Navigating the poly-crisis

2023 ODI Public Finance Conference, in collaboration with the World Bank

ODI (203 Blackfriars Road, London, SE1 8NJ) / online

Tuesday 26 September – Wednesday 27 September 2023

Contents

Navigating the poly-crisis

A series of major shocks have hit the global economy, putting public finances under pressure. Covid-19 and the war in Ukraine have led to rising inflation, interest rates and public debt. They have also placed significant demands on public spending. Since 2020, governments have increased health spending and expanded social safety nets – often to unprecedented levels. Now, slower growth and higher debt service costs are squeezing the fiscal space for spending on public services at a time when global poverty is rising and the pressures to address the climate crisis are becoming increasingly urgent.

Held in collaboration with the World Bank, ODI's 2023 Public Finance Conference will explore the trade-offs facing finance ministries as they navigate this 'poly-crisis', drawing on the latest research and international experiences. In doing so, we will help to shape a new 2050 agenda for public finances in low- and middle-income countries.

Agenda

Tuesday 26 September

08:30-09:15 – Registration

09:15-09:30 – Opening remarks

Rathin Roy – Managing Director, ODI

09:30-11:00 – Session 1: Finance ministries in the poly-crisis

Public finances are under pressure from a series of major shocks just as spending needs are rising. How will the institutions that govern public finance meet this challenge?

Moderator:

Rathin Roy – Managing Director, ODI

Speakers:

- Masyita Crystallin – Special Advisor to the Minister of Finance, Indonesia *(joining online)*
- Marc Robinson – International Consultant, PFM Results and author, *Bigger Government*
- Abebe Aemro Selassie – Director of the African Department, International Monetary Fund (IMF)

11:00-11:30 – Coffee break

11:30-13:00 – Session 2: Budgeting in the fiscal squeeze

When designing and delivering fiscal consolidation packages, what can finance ministries learn from contemporary and historical experience to retain control over public finances?

Moderator:

Tom Hart – Senior Research Fellow, ODI

Speakers:

- Kay Brown – Executive Secretary, Collaborative Africa Budget Reform Initiative
- Luc Eyraud – Division Chief, IMF
- Delphine Moretti – Lead, Organisation for Economic Co-operation and Development (OECD) Working Party on Public Financial Management, Public Governance Directorate

- Daniel Ndirangu – Country Lead and Head of Programmes, Institute of Public Finance, Kenya

13:00-14:00 – Lunch

14:00-15:30 – Session 3: Facing long-term challenges

How do finance ministries look beyond balancing the books in the short term? What types of analysis and institutions can help focus attention on longer-term challenges and fiscal risks?

Moderator:

Ipek Gençsü – Acting Director of Programme,
Climate and Sustainability, ODI

Speakers:

- Rosamund Edwards – Former Financial Secretary, Dominica
- Richard Hughes – Chair, UK Office of Budget Responsibility
- Arvind Mayaram – Former Finance Secretary, Ministry of Finance, India

15:30-16:00 – Coffee break

16:00-17:30 – Session 4: Keynote speech – The international economic order in an age of poly-crisis

Speaker: Adam Tooze – Kathryn and Shelby Cullom Davis Professor of History and Director of the European Institute, Columbia University

Adam is the Kathryn and Shelby Cullom Davis Professor of History at Columbia University and serves as Director of its European Institute. In 2019, Foreign Policy Magazine named him one of the top Global Thinkers of the decade. A prolific writer, his latest book is *Shutdown: How Covid Shook the World's Economy*.

17:30-19:30 – Drinks reception

Wednesday 27 September

08:30-09:30 – Registration

09:30-11:00 – Session 5: Growth strategies in the face of crisis

How should growth strategies change to respond to the debt and climate crises? What role can industrial policy play at a time when a ‘New Washington Consensus’ is overturning many policy orthodoxies?

Moderator:

Jodie Keane – Senior Research Fellow, ODI

Speaker:

Andrés Velasco – Dean of the School of Public Policy, London School of Economics and Political Science

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11:00-11:30 – Coffee break

11:30-13:00 – Session 6: Targeted and responsive fiscal policy

Can fiscal policy be more targeted in response to rising poverty and economic shocks? How could new digital capabilities and institutional arrangements help deliver this?

