsidy. That trade negotiations are underway again is encouraging but that is no cause for complacency as much work needs to be done to ensure that the loose commitment of developed countries to reduce export subsidies is translated into substantive action, all the more since the process has no timescale as yet.

4 Ever since the unique vulnerabilities of small states were highlighted in the mid to late 1990s, Commonwealth meetings have given space for discussion of these. And well they might as, alone among international organisations, small states comprise a majority (30) of Commonwealth members. As well as the Commonwealth, the main forums for driving the issues close to the heart of small states (which are defined as having a population of 1.5M or less) have been the joint Commonwealth/World Bank task force on Small States, which meets annually and the work of the UN General Assembly on SIDS (Small Island Developing States).

Although qualitatively the unique vulnerabilities of small states are by now well known: economic due to single commodities and remoteness; physical due to their disaster proneness, and environmental; a quantitative measurement tool as proposed in the form of vulnerability indices has not yet been widely accepted by international institutions as adequately summarising their vulnerabilities in an objective manner.

Last years CFMM communiqué concentrated on three areas of concern to small states: offshore financial centres, diversification of their economy, graduation from IMF list of Least Developed Countries and strengthening the capacity of the small states forum.

This year is likely to continue in a similar vein, although the fact that the Mauritius meeting to review the Barbados Programme of Action is to take place early next year will no doubt influence the discussions. The UN adopted the Barbados Programme of Action in 1994 to promote the sustainable development of SIDS. Ten years on the General Assembly is calling for a comprehensive review of the programme due to mixed progress. This will take place in Mauritius in January 2005 and will concentrate on a collaborative approach utilising novel means to strengthen implementation strategies.

The Secretary General of the UN produced a report in March this year on the progress of the Barbados Programme and concluded that the salient points for the discussion remain ecological vulnerability, financial and trade vulnerability and the economic impacts thereof. The problems are the same, and the search for new solutions continues.

5 The way in which investment is treated has changed radically over the last few years. The WTO's Trade Related Investment Measures (TRIMs) place many countries - developed, transitional and developing - in effective competition with each other to attract investment from multinationals. The demand for 'flexible' labour conditions, the availability of an educated workforce and tax breaks can all affect the ability of a country to attract investment. The Caribbean, Mauritius and other Commonwealth areas have had some success in attracting tourism. While Foreign Direct Investment (FDI) can provide benefits to developing countries, such can be outweighed by the adverse effect that investment can have on indigenous capacities, and the influx of foreign ownership through acquisition and the consequent repatriation of profit off-shore suggest that developing countries can pay a high price to host multi-national activity. The poorest countries receive the least investment.

While the benefits of investment are arguably less clear cut than ever, FDI can prove to be of benefit to developing countries; multinationals often have high standards of compliance with local laws, formal sector employment is encouraged and it can, though does not necessarily, stimulate the development of local capacities through the 'knock-on' effect. FDI often leads to fast pack manufacture, with little lasting value accruing to local economies beyond some degree of employment.

The inclination of a company to make an investment is conditional upon a number of other factors as well, including regional and local political stability and the world economic climate. Global investments are increasing again, following a global downturn in the wake of 9/11 and SARS.

6 Last year's CFMM addressed issues of Commonwealth Co-operation in Development, considering the CFTC, and the Millbrook Action Programme, to ensure resources for the CFTC. The Commonwealth Business Council was also commended and the CPTM (Commonwealth Partnership for Technology Management) reported to the meeting.

The CFTC is one of the main direct ways in which the Commonwealth promotes development; namely through the sharing of skills and knowledge. However the small size of the fund less than £15M direct project expenditure in 2002/2003 means its full potential cannot yet be reached.

The Commonwealth Secretary-General in a speech at the Royal College for Defence Studies, UK, in July this year noted several areas where the CFTC is utilised to good effect:

Natural resource exploitation
Debt Recording and Management System
Youth enterprise (setting up businesses)
Commonwealth Private Investment Initiative
Public sector reform
Youth Ambassadors for Positive Living
Training journalists

This years CFMM will concentrate on one of the issues mentioned:

- The Commonwealth Private Investment Initiative (CPII)

As well as two other issues:

- Promoting Investment into Economies with “Endowed” Handicaps
- Progress Report on Caribbean Investment Fund

The CPII was launched in 1996. Five regional venture capital funds have been established, the latest, the Commonwealth Fund for Africa, in March 2002. The aim of the funds is to spread private investment wider among poor countries. Most private investment in developing countries is concentrated in the ten richest countries. The fund is worth approx \$200M.

Initiatives of the Commonwealth Business Council such as the 16 point action programme, endorsed by the CHOGM in 2002 and since then begun in Tanzania and Mozambique is assisting in creating an environment where private investment in the poorest countries is being encouraged. There is an emerging trend of thought which argues that the poorest countries present a useful business opportunity, the investment in which will promote development.

