C20
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Inclusive Growth:

Ensuring everyone shares in the benefits of G20's 2% growth target

BRIEFING PAPER

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Executive Summary

The G20's two percent growth target is projected to boost world GDP by a staggering USD2 trillion dollars over the next five years. We commend the commitment to growth but question where this USD2 trillion will go? Will it go to those who need it most?

While a general commitment to growth across the G20 is necessary, we encourage leaders to recognise the central importance of inclusive growth. The evidence is mounting that rising inequality could act as a significant brake on future economic growth and prosperity.

There are numerous ways to measure inclusive growth – many are complex. That is why a relatively simple approach is needed to start the discussion and demonstrate a firm commitment. Improved data and measurement will also provide the means to hold governments accountable for ensuring the growth is shared.

If G20 leaders committed to inclusive growth by ensuring, for example, incomes for the bottom 20 percent of households in each G20 country also increase by at least two percent, this means by 2018:

> **Around 950 million of the poorest people in G20 countries would be better off with increased incomes of USD800 per person on average.**

Such a measure would be a minimum standard to 'hold the ground' and ensure that income inequality does not widen dramatically over the next five years as G20 nations introduce major structural reforms.

To achieve this, governments would need to appreciate the impact of their policies on the poorest people. Analysis of these impacts should be undertaken and published along with the analysis of the contribution to growth of the major new initiatives.

We therefore call on G20 leaders to:

- **Reaffirm their commitment to inclusive growth made at the St Petersburg Summit in 2013.**
- **Ensure growth benefits the poorest households with a 'two percent inclusive growth target'.**
- **Assess the distributional impacts of major economic reform measures proposed as part of the two percent growth target.**

Background

On the eve of the Global Financial Crisis in 2007, the International Monetary Fund (IMF) wrote:

> "The financial turmoil of August and September threatens to derail what has been an excellent half-decade of global growth. At this point, we expect global growth to slow in 2008, but remain at a buoyant pace."

What followed was the most severe financial crisis to hit the global economy since the Great Depression.

In the wake of the crisis, the G20 or 'Group of 20' (19 countries plus the European Union) was elevated to a Leaders' Summit. The swift and coordinated actions of the G20 to limit the collapse of financial markets and stimulate the economy are generally regarded as the height of the G20's success to date.

G20's commitment to inclusive growth?

Six years later, the world economy is still reeling from the aftershocks of the financial crisis. This year, the IMF has downgraded its growth forecasts twice (in July and October) citing weaker than expected global activity, worsening geopolitical tensions and volatility in financial markets[1]. The Head of the IMF, Christine Lagarde

has depressingly referred to the current path as the "new mediocre".

Against this backdrop, the G20's focus on boosting economic growth is welcome. Economic growth is crucial to increasing prosperity and reducing poverty: "It can spare people en masse from poverty and drudgery. Nothing else ever has"[2]. Nonetheless, growth is not an end in itself. Economic growth makes it possible to achieve other important objectives of individuals and societies[3].

What country does not want to pursue economic growth? Arguably, this was an easy sell for the Australian presidency.

The real issue is not the two percent growth target itself. It is what happens next. Here, the G20 risks missing the main game.

All over the world, people are talking about the headwinds of poverty and inequality and the threat to economic growth. This includes economic heavyweights such as Head of the IMF, Christine Lagarde[4], Governor of the Bank of England, Mark Carney[5] and Chair of the US Federal Reserve, Janet Yellen[6]. Indonesia's new President Joko Widodo has said that income inequality is his number one challenge[7], and the BRICS[8] summit earlier this year focused on inclusive growth and sustainable solutions.

Australia's own Foreign Minister, Julie Bishop, has said:

> "There is an urgent need to ensure the benefits of global and national growth reach poor people. Severe imbalances in wealth distribution have led to instability as those without rise up to demand a fair share of the economic spoils. The current conflicts in the Middle East are based on a myriad of complex issues, but inequality is a common feature."[9]

To sustain economic growth and prosperity, the distribution of income matters.