Moderator:

Laura Abramovsky – Research Associate, ODI

Speakers:

- Yamini Aiyar – President and Chief Executive, Centre for Policy Research (India)
- Fantahun Belew Asfaw – Disaster Risk Finance Workstream Lead, Oxford Policy Management, Ethiopia
- Mike Bracken – Partner, Public Digital
- Mezgebu Amha Terefe – Senior Fiscal Policy Advisor, Ministry of Finance, Ethiopia *(joining online)*

13:00-14:00 – Lunch

14:00-15:30 – Session 7: Reform of the international financial architecture?

How can international financing help ease fiscal pressures at a time when spending needs are rising?

Moderator:

Annalisa Prizzon – Principal Research Fellow, ODI

Speakers:

- Sara Jane Ahmed – Finance Advisor, V20 Group of Finance Ministers of the Climate Vulnerable Forum *(joining online)*
- Kalpana Kochhar – Director, Development Policy and Finance, Bill & Melinda Gates Foundation
- Moussé N. Sow – Senior Advisor to the Minister, Ministry of Finances and Budget, Senegal
- Jeromin Zettelmeyer – Director, Bruegel

15:30-16:00 – Coffee break

16:00-17:15 – Session 8: Shaping a new agenda on public finance

Do we need a new public finance agenda for the 21st century? And how will this be different from the consensus that followed the global financial crisis?

Moderator:

- Serdar Yilmaz – Practice Manager, Public Finance, World Bank

Speakers:

- Indermit Gill – Chief Economist, World Bank Group & Senior Vice President for Development Economics *(joining online)*
- Amélie de Montchalin – Ambassador and Permanent Representative of France to the OECD
- Marc Robinson – International Consultant, PFM Results and author, *Bigger Government*

17:15-17:30 – Closing remarks

Frederique Dahan – Director, Development and Public Finance, ODI

Session 1: Finance ministries in the poly-crisis

Public finances are under pressure from a series of major shocks just as spending needs are rising. How will the institutions that govern public finance meet this challenge?

The global economy is facing challenges at a scale not seen for at least a century. Spreading rapidly from its (still disputed) origins in China in 2019, the Covid-19 pandemic triggered the largest global economic recession in more than a century (World Bank, 2022), prompting an unprecedented fiscal policy response (Gentilini, 2022) and adding to already high levels of public debt in countries across all levels of income (Kose et al., 2021). War has broken out in Europe, creating an energy and 'cost of living' crisis that extends far beyond the region's borders, creating demands for more social assistance. With inflation rising to levels not seen in many countries since the 1980s, central banks have been pushed to raise interest rates; the US Federal Reserve has hiked rates at the fastest pace for forty years. At the same time, geopolitical tensions have been rising, fuelling economic competition between China, the United States and the European Union – most notably on the technologies and critical minerals needed for the green energy transition (IMF, 2023b; Kaya Partners, 2023).

The effect of these shocks is widespread, but the nature of the 'poly-crisis' still varies across regions and countries. In its Regional Economic Outlook for Africa, the IMF warned of a 'brutal funding squeeze' with slow growth compounded by rising costs of debt service and a long-term decline in international aid (IMF, 2023a; The Economist, 2022). Governments in Latin America are struggling with the economic slow-down and 'cost of living' crisis, while Europe faces significant pressures to expand taxes to maintain the services citizens demand (Robinson, 2020). Asia is the most dynamic regional economy, but countries such as China, Japan and South Korea have to contend with a rapid ageing of their populations.

One pressing challenge that affects all countries is the climate crisis. The conclusions of the Intergovernmental Panel on Climate Change's report in 2022 suggest that the world is highly unlikely to keep global warming to within 1.5ºC of pre-industrial levels. For those states and populations most at risk – which are often those that have contributed least to global carbon emissions – this is an existential challenge

(Moseman, 2021). The World Bank has estimated that low-income countries will also have to bear the biggest costs – as a proportion of GDP – to transition to a climate-resilient, low-carbon growth path (World Bank, 2023a).

