Round tables 2, 4 and 6

Ensuring Policy Coherence and an Enabling Environment at all Levels for Sustainable Development

Background note by the Secretariat

The first and second International Conferences on Financing for Development in Monterrey in 2002 and in Doha in 2008 recognized the importance of the enabling environment at all levels, as well as the importance of coherence and consistency of the international financial and monetary and trading systems in support of development. In the draft Addis Ababa Action Agenda, world leaders further recognize that “since Monterrey we have become increasingly aware of the need to take account of economic, social and environmental challenges, including the loss of biodiversity, natural disasters and climate change, and to enhance policy coherence across all three dimensions of sustainable development.”

As noted in the draft outcome document, the world has made significant progress since Monterrey. Global economic activity and financing flows have increased substantially, and many developing countries have implemented policy frameworks that have contributed to higher levels of economic growth and social progress. As a result, there has been a substantial reduction in the number of people living in extreme poverty, as well as notable progress towards the achievement of the Millennium Development Goals (MDGs).

Nonetheless, the Addis Ababa Conference is taking place at a challenging time. The world economy is still struggling to recover fully from the global financial and economic crisis that erupted in 2008. Financial regulatory reforms undertaken in the wake of that crisis have reduced susceptibility to renewed international financial crises, but it is unclear that they have done so sufficiently. The risk of spillover effects from policy decisions beyond national borders and from financial crises remains, and the sovereign debt crisis in Greece risks threatening regional and global financial stability. Many countries are witnessing rising income inequality. Food insecurity and extreme poverty persist, along with gender inequalities and the vulnerability of disadvantaged population groups. These developments are compounded by climate change and other environmental challenges.

Achieving the post-2015 development agenda, including the Sustainable Development Goals (SDGs), which are much more comprehensive in scope than the Millennium Development Goals (MDGs), will require comprehensive national sustainable development strategies, supported by strengthened inter-governmental, inter-ministerial and inter-institutional policy coherence, as well as an enabling and supportive international environment. World leaders meeting in Addis Ababa would be committing to pursue policy coherence and an enabling environment across all the three dimensions of sustainable development at all levels and by all actors. The draft Addis Ababa Action Agenda has specified a number of steps in this direction to be taken at the domestic and international levels.

The present set of roundtable discussions presents an opportunity to consider these issues in a multi-stakeholder format. Discussion in the three round tables may help guide implementation of agreed reforms and their monitoring, while offering opportunities to consider further reforms**.**

The domestic enabling environment and policy coherence

In the Monterrey Consensus, world leaders noted that policy actions at different levels need to be coherent to achieve sustainable economic growth, poverty eradication and sustainable development, including: (a) coordination of relevant ministries and institutions within respective national governments; and (b) policy and programme coordination of international institutions and coherence at the operational and international levels, especially in the areas of finance and international trade. Monterrey also identified the importance of an enabling domestic environment that encourages decision-making for long-term investment for growth, and an enabling international environment that offers dynamic trade and investment prospects without undue international economic volatility.

An enabling domestic environment

The usual connotation of an enabling environment is that independent economic actors should not be hindered by governance, including the operation of legal systems and corruption. A theme of Financing for Development has been the promotion of market forces where they can do the most good by supporting a policy environment that provides "transparent, stable and predictable investment climates with proper contract enforcement and respect for property rights, embedded in sound macroeconomic policies and institutions."

In the current Conference, world leaders would be reaffirming their commitments to strengthening the domestic enabling environment. But the draft Addis Ababa Action Agenda also recognizes that despite improvements in their investment climates, many Least Developed Countries (LDCs) have not attracted sufficient private investment that could help diversify their economies. It stresses that an enabling environment must be paired with an appropriate regulatory framework, development of local markets, and incentives to better align private investment with public goals. This is made especially germane by the shift in policy focus to sustainable development and the social, economic and environmental imperatives embodied in the SDGs. It is also germane to fostering the scientific and technological advances and their dissemination that the world requires. In particular, world leaders would note that the lack of long-term orientation of many investors means that they do not necessarily or sufficiently take into account longer-term economic, social and environmental risks, and their long-term financial implications.

In this context, world leaders would welcome the growing number of businesses that embrace a core business model that takes account of the environmental, social and governance impacts of their activities. But the draft Addis Ababa Action Agenda also emphasizes the need for public policies and regulations to incentivize the private sector to adopt sustainable practices, and foster long-term quality investment.

One key area highlighted in the draft Agenda is infrastructure. World leaders would commit to addressing impediments to greater private investment in infrastructure both on the demand side, by strengthening enabling environments and by preparing infrastructure plans and investable projects, and on the supply side, by removing potential biases against long-term lending in regulatory regimes and by incentivizing long-term investment by institutional investors. At the same time, they would call for intensified efforts by national and multilateral development banks. One aim of the draft Agenda is to identify and address infrastructure gaps, including through a new global infrastructure forum, to ensure that no one is left behind.