In the past, the prevailing economic view was that some inequality was a price worth paying for economic growth. However, the evidence is mounting that low inequality is associated with faster and more durable growth and redistribution generally does not appear to act as a brake on growth[10].

Moreover, inclusive growth is essential for citizens to support reforms. As the 21 leaders, academics, policy makers as part of the Commission for Growth found, reforms "will only succeed if promises are credible and inclusive, reassuring people that they or their children will enjoy their full share of the fruits of growth"[11].

Some inequality is intrinsic to any high performing economy. But clearly there is a tipping point beyond which inequality is destructive to sustained prosperity. In some G20 countries, including the United States, that tipping point may be approaching. For others, it is creeping up rapidly. Earlier this year, forward looking business leaders together with economic experts assessed the chronic gap between the incomes of the richest and poorest citizens as the risk that is most likely to cause serious damage globally in the coming decade[12].

Yet, despite the momentum building behind inequality and inclusive growth, there is an ongoing lack of formal action from governments to address it.

The G20 is right to focus on growth and the structural reforms necessary in G20 economies. However, there is also a need and opportunity to ensure this growth addresses the challenge of inequality and includes all citizens in the benefits that economic growth can bring.

The G20 previously recognised the importance of inclusive growth at the St Petersburg Summit in 2013. However this commitment has seemingly slipped off the G20 agenda in 2014. We call on G20 Leaders to reaffirm their commitment given the importance of inclusion to economic growth, stability and opportunity into the future.

Recommendation:

The G20 reaffirm their commitment to inclusive growth made at the St Petersburg Summit in 2013

An inclusive growth target

Around the world, different approaches to inclusive growth are emerging. However, at their root, all share a call for growth that combines increased prosperity with greater equity.[13]

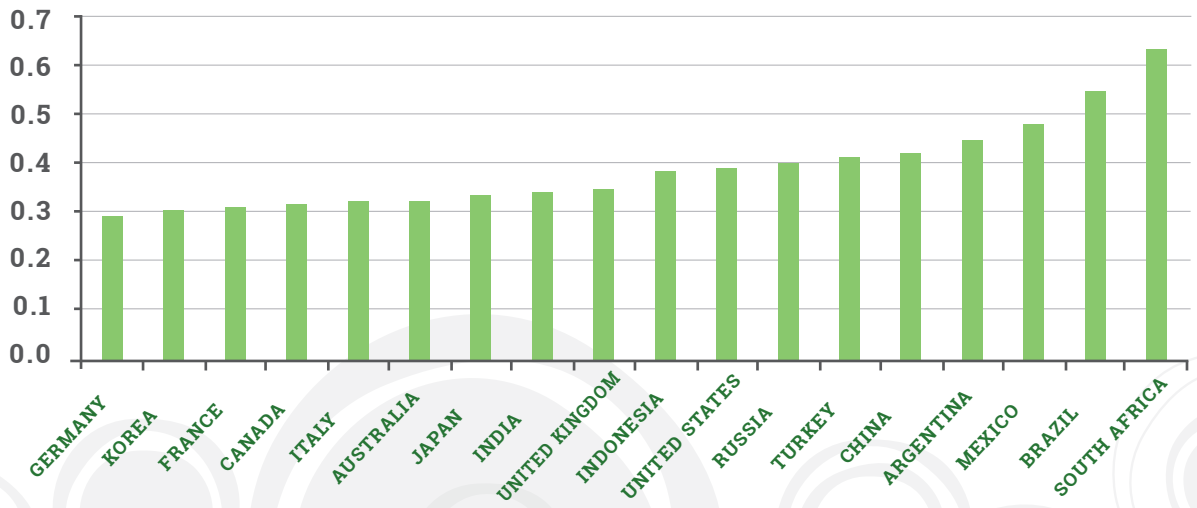
Our working definition of inclusive growth