But even in advanced economies, the impact of more extreme weather events is affecting communities. For example, France has declared a number of towns in its southern regions unfit for investment and future habitation (Spano et al., 2021). As a result, concerns with the climate crisis are rising up the domestic political agenda, while the question of who takes responsibility for lowering emissions and protecting vulnerable countries and populations is a source of deep discontent between the Global South and North.

The poly-crisis is placing intense pressure on finance ministries. Not only have they had to balance health, social and economic risks during the pandemic, but they must now find ways to fight inflation and keep government spending on a sustainable footing, while also helping to coordinate the central government response to the climate crisis in a way that can support economic growth in the long term. It raises many basic questions: how significant are these challenges from a historical perspective? Will this era lead to a significant change in the size and nature of the state? Will it change the institutions that govern public finances? And what does it feel like inside a finance ministry trying to prioritise the many demands that emerge with the ‘poly-crisis’?

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Session 2: Budgeting in the fiscal squeeze

When designing and delivering fiscal consolidation packages, what can finance ministries learn from contemporary and historical experience to retain control over public finances?

In the short term, finance ministries will need to find strategies to retain control over public finances – but how should they approach this period of fiscal austerity?

A look back in history has shown a change in pattern in the UK. Recent fiscal consolidation has been characterised by a 'boiling frog' approach where the fiscal squeeze takes place gradually over many years, which stands in contrast to the 'surgery without anaesthetics' approach taken in fiscal squeezes in the first third of the 20th century, when rapid consolidation was the aim (Hood & Himaz, 2017). But many attempts at fiscal consolidation are not successful (Balasundharam et al., 2023), and countries such as South Africa have faced more than a decade of fiscal squeeze without stabilising public debt (Sachs et al., 2023).

The evidence on how to do austerity well – reducing deficits and debt while promoting positive impacts on growth and inequality – is being updated rapidly (Balasundharam et al., 2023). The latest research argues that lower-income countries should rely more on revenue measures than cuts to already minimal levels of public spending (Ardanaz et al., 2021). This is in contrast to advanced economies where a powerful case has been made that austerity based on expenditure cuts has a much smaller negative effect on output than one based on tax increases (Alesina et al., 2020). Recent research also suggests that a fiscal squeeze is much more likely to reduce the debt-to-GDP ratio when there is a domestic or global economic boom (IMF, 2023b).

In practice, most fiscal consolidations will rely on some combination of tax rises and expenditure cuts. The IMF is forecasting that over two-thirds of emerging markets and low-income developing countries are planning on making expenditure cuts as a proportion of GDP over 2023-25.[1]

[1] Authors' calculations from the April 2023 World Economic Outlook database.

Managing a process of spending cuts creates its own challenges. Where spending is being cut, budgeting becomes redistributive – it requires the reallocation of existing allocations to fund new government priorities. And this will tend to mean it becomes a conflictual process as each line ministry seeks to protect its own budget.

This conflict in turn makes the effective reallocation of expenditure even more challenging. Ministries of Finance should aim to make targeted and selective cuts, rather than across-the-board measures. But line ministries lack the incentives to propose expenditure cuts that they will not benefit from (Raudla et al., 2015), and the Ministry of Finance may not have sufficient information to make effective proposals for cuts in line ministries' budgets.

This may mean that a Ministry of Finance is reduced to relying on 'cheese-slicing' or pro rata cuts, which typically require all ministries to cut back by a predetermined amount. This reduces decision-making costs and minimises conflict across different spending units, but cuts areas of effective and ineffective spending alike (Levine, 1979; Pollitt, 2010).

Effective management of spending cuts will thus need a joint approach between the Ministries of Finance and line ministries, allowing for dialogue and consensus building. Spending reviews that seek to find budget savings have grown in popularity in OECD countries and are typically joint exercises between Ministries of Finance and line agencies. Building trust and an effective working relationship may help to mitigate the conflicts stemming from competing spending needs across different agencies (Wheatley et al., 2018).