Countries with “endowed” handicaps against private investment may not only include small states as described in vulnerability indices, but also those which though not small have similar economic vulnerabilities such as being landlocked, being resource poor or in the vicinity of war zones. Promoting investment in these areas is an even greater challenge which the CFMM must address.

The Caribbean Investment Fund was established among the 14 members of CARICOM in 1993. It falls under the IMF Multilateral Investment Funds group. Its formation has encouraged the investment of international capital and the promotion of international financial expertise in the Caribbean area. As a CARICOM member, St Kitts, the CFMM host country, will have a special interest in the Fund’s current projects and returns.

7 The effects of premature trade liberalisation, often pursued hand in hand with IFI-funded structural adjustment programmes, are well-documented. Rapid dismantling of import and export barriers has often led to deindustrialisation in developing countries, unemployment and damage to fragile labour markets. Cheap imports crowd out previously protected domestic capabilities and lead to a loss of government revenue.

The attitude to trade reform at the World Bank and the IMF remains very much the same, with the view predominating that the developing world cannot expect concessions from the developed world on agricultural subsidy without offering concessions in the form of liberal market access as a *quid pro quo*.

Trade liberalisation is an integral part of the IMF's Poverty Reduction and Growth Facility and, therefore, the PRSP and as yet there is little sign that there is any appetite within the IFIs to support changes in the way that trade policy and developing countries is approached and managed.

While the IFIs may well remain committed to neo-liberal economic views on trade, they can do much to promote the development of institutional capacity in developing markets to help ensure that developing countries are able to participate equally in WTO discussions. Thus, the IFIs could play a key role in promoting increased capacity in developing countries, but an intransigent, ideological view of the benefits of trade liberalisation is likely to hamper this and pressure will need to be maintained on them.

The challenge in trade liberalisation, as in reform generally, is to ensure that reforms are appropriately sequenced and closely allied to the needs and local idiosyncrasies of development strategy. These needs may well be for special treatment involving delayed deadlines for implementation of liberalisation reforms and the abandonment of a reciprocal stance in favour of a true development round.

The key question then is whether the IFIs are able and prepared to support more gradual, country-specific trade liberalisation and as ever this relies as much on the desire and ability of the IFIs to effect (institutional) changes in their policies. The World Bank, for example, needs to do more than showcase its developmental and pro-poor concerns.

5 Interaction with other bodies

It has become ever clearer that no one in the Development field can go it alone. Of necessity, and out of efficiency and effectiveness considerations, the Commonwealth works alongside the other major international actors.

In debt relief a relationship with creditors is vital and therefore the OECD countries and the Paris Club play a vital role. The developing Commonwealth countries must influence and interact with these, not least through their developed country members with which they can closely negotiate in Commonwealth forums.

On small states issues the Commonwealth continues to co-operate with the World Bank in the Small States Forum and with the UN General Assembly, which is pushing a similar agenda with regard to SIDS. Close co-operation will be necessary, especially as defining and quantifying vulnerability remain unresolved questions.

Interaction is actively pursued through the Commonwealth Cooperation in Development agenda which, as noted above, will be discussed at the meeting.

Increasingly a united front in pursuing development issues is sought, for example through the PRSPs, which most if not all actors in developing countries are obliged to abide by; and through public-private partnerships. Co-operation between civil society, the private sector and governments is increasing and the Commonwealth acts as an initiator and facilitator of such cooperative programmes. Interaction with all sectors increases and one hopes that, as civil society in developing countries increases its voice, the poorest will increasingly participate. A step forward has been taken by the modest participation of civil society in Commonwealth meetings. Many more steps are necessary until true participation of the poorest becomes a reality.

6 Other issues

Questions of standards and governance within the IFI, and developing countries alike, remain of concern for policy makers.

Security for both developed and developing countries - informed by the global threat of terrorism on the one hand and local/regional instabilities on the other - is a key issue for this year's conference, all the more since the prospect of the next 9/11 is a constant spectre haunting economic recovery.

The US's concerns over its own security has meant that aid from its 'coalition of the willing' has been diverted to aid the establishment of the new regime in Iraq and that is likely to remain a concern for developing Commonwealth states; concerns also exist that aid is targeted towards middle income countries rather than to the poorest ones.

2004/5 will be a good year for the Commonwealth to pursue many of the issues outlined herein with the **G8 summit**, Jubilee 2000 anniversary, Live Aid anniversary, G8 finance ministers meeting, African Commission, ASEAN, CARICOM meetings and so on.

Authors, Commonwealth Policy Studies Unit, acknowledgments

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The Commonwealth Policy Studies Unit (CPSU) founded in 1998, is working on aspects of globalisation and on a "Harare programme" for democratisation, civil society and human rights. Output is publicly available on its website: www.cpsu.org.uk

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