Policy coherence and the macroeconomic environment

The new agenda also emphasizes the developmental role that domestic macroeconomic policies can play. Article IV of the Articles of Agreement of the IMF that lays down the basic principles for macroeconomic policies states that "each member shall: (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances; (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions; (iii) avoid manipulating exchange rates."

There is a concern, however, that macroeconomic policies in developing countries often focus on stabilization at the cost of long-term development. According to an IMF-World Bank Development Committee interim report "evidence from countries that stabilized their economies by reducing their deficits indicates that countries often did so by cutting public capital formation significantly, despite its potential negative impact on growth and poverty reduction."[1] The draft Addis Ababa Action Agenda thus calls for sound macroeconomic policies to contribute to both global stability, as well as equitable growth, sustainable development and employment.

The draft Agenda underscores the importance of countercyclical fiscal policies, along with fiscal policy space for sustained growth and sustainable development. It calls for social floors in the context of the new social compact, which also act as automatic stabilizers. The draft Agenda further stresses the stabilizing role that public financial institutions, such as development banks, can play during financial crises, when private financial institutions reduce their lending. Fiscal policy space is constrained in particular when countries are highly indebted. It stresses the importance of sustainable debt levels, as well as fair and efficient ways to deal with debt distress.

The draft outcome document further stresses the importance of macro-prudential regulations. It emphasizes that financial inclusion should not be viewed as separate from financial regulations, and that ensuring access to credit and financial services needs to be viewed within the greater context of financial stability, while the impact of financial regulations on access needs to be better understood and taken into account. In addition, countries commit to strengthen domestic bond markets, with international assistance as necessary, but within the context of risk management. In particular, the draft Addis Ababa Action Agenda recognizes that foreign presence in the domestic credit, bond, equity and property markets of developing countries has increased substantially. While this has brought in new capital, new channels for the transmission of financial shocks from global boom-bust cycles have emerged. In this context, the draft Agenda recognizes the importance of effective risk management.

[1] Development Committee (2006), "Fiscal Policy for Growth and Development: An Interim Report." DC2006-0003, 6 April 2006.

Domestic policy and programme coherence

The enabling environment and policy coherence for sustainable development are tightly linked and intertwined. Policy coherence among relevant ministries is crucial for enhancing domestic enabling environments to boost productive investment, to accelerate structural transformation and to ensure an inclusive and sustainable development path. Coherence problems can arise due to competition among ministries for funding as they seek to implement their respective mandates, drawn from varying national priorities. The issue of coherence across ministries becomes even more relevant when incorporating the three dimensions of sustainable development. Over past three decades, the role of the ministry of planning has been diminished. However, the sustainable development agenda encompasses economic, social and environmental dimensions at all levels, which requires a very high degree of coordination for an integrated policy approach. In addition, it is important to ensure coherence between domestic policies and the international enabling environment.

Another set of the contending interests in ensuring an enabling environment and making coherent national economic policies and budgets is that of sub-national units of government. The draft Addis Ababa Action Agenda thus includes a focus on cities and local authorities, and on strengthening their capacities in policy implementation and resource mobilization. The allocation of responsibilities between central and local units of government often follow the principle of "subsidiarity", which means pushing responsibility for decisions down to the level of government closest to the affected people without sacrificing the efficiency and effectiveness of national policymaking.

<u>Questions for discussion</u>

1. What role can a coordinating ministry play in bringing policy and programme coherence at all levels for sustainable development, and how can such a coordinating ministry be strengthened? How should it interact with other ministries, such as finance? What are country experiences in this regard?
2. How can socially responsible business behaviour be ensured? How effective is environmental, social and governance impact (ESG) reporting? Are voluntary guidelines sufficient? How can global standards for preventing and addressing human rights linked to business activity, such as the United Nations Guiding Principles on Business and Human Rights (UNGPs), be adhered to? What are country experiences in this area and how can country experiences be shared in a more systematic manner?
3. What are the lessons learned from national experiences on how the policy demands of sub-national units should be made consistent with national priorities and overall fiscal impacts?
4. How could macroeconomic policies (fiscal, monetary and exchange rate) be made more supportive of development without jeopardising macroeconomic stability? What policies can lead to stability with growth? How can countries ensure fiscal space? What are the country experiences with revenue mobilization and expenditure reprioritization to create policy space for sustainable development? To what extent have development partners – donors and international organizations – been helpful in this regard?
5. To what degree and in what ways should countries monitor commitments to the social compact contained in the draft Addis Ababa Action Agenda and its proposal that

countries establish specific spending targets on investment in essential public services, consistent with national sustainable development strategies?

Forging international policy coherence for sustainable development

Policy coherence among major countries is vital, with implications for systemic risks as well as domestic policymaking and policy space. Policy coordination among major countries, especially those in the G-20, was the hallmark of initial response to the 2008-2009 global financial and economic crisis. However, there has been divergence in policy stances since 2010, characterized by fiscal consolidation and monetary expansion not matched in all major countries. Monetary expansion in some developed countries resulted in high capital inflows to some developing and emerging economies, which have faced exchange rate volatility and sudden capital outflows in the wake of policy uncertainties in developing countries.

Although flow imbalances have narrowed substantially since their peak in 2006, a recent IMF study shows that stock imbalances have continued to widen, leaving some debtor economies vulnerable.[2] As a result, a new pattern of current account deficits and surpluses has emerged. For example, the U.S. deficit as a percentage of global GDP has contracted by almost two-thirds, and some European economies that had large deficits have moved to small surplus positions. At the same time, among large surplus economies, China's surplus almost halved in relation to global GDP. But by 2013 a number of commodity exporters and major emerging market economies, some of which had current account surpluses in 2006, have become among the largest deficit economies in the world. The current account positions of oil exporters and northern European economies, which already had large current surpluses, have expanded. Large current account surpluses can also be problematic when they arise in a world of deficient aggregate demand, a phenomenon observed since the global financial crisis.

The importance of coherence and coordination of policies in major economies of the world has become increasingly important, given that developing economies have become more closely integrated into global financial markets since the Monterrey Conference. The problem is likely to be compounded by the absence of adequate multilateral mechanisms for an orderly and equitable resolution of external financial instability and crises, as well as debt workouts from sovereign debt distress. As recognized in the draft Addis Ababa Action Agenda, "regulatory gaps and misaligned incentives continue to pose risks to financial stability, including risks of spill-over effects of financial crises to developing countries". In this context, the draft Agenda recognizes that "when dealing with risks from large and volatile capital flows, necessary macroeconomic policy adjustment could be supported by macro-prudential and, as appropriate, capital flow management measures".

In parallel, the international economic environment should enable trade and investment that accords well with the goals of sustainable development. In this context, the cross-border legal frameworks and practices for trade and investment warrant consideration, which they receive in various venues, including the United Nations Conference on Trade and Development and the United Nations Commission on International Trade Law.

International trade policy is central to an enabling international environment and indeed the international community is committed to building a single liberalized global trading system

[2] Available at http://www.imf.org/external/pubs/ft/survey/so/2014/new093014b.htm

under the World Trade Organization (WTO). However, the repeated disappointments in bringing to closure the Doha Round of global trade negotiations that the WTO opened in 2001 may be contrasted with the expanding efforts of a number of major trading nations in reaching broad agreements with limited numbers of partners (e.g., Trans-Pacific Partnership) or on a limited area of trade (e.g., negotiations outside WTO on a Trade in Services Agreement). Building coherence between bilateral and regional trade and investment agreements and the multilateral system is also essential.

In addition to these challenges to the future of the WTO as *the* global trading regime, many countries have concerns about persisting lack of coherence between national agricultural and fisheries policies and international priorities. Thus, the draft Action Agenda calls on all WTO Members “to correct and prevent trade restrictions and distortions in world agricultural markets … [and] strengthen disciplines on subsidies in the fisheries sector …”.

There is a need to strengthen the global coordination of economic decision-making, in order to minimise the number of cases where rules dealing with trade, aid, debt, finance, migration, environmental sustainability and other development issues come into conflict. At present, there is no international agency dealing systematically with questions of coherence and consistency in multilateral rules-setting. Although in 1995, it was proposed that a reformed United Nations Economic and Social Council (ECOSOC) exercise this directive role, the proposal received only modest support at the time.

The draft Addis Ababa Action Agenda envisages a new Forum on Financing for Development under the Economic and Social Council that would bring together representatives of Governments, international institutions, civil society and business for up to five days per year. It would address policy issues in follow-up as well as monitor overall implementation of the Agenda in debates that are meant to reach inter-governmentally agreed conclusions and recommendations.

<u>Questions for discussion</u>

1. What should be policy stance of major economies in order to be consistent for sustained, inclusive and sustainable global economic recovery?
2. How can international coordination and coherence of macroeconomic policies be strengthened to enhance global financial and macroeconomic stability, and prevent financial crises, acknowledging that national policy decisions can have systemic and far-ranging effects well beyond national borders, including on developing countries?
3. Is the global system giving way to a more decentralized set of arrangements, reflecting frustration at the inability to come to closure in global negotiations, perhaps itself related to increasing confidence and capacities of nations and regions to strike out on their own? While the current initiatives are meant to be compatible with the global system, will this perforce become contingent on the perceived effectiveness of the global institutions?
4. How might the new structure as envisaged in the draft Addis Ababa Action Agenda operate most effectively, including selection of topics to be addressed in depth as well as in reviewing progress in implementing the Agenda? While some targets can be reduced to quantitative indicators, what can be done for others which are less susceptible to quantitative measures, such as efforts to forge coherent global policies for sustainable development and to raise the priority of delivering the means of implementation of the proposed SDGs?