Beyond choices over revenue or expenditure measures, the fiscal squeeze poses questions of how these decisions are made and implemented, and how the institutions for managing public spending are arranged. Finance ministries in many countries shifted back to the basics of fiscal control following the 2009 global financial crisis. The number of countries with independent fiscal councils also expanded. The use of spending reviews to find savings or options for improving the quality of expenditure is a more recent trend. Will these kinds of reforms continue to spread across the globe? And to what extent will they really shape budget choices and the politics of cutback management?

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Session 3: Facing long-term challenges

How do finance ministries look beyond balancing the books in the short term? What types of analysis and institutions can help focus attention on longer-term challenges and fiscal risks?

Finance ministries are often criticised for being too short term in their outlook and too focused on cost in their choice over allocations – but what implications does that have for government action on the climate crisis?

The combination of an annual budget process and periodic electoral cycles can create incentives for governments to misallocate funds and delay reforms in critical sectors such as state-funded pensions or investments that pay off in the longer term – as the UK's Office of Budget Responsibility pointed out in its 2022 Fiscal Sustainability Report.

These pressures are particularly pronounced in times of fiscal consolidation, where the temptations for fiscal gimmickry, for cutting spending on public investments or local government services, and for focusing on the economy of spending as opposed to efficiency or performance are well documented in the literature on public finance.

Common institutional solutions to short-termism include the use of fiscal rules, the creation of independent fiscal councils, the separation of economic ministries or planning commissions and the requirements to publish information on long-term economic forecasts and fiscal risks.

But how much do these kinds of reforms really influence what a finance ministry does? And is there anything more to learn as governments across the world face up to the long-term impacts of the climate crisis?

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Session 4: Keynote speech – The international economic order in an age of poly-crisis

Adam Tooze is the Kathryn and Shelby Cullom Davis Professor of History at Columbia University and serves as Director of its European Institute. In 2019, Foreign Policy Magazine named him one of the top Global Thinkers of the decade. A prolific writer, his latest book is *Shutdown: How Covid Shook the World's Economy*.

His keynote speech will discuss the international economic order in an age of poly-crisis, including the implications of the poly-crisis for the Global South, how the changing economic strategies of the major powers are affecting their opportunities and constraints, and how prospects for reform are faring.

Session 5: Growth strategies in the face of crisis

How should growth strategies change to respond to the debt and climate crises? What role can industrial policy play at a time when a 'New Washington Consensus' is overturning many policy orthodoxies?

The only way governments can increase revenues without growth is by increasing the tax take from the private sector. If revenues are stagnant, spending choices become zero sum. Ministries of Finance thus have an immediate interest in growth. Fiscal policy choices affect growth: investments in areas such as research and development, education and infrastructure have long-term economic benefits. But Ministries of Finance also typically have a broader planning or economic policy function; they must lead or coordinate a growth agenda across government. They may therefore set the agenda for the broader business environment, the role of regulatory reforms, and what role more spatially or sectorally targeted policies may play.

Growth strategies must now adapt to the various crises that countries face. Growth paths must be consistent with government net zero pathways and resilient to the impact of the climate emergency. This creates several new challenges, not least the need to deal with the various cross-border effects of the climate crisis, ranging from the physical impacts to the policy responses taken to decarbonise the global economy elsewhere.

In the US and the EU, the revival of industrial policy to support a green transition and other policy goals has led to talk of a 'new Washington consensus'. This is mirrored by a revaluation of the economics of industrial policy under way in the academy (Juhász et al., 2023).

But these types of policies – which include measures such as the EU's carbon border adjustment measure (CBAM), new rules for mandatory supply chain due diligence, and product sustainability standards – may also induce a 'green squeeze' on low- and middle-income country access to existing value chains, unless their producers and exporters can adapt to these changing norms and standards. As well as climate finance, countries in the Global South need a trading system that supports the global green transition. This includes the creation of resilient supply chains that benefit countries with critical materials, enabling processing and supporting the transfer of technology (as called for in the Bridgetown Agenda 2.0).

Finance Ministers in developing countries with low emissions may feel that green growth is of little concern. However, they actually face a different question: not how to reduce emissions, but rather how to promote development by breaking into the fast-growing green industries that are needed to get the world economy to net zero (Hausman, 2022). A basic requirement is good macroeconomic management that keeps the cost of capital low for new investments in renewable energy. Countries with the mineral resources needed for the green transition – such as lithium, cobalt, copper, aluminium, nickel and rare earth elements – must effectively manage a mining boom.

The promise of climate finance from high-income countries also raises macroeconomic challenges (Velasco, 2023). Spending large in-flows of capital on non-traded goods – such as building green and climate-resilient infrastructure – could cause exchange rate appreciation, damaging export competitiveness. Measures to mitigate this risk, such as importing equipment and professionals from abroad, may be politically difficult.

In countries experiencing a debt crisis, growth strategies must adapt and address vulnerabilities. External debt-funded investments must lead to the productivity growth and structural transformation that can generate the export revenues needed to service debt.

Breaking into green industries will also require the development of a range of capabilities for economic management that go well beyond the usual functions of a Ministry of Finance. Governments with abundant renewable energy potential from solar or wind could attract energy-intensive industries. But many technologies are uncertain. How many governments are carrying out technological surveillance or have a chief scientist in their ministry to help plan research and development investments? Countries with credible institutions may be able to obtain carbon credits through reforestation or by protecting existing forests, but this often requires strong legal frameworks to support compliance mechanisms and the development of high-integrity carbon markets. Overall, Ministries of Finance may require a renewed focus on growth: one that grapples with both the new challenges and the important economic opportunities presented by a climate-changed world.

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Session 6: Targeted and responsive fiscal policy

Can fiscal policy be more targeted in response to rising poverty and economic shocks? How could new digital capabilities and institutional arrangements help deliver this?

In a world of increasing economic shocks, rising poverty and tight fiscal constraints, many governments are trying to make fiscal policy more responsive and targeted.

To be responsive at scale, these policies often need to leverage existing tax and spending programmes and delivery systems. To be responsive at speed, governments need capabilities to adapt existing programmes and delivery systems or create new ones in a matter of weeks (Bowen et al., 2020; World Bank Group, 2019). Better targeting to make the most of constrained resources and tackle cross-cutting issues related to inequality, climate and gender requires a *whole-of-government approach* in which the impacts of tax and spending are considered together rather than in isolation (Granger et al., 2022).

However, the delivery of existing tax and spending programmes is often constrained by insufficient funding, informal labour markets and inadequate state capabilities (Hanna, 2023). And as the pandemic has shown, these constraints are much more pronounced in lower-income countries. Meanwhile, siloed data and systems constrain the potential for taking a more holistic approach to policy formulation and delivery (OECD, 2016).

Nevertheless, this moment presents a potential opportunity to reimagine our public finance systems. As our economies and societies become increasingly digital, new data and models of governance are challenging the *status quo*. The key challenge is whether we can harness these new digital capabilities and put in place new institutional arrangements to bring policy and delivery closer together, while also mitigating the potential dangers of doing so.

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Session 7: Reform of the international financial system?

How can international financing help ease fiscal pressures at a time when spending needs are rising?

From meeting the challenges of the climate crisis and reversing the increase in poverty seen during the Covid-19 pandemic, to addressing the impacts of rising inflation and resuming progress on the Sustainable Development Goals (SDGs), spending needs are rising dramatically.

It has been calculated that emerging markets and developing economies (excluding China) require additional domestic revenues of 2.7% of GDP above 2019 levels by 2025 (or $653 billion) in areas including sustainable infrastructure, the acceleration of energy transitions, climate adaptation and resilience (Bhattacharya et al., 2022). An additional $652 billion will also need to come from increasing ODA by 50% over 2019 levels, tripling non-concessional multilateral development bank (MDB) lending, doubling bilateral non-concessional lending, and doubling private financial flows.

Yet these spending pressures come at a time when many low- and middle-income countries are facing a fiscal squeeze as they seek to combat inflation, reduce deficits and debt servicing costs, and face declining external financing flows. The latest IMF forecasts show that nearly two-thirds of emerging markets and low-income developing countries are undertaking fiscal consolidation and planning expenditure cuts over the next few years, which may lead to spending cuts on education, health and infrastructure, weakening growth potential. And lower-income countries face particularly tight constraints at the moment. The IMF classifies over half of such countries as being in or at high risk of debt distress. What role can the international financial system play in increasing resources for low-income and middle-income governments to meet their priorities and in helping to relax the tight fiscal constraints they currently operate under?

This gap between what is needed to respond to the poly-crisis and available resource levels has led to a multitude of ideas on how to increase international financing flows to low- and middle-income countries.

The G20 Independent Expert Group on Strengthening Multilateral Development Banks has called for radically reformed and strengthened MDBs that focus on contributing to global public goods (GPGs), eliminating extreme poverty and boosting shared prosperity. The group has also argued that MDBs should triple their lending levels by 2030 and establish a Global Challenges Funding Mechanism that could attract both sovereign and non-sovereign funding to address GPGs.

Furthermore, the report advocates for both balance sheet optimisation and a new general capital increase. Proposals have also been made to use some of the $650 billion Special Drawing Rights (SDRs) issuance of 2021 to expand the balance sheets of MDBs. This includes an African Development Bank proposal to use SDRs as hybrid capital and a plan for the World Bank to issue an SDR-denominated bond.

But while these measures can fund the expansion of non-concessional lending by MDBs, and so address some of the financing needs of the mainly upper-middle income client base of the International Bank for Reconstruction and Development and equivalents, it does not address the needs of low-income countries and half of lower-middle-income countries who can only borrow on a concessional basis from IDA. IDA commitments in 2023/24 and 2024/25 are forecast to decline by around $10 billion to around $26 billon due to a front-loading of lending to address Covid-19 and the fallout from the war in Ukraine. The World Bank is seeking $6 billion for a IDA Crisis Facility (World Bank, 2023b). Recycling SDRs has been used to expand IMF concessional lending, with $100 billion of SDRs from high-income countries and China being recycled through the Poverty Reduction and Growth Trust (the IMF's concessional lending instrument) and a new Resilience and Sustainability Trust set up by the IMF to fund climate change and pandemic preparedness.

There are also ongoing debates on climate finance, including on the future of current funds such as the Green Climate Fund, a proposed Loss and Damage Fund, and plans for new sources of financing such as a levy on carbon emissions from shipping.

This panel will take stock of these debates and ask:

- What are the priorities of the most vulnerable countries?
- Where do we stand on MDB reforms and how are borrowers likely to benefit?
- What are the prospects for expanding affordable and predictable financing to low- and lower-middle-income countries?

- What can realistically be done on debt restructuring and relief?

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Session 8: Shaping a new agenda on public finance

Do we need a new public finance agenda for the 21st century? And how will this be different from the consensus that followed the global financial crisis?

The role that the government should play in a crisis has been expanded by the global response to Covid-19, as has the use of transfers to firms and households. Public debt has grown almost everywhere, while rising interest rates may mark an end to the era of low borrowing costs. War in Ukraine and tensions between China and Western governments and allies has pushed up military spending, fuelled a new era of industrial policy and increased the cost of energy, food and even high-end technology such as microchips. Over and above this, growing concerns over the climate crisis have become central to international relations and the future of economic management, while artificial intelligence tools raise similar questions about global governance structures.

As important actors in the economy, Ministries of Finance are being asked to support a coherent response to this ‘poly-crisis’ – and may be required to do so for much of the 2020s (World Bank, 2022). Yet disciplines central to the work of Ministries of Finance, such as economics and public finance, were already under scrutiny prior to the pandemic. In this context, it is important to look again at the issues and ideas that will guide governments to build an international agenda for public finance that reflects how the world has changed. Given the climate emergency, the debt crisis and the likelihood of missing the global targets set through the SDGs, this needs to happen quickly; organisations like the World Bank must play a crucial role in supporting action on a national and global level.

ODI’s 2023 Public Finance Conference represents a first step towards shaping a new 2050 agenda for public finances.

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