

Global Agenda Council on New Growth Models

New Growth Models: Challenges and steps to achieving patterns of more equitable, inclusive and sustainable growth

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Contents

- 4 Introduction
- 5 Measurement
- 7 Fiscal, trade and financial policy
- 8 The sustainability and inclusivity agenda
- 10 Entrepreneurial ecosystem
- 11 Institutional learning and innovation
- 12 Members of the Global Agenda Council on New Growth Models

Introduction

The global economy is becoming bigger very quickly mainly as a result of developing country growth and increasing scale in the global economy. The roughly 85% of the world's population that lives in developing countries are in a multi-decade process of moving to high-income status. In the course of this convergence process, new challenges have emerged that call for better measurement, new analysis of growth patterns, the adaptation of existing growth models and creative responses by corporations, labour, governments at all levels, and more effective international policy coordination.

The pressing challenges seem to us to include the following areas.

Self-limiting growth patterns based on leverage and current account imbalances have emerged in a broad set of advanced economies. These defective growth patterns need to be better understood and corrected before they experience catastrophic collapses threatening prosperity everywhere. One insight is that in the global economy populated by largely open national economies, the menu of unbalanced, unstable and unsustainable growth patterns has increased. We want to avoid choosing from this menu, but at this point we are not advanced in determining the structural elements of balanced growth patterns on the supply and demand side.

By almost any measure, in a wide range of countries, domestic income inequality is rising even as the gap between average incomes in advanced and developing countries declines. The upper end of the income distribution is developing a fatter and fatter tail, while the median income remains stuck in low-growth mode. Post crisis, the lower tail of the income distribution is also fattening as poverty increases. This pattern has emerged in the past 30 years. It undermines social cohesion, political stability and causes declining support for an open global economic and financial system.

Compounding the distributional challenge is persistently high unemployment in the post-crisis period. Growth is nowhere near high enough to bring down these numbers fast enough. And in advanced countries, growth in the tradable sector of the economy has contributed relatively little to net employment growth in the past two decades. Apart from lost income and a disproportionate share of the burden of rebalancing economies falling on the unemployed, including the young, there is an important non-financial element of work: the dignity that goes with being a contributing member of society.

In a number of countries, environmental degradation is significantly diminishing the health of citizens and the quality of life even as incomes rise. Water supplies and security are in question. Ecosystems' biodiversity are under pressure. What has come to be called the natural capital base of

individual economies and, in some dimensions, the global economy, is being eroded. The existing growth patterns, most believe, will not work as the global economy triples in size. The destruction of natural capital will ultimately short-circuit growth and expanding prosperity. Running down natural capital has adverse intergenerational implications. We believe that is a basis for action.

In the face of such a daunting array of challenges, without commonly accepted processes for dealing with them, it would be easy to become paralysed and proceed with the old measurement systems and growth models.

Fortunately, that is not what is happening. Instead among citizens, corporations, governments and policies, educational institutions, civil society organizations and international institutions, there is a groundswell of diagnosis, initiative and action. The search for new growth models is well underway in multiple dimensions. In many ways, it is a blizzard of bewildering complexity, but it is a start.

The "new" growth models will take time to develop. They will require shifts and innovations in policies, changes in values, and new coalitions to accomplish complex transitions that require coordination. These new growth models will contain essential ingredients of the "old" models: an open global economy, specialization as a function of stage of development, innovation and competition, and high levels of investment. But there will be new elements. Natural resources will have prices that rise with scarcity and rising demand. Negative externalities will be priced or constrained by efficient regulatory policies. Intertemporal choices and balance sheets will occupy a more central position. It may be slight exaggeration, but the mindset will likely become similar over time to the endowment model of managing assets where the core principal is that income from the endowment should not decrease its real value over time. In other terms, it is an investment model with a long time horizon and a zero or very low discount rate.

Our purpose as a Council is modest in relation to these large challenges. It is to suggest agendas for analysis, measurement and action in the short to medium term that will accelerate the adaptation of our growth models to become more inclusive and sustainable. Our focus is on five areas: (1) measurement of economic performance; (2) fiscal and financial rebalancing and trade and capital flows; (3) addressing the distributional and sustainability challenges, interactions and trade-offs; (4) institutional innovation; and (5) promoting entrepreneurial ecosystems and activity.

Our belief is that various aspects on inclusiveness and sustainability need to move closer to the centre of the policy-making agenda along with growth and employment.

Measurement

Measurement is a key to making that happen, and hence we begin with measurement.

For decades, the main measure used to report a country's progress has been narrowly focused on levels and growth rates in gross domestic product (GDP), and GDP per capita. The latter is a measure of market production and income generated per person in an economy. We say market production because there are services that are produced but not mediated by market transactions. These elements of value creation are not captured in GDP accounting.

A single measure of progress may be satisfactory provided other important dimensions of well-being are all highly correlated with each other and with average income. Evidence suggests that this correlation is declining and hence, recently, a debate has started on how to move beyond GDP to measure true wealth and well-being. Governments, international organizations, the private sector and academia have come up with a wide range of innovations in measurement of desirable growth paths addressing the limitations of GDP. These innovations may be grouped in three categories:

Inclusiveness of growth

Recent experience demonstrates that a growing country can experience rising inequality and accompanying economic and political instability. This has led to the development of new concepts for pro-poor growth and an increased focus on income distribution. Consistent with this principle, the World Bank Group's goal of promoting "shared prosperity" uses income growth of the bottom 40% of the population in every country as an indicator.

An important policy question is whether the focus should be on reducing inequality of outcomes versus inequality of opportunity. Opinions differ on this point. Our view is that both are important to people and deserve attention in measurement systems. The Human Opportunities Index (HOI), developed by a group of economists from the World Bank, Argentina and Brazil, measures the inequality of opportunity in basic services for children.

Sustainability of growth

Income growth should not be sustained at the expense of future generations by depleting its wealth in terms of physical, human and natural capital. There are several important initiatives to assess performance in terms of sustainability.

The World Bank has developed the adjusted net savings or genuine savings indicator based on standard national accounts measure of gross national savings to monitor the changing wealth of nations. Natural capital accounting (NCA) is a measure to integrate the value of natural

resources in the system of national accounts. The *Ecological Footprint* compares consumption levels to the planet's carrying capacity. Composite indices aggregating a number of economic, social and environmental indicators, such as the Environmental Performance Index (EPI), by the Yale University, and the Sustainability Index, by FEEM, have been reported. UNEP is currently working on an Inclusive Green Economy Index (IGEI). The OECD is reporting the *OECD Green Growth Statistics*, a dashboard of indicators that allows focusing on country-specific issues.

Multiple dimensions of human well-being

Human well-being depends on many other aspects, such as health, education, employment, political freedom, social relationships, and environmental quality and security. The UN's human development index (HDI) is a composite measure that combines indicators of life expectancy, educational attainment and income. The OECD's Better Life Initiative supports a better understanding of what drives the well-being of people and nations, and what needs to be done to achieve greater progress on this for all.

The goal is to develop a set of measures and a dashboard that allow all concerned parties, from policy-makers to citizens, to quickly and consistently assess progress or its absence in important areas of prosperity and quality of life for a full range of income levels within an economy.

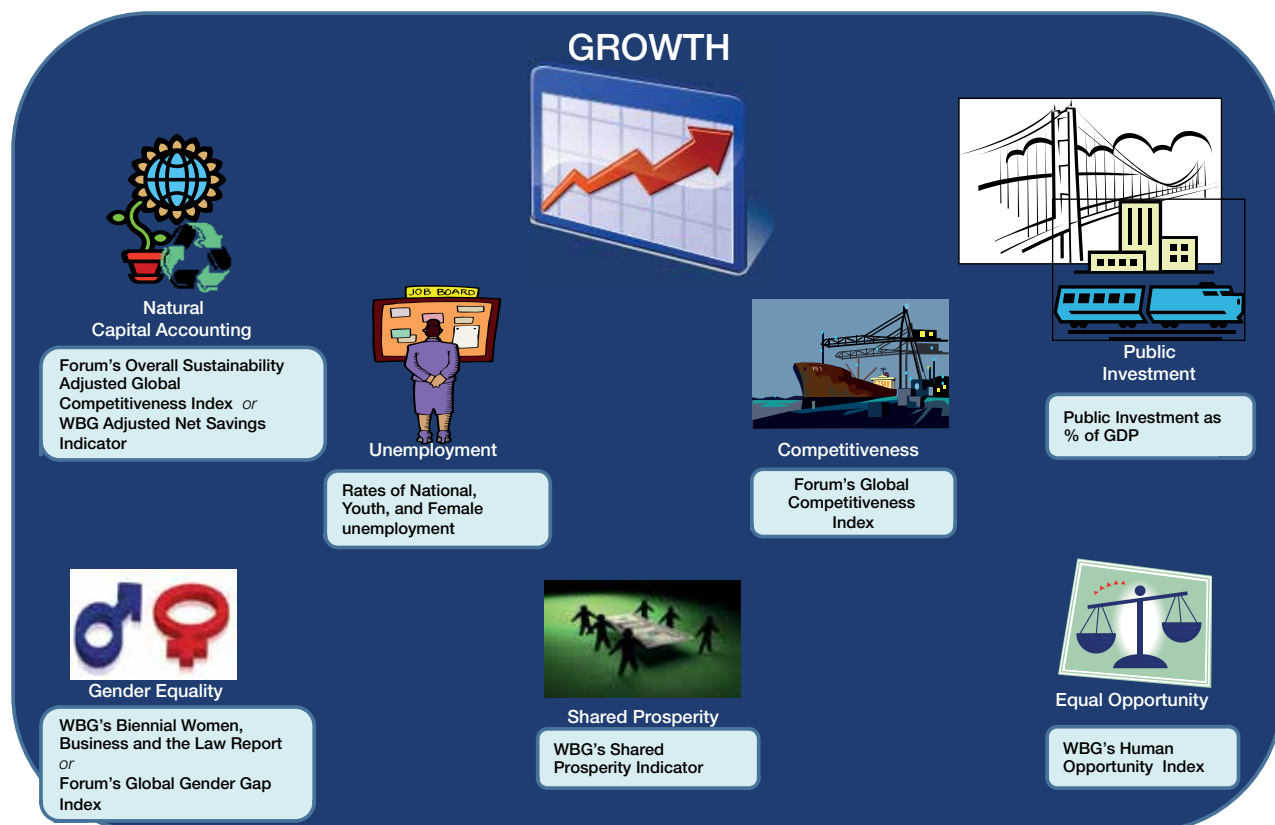
Improving national statistics and their use

The key to progress at this stage is data and implementation. Appropriate data must underpin any growth measures to provide credibility in assessing progress and measuring results and policy impact. There is an urgent need for countries to improve their data and statistics so they can track progress and make sure their decisions are evidence-based.

While significant progress has been made in developing and getting buy-in on new approaches to measuring progress, financing, capacity building and implementation of the new approaches remain significant impediments. New partnerships and cooperation among development agencies, governments and academic organizations are also essential to facilitate and expedite implementation.

Business reporting

In parallel, business and financial markets have made substantial recent progress in reporting on environment, social and governance issues (ESG). Leading business and financial/investor groups should promote the expansion of this kind of reporting with a goal of achieving full coverage.



Dashboard for inclusive, sustainable, and multi-dimensional growth (draft for discussion)

Dashboard glossary

Adjusted net savings indicator: The World Bank Group's adjusted net savings or genuine savings indicator is based on standard national accounts measure of gross national savings. Adjustments are made for changes in the countries' physical, human and natural capital. The idea behind this indicator is simple: negative adjusted net savings indicate that a country has disinvested by depleting wealth.

Global Gender Gap Index: The Global Gender Gap Index, introduced by the World Economic Forum in 2006, is a framework for capturing the magnitude and scope of gender-based disparities and tracking their progress. The Index benchmarks national gender gaps on economic, political, education and health criteria, and provides country rankings that allow for effective comparisons across regions and income groups and over time in 136 countries. The rankings are designed to create greater awareness among a global audience of the challenges posed by gender gaps and the opportunities created by reducing them.

Global Competitiveness Index: The annual World Economic Forum report presents the rankings of the Global Competitiveness Index (GCI), which is based on 12 pillars of competitiveness, providing a comprehensive picture of the competitiveness landscape in countries around the world at different stages of economic development. The report contains detailed profiles highlighting competitive strengths and weaknesses for each of the economies featured, as well as an extensive section of data tables displaying relative rankings for more than 100 variables for 148 economies.

Human Opportunity Index (HOI): This index developed by the World Bank Group along with economists from Argentina and Brazil measures the inequality of opportunity in basic services for children. HOI summarizes two elements in a composite indicator: (i) how many opportunities are available, that is, the coverage rate of a basic service; and (ii) how equitably those opportunities are distributed, that is, whether the distribution of that coverage is related to exogenous circumstances.

Shared Prosperity Indicator: This indicator, introduced by the World Bank Group, uses income growth of the bottom 40% of the population in every country. It measures the convergence of the income per capita for the bottom 40% with the average income per capita of the society.

Women, Business and the Law Report: This biennial World Bank Group report examines laws and regulations affecting women's prospects as entrepreneurs and employees in 143 countries. The report's quantitative indicators are intended to inform policy discussions on how to remove legal restrictions on women and promote research on how to improve women's economic inclusion.

Fiscal, trade and financial policy

Post-war history has shown that trade and investment, when conducted under an open, transparent, rules-based and properly regulated framework, are powerful engines of growth and job creation. Expanding this system must be part of any sustainable, inclusive solution. While free flows of goods, services and capital drive global growth, our thinking about fiscal, trade and finance policy needs to evolve to provide a better foundation for future prosperity. Specifically, new growth models should address the following:

Fiscal policy: back to a balanced approach

Fiscal policy should be counter-cyclical. In the present conditions, governments must try to demonstrate a strong credible commitment to reducing deficits by establishing a series of credible medium- and longer-term fiscal targets, but the speed of progress toward the goal of consolidation should be gradual enough to allow the private sector to restore balance sheets and adjust structurally and competitively. The short-term goal is not to balance the budget immediately, but to create stability and pave the way for long-term growth. When financial markets lose confidence in the policies of a nation, that country may have no choice but to embrace tough measures to regain access to international capital markets, but when that is not the case, a measured pace of fiscal consolidation may be more appropriate. A gradualist approach to deficit reduction does not mean a lack of commitment – it is about altering the speed of progress toward a specified fiscal target, not about changing the desired destination or sense of purpose.

To the extent possible, fiscal consolidation should not be allowed to crowd out growth promoting public sector investment in hard and soft infrastructure. It is important to remind ourselves that growth is an important tool in fiscal stabilization. Too often the discussion focuses exclusively on cutting costs or increasing revenues. It is the ratios not the levels that matter.

Trade: promoting recovery in the presence of fiscal constraints

The current constraints on fiscal policy in advanced nations point to the need for fiscal-free stimulus. International trade could provide a boost to the global economy that does not require new fiscal commitments, but only if trade is nurtured and supported in the way that the multilateral system operating under the World Trade Organization (WTO) was designed to do. While preferential agreements (bilateral and regional) define the current climate, they should operate in tandem with a multilateral framework so that all countries can integrate trading activities over time and help drive global growth, taking full advantage of economies of scale and scope without facing unnecessary barriers. The WTO's recent completion of a trade facilitation agreement under the Doha round after a long impasse is a big step forward.

Domestically, because of the overall gains that trade represents, policy-makers must find a way to embrace pro-trade language and policies while acknowledging and mitigating the uneven distribution of jobs and income that may result in part from further liberalizations. Trade protection as a means of dealing with employment and

distributional challenges has partially hidden costs that rise with time. That said, social and distributional policies and trade policies are important complementary parts of inclusive growth strategies.

Finance: more investment, less leverage

The need for a multilateral approach applies equally to the areas of global trade and investment. The role of finance is to provide a way of facilitating the transformation of savings into the real capital formation needed to promote growth within advanced and developing countries and between nations. As the elements that make global trade in goods and services flow smoothly, freely and fairly are the same ones needed for a more efficient flow of capital across borders, a WTO-like framework could provide a good model for an international agreement on investment that enables more rapid capital formation with less volatility and incidence of financial distress. Such an agreement could facilitate FDI and ensure a better match between financing supply and demand, especially when it comes to critical infrastructure investments. It should also help to reduce volatility and financial distress, in part by increasing protection for equity investments and thereby reducing the current, damaging bias toward debt, especially in developing countries.

This is a complex area. Thinking about the regulatory structures for international capital flows will need to take stability issues into account. Recent experience with spillover effects of unusual monetary policies clearly illustrates the need for a flexible system in which countries can take defensive action on the capital account when needed to counter the side-effects of these policies. Designing international financial frameworks for a world that is periodically seriously out of balance is a complex undertaking, one that has just begun.

The sustainability and inclusivity agenda

Inclusive, sustainable prosperity is the purpose of economic growth

Today, that purpose is not being fully realized, creating social, political and economic tensions that must be addressed systemically rather than only symptomatically.

Inclusivity

Inclusivity refers to the distribution of outcomes for and between citizens, which would include income but also access to public goods, such as health and education and security, and citizens' freedom to avail themselves of opportunities and not be subject to arbitrary or legally enforced discrimination.

Recent decades have produced extraordinary social and economic progress but created systemic stresses that have to be addressed. Hundreds of millions of people have escaped poverty through high growth in developing countries. Globalization has played an important enabling role. Economic growth will continue to be catalysed by technological innovation combined with the emergence of new business models supported by dynamic financial markets. And catch-up growth in developing countries via knowledge and technology transfer will continue to support rapid productivity gains and high growth.

At the same time, inequality within nations is rising rapidly almost everywhere. Median incomes are falling behind average incomes or per capita GDP. The latter is the datum we use when measuring growth. If you looked at the growth in median income in the US over the past three decades, you would get a very different picture. The unemployed, especially the young, are bearing a disproportionate share of the burden of rebalancing economies and restoring growth in the post-crisis period. Put simply, the outcomes are not fair.

Our view is that these trends are largely the result of market outcomes in combination with powerful forces associated with technologies that reduce routine jobs and with the movement of jobs around an increasingly integrated global economy. Safe havens for middle-income workers are under siege. To be fair, there may also be a component associated with successful rent-seeking behaviour – that is subgroups capturing a disproportionate share through power to influence the rules of the game.

Most countries attempt to address these problems with various combinations of instruments, including the social provision of basic services (education and skills training, healthcare, and especially early childhood development), a minimum wage, progressive taxation of income, property taxes whose importance stems in part from mitigating adverse incentives associated with high marginal income tax rates. In some countries, broadly shared restraint

on income and wage growth when needed to restore competitiveness, growth and employment engines seems to have been important. There are also measures that partially protect tradable industries from external competition, or that alter the terms of trade in the case of the exchange rate and the management of the capital account. Of course, international agreements put some limits on the latter two to preserve a relatively open global economy whose aggregate benefits are large even as the distribution of benefits and costs remains a challenge. And all of these measures have implications for efficiency and adaptability of economies.

We have lots of instruments. The design problem is to use sensible combinations of them that significantly promote equity and equality of opportunity while interfering as little as possible with the flexibility and dynamism of the economy. One important lesson that has been learned and needs to be broadly implemented is that in the face of turbulence of structural change, it is far better to protect people and families directly rather than trying to protect them by protecting jobs, companies and sectors.

This is an important agenda, with no easy answers. Persistence in eliminating deficiencies and experimentation to see what works will pay off over time, and learning across boundaries from the experience of different countries will be valuable. Social and political tensions are rising and may increase in scope and disruptive potential if these issues do not move to the centre of the political agenda.

Sustainability

Sustainable development refers most simply to living within the environmental-carrying capacity of the planet, for today's and future generations, and more broadly to living in an inclusive manner.

In a sense, sustainability is a distributional/inclusivity issue with an important intertemporal intergenerational element. For many of us, one of the most distressing trends is the rising number of our fellow citizens in many countries (especially advanced ones) who believe that the employment opportunities and quality of life for their children and their children will fall below what their parents enjoyed. Depleting natural capital is certainly not now the driver of these pessimistic concerns, but it could move to centre stage if we remain on the present course.

Rising prosperity means growing consumption of food, energy and water and continued polluting behaviour, including climate-impacting carbon emissions. It is creating economic and broader stresses, some of which may be hard or impossible to reverse or overcome if we stay on the present course.

Left unresolved, these stresses will increasingly undermine growth itself, and ultimately the possibility of achieving its underlying purpose. Such trends are, in turn, likely to be reinforced by negative impacts on the stability and vitality of the national and international political economy on which progressive progress depends.

There are several keys to dealing with these issues.

In both cases, the primacy of growth as an objective in the economic agenda needs to be challenged. Growth should not come first, and then we do the best we can with inclusiveness and sustainability. This is a mindset change, which will be supported by better and more comprehensive measures of economic and social performance, including especially those that relate to natural capital.

In the case of sustainability, substantial progress is being made with a combination of bottom-up and top-down activity. Many corporations have become leaders in developing sustainable business models and technologies. Many have also embraced the notion of creating shared value. Thousands of NGOs and smaller enterprises are generating innovative solutions to excess resource use and pressure, and educating people about sustainability. Over time, these efforts will have a high pay-off and will be even more effective if supported by well-constructed policy frameworks: ones that price carbon and negative externalities and create additional incentives for innovation. Sustainability is making its way toward the centre of the policy agenda (domestically and internationally), but the process is slow and there is a long way to go. We are in a sense climbing a mountain and have only just started. Endurance, persistence and determination, and a multipronged approach, are the keys to success.

Unrestrained population growth globally has the potential to defeat these efforts to bring growth pattern into line with the planet's resources. No one has a comprehensive solution to this as choices about family size fall within the territory of freedom on individual choice. But there is hope. Rising prosperity brings down family size. Social norms can play a role. Additionally by careful design, it may be possible to construct the cost-sharing features of social service and security systems in such a way as to create incentives for families to make rational choices about family size.

Entrepreneurial ecosystems

Entrepreneurial ecosystems

In most countries we see today an unprecedented economic growth challenge, which if not met will yield massive unemployment and the inevitable negative social consequences. Given economic constraints, this challenge cannot be met by government action or policy alone. In fact, more than ever, the response will need to come through private investment and entrepreneurship. Different economies are at various stages of economic development, and while each country is unique in its socio-economic make-up, a common theme underlying them is an increasing demand for inclusive growth. Evidence suggests that entrepreneurship can play a key role in providing that inclusive growth.

Engaging the private sector

While supportive government policies are clearly relevant to catalyse such investment and risk-taking, it is the action of the private sector that is needed to drive growth. Sustained growth is driven by investment, entrepreneurial initiative, and innovation. Policy initiatives are important in providing the supporting framework. However, it is ultimately the extent to which the private sector is catalysed and engaged that determines whether growth trajectories are efficient and sustainable. Only through private sector engagement can we ensure the orderly and efficient allocation of resources over the long term necessary for a successful entrepreneurial environment.

The entrepreneurial enabling environment

Entrepreneurship is effectively the willingness and capacity of individuals to take risk in the creation of a business opportunity. This requires an ecosystem that encourages entrepreneurship and innovation through “institutional technology” whereby the institutions, policies, business culture and rule of law provide market dynamics that create a level playing field and hence foster competition and innovation. This ranges from basic infrastructure to a robust regulatory and legal framework, which establishes efficient market entry and exit and protects intellectual property rights, to building a culture that celebrates its entrepreneurs and success stories and tolerates failure, to having sufficient providers of capital in the system. Aside from the regulatory “infrastructure”, fostering a culture that is inclusively conducive and positive to entrepreneurship is key.

Developing capacity and effective innovation

Any successful intervention has to prioritize building capacity within the people, private enterprises and institutions, and public policy framework to generate private sector-led growth. From the individual entrepreneur’s point of view, what is needed is a supportive ecosystem with access to quality education that establishes entrepreneurial principles early and a meritocratic system that rewards innovation. And economies have to create the type of jobs across the spectrum of education and skill levels in sustainable, growth-oriented industries. This, in turn, generates a virtuous cycle on socio-economic development and growth.

The Council believes that the importance of fostering entrepreneurial ecosystems and cultures in pursuit of shared prosperity is not fully reflected in policy agendas, the allocation of public resources and, in many cases, in educational curricula and programmes. Our proposal then is simple. Elevate the status of entrepreneurial dynamism and capacity in the policy agenda and engage the business, financial, legal and educational communities as partners in building vigorous entrepreneurial ecosystems. Learning across borders and from case studies will be a valuable input.

We have also noted that the rapid expansion of online distribution and retail systems in advanced and emerging economies creates expanded opportunities for start-ups in a variety of sectors to access larger potential markets at lower cost than previously. The returns to investing in supportive conditions for entrepreneurial activity may, therefore, be rising, in terms of productivity growth and expanding employment opportunities, pretty much everywhere.

Institutional learning and innovation

A growing body of evidence makes a compelling case that the success and failure of nations has much to do with the quality of their institutions, i.e., those human-created structures and mechanisms of social order, which not only govern the behaviour of individuals but also shape their values and norms. In fact, good institutions are essential building blocks of prosperous and sustainable societies. Markets plus the rule of law, respect for human rights, including property rights, freedom of speech and the media, equal access to justice and to basic education, transparent and responsive governments not only help to drive development goals but have intrinsic values of their own. Any sensible long-term growth models and strategies cannot neglect the role of institutions. It is particularly true in light of the twin pressures of population growth and resource constraints. Being norm-shaping, institutions are pertinent in addressing fundamental questions about growth. Shouldn't growth be people-centric and nature-friendly? Put differently, shouldn't growth be inclusive and sustainable? Different institutional settings would have different answers, and consequently different policy prescriptions.

Institutions and institutional learning and innovation happen at many different levels: the corporate, the state, and the international, to name a few. While the current international system is state-centric, common threats such as global warming have shown the glaring inadequacy of existing institutions, thus highlighting the need for institutional innovation at the global level. At the state level, the rule of law with an independent judiciary is a different institutional design from the practice of rule by law where some privileged individuals stand above the law. Such differences have different implications for human and property rights, which would encourage or impede long-term growth. At the corporate level, different corporate governance could affect firms' performance. For instance, "soft budget constraints", according to Janos Kornai, explains why managers of the former Soviet system failed to improve efficiency, which ultimately led to an economy of shortages.

A key aspect of learning what we call "institutional technology" is to draw the right balance between hierarchy and markets with the correct alignment of incentives: When do markets provide the right incentives, and when do they fail? When are private rewards aligned with social returns? How can government help align the two but not become over-reaching by turning a helping hand into a grabbing hand? Related, market-oriented reforms are not only about goods and services but also about factors of production, i.e., land, labour and capital. In China, for instance, while it has set up markets for the former, it has yet to improve the latter and work hard against various administrative monopolies to avoid "middle-income trap".

Our conceptualization of new growth models, with an eye on institution learning and innovation, reflects a long-term vision and is also consistent with the principles of economics. People may be rational, but we believe that their rationality is also a function of institutional environment. As such, market principles aside, there is ample room for strategic vision, local adaptation, human empathy, public spiritedness, and the role of government – at both national and international levels – if only because such problems as monopolies, externalities and information imperfections exist. Therefore, we highlight the role of institutional learning and innovation as an important source of sustainable economic growth.

Institutional adaptation, innovation and leadership in this domain seem particularly important at this time when many countries are experiencing political and policy paralysis. Well-managed corporations encourage multiple inputs as part of the decision-making process, but there are time limits and a clear structure that defines the authority to make decisions. Political systems are not corporations, so the bases for legitimacy and authority are different. But systems that get locked up in endless debate accompanied by little action are not well adapted to current conditions and may need to be changed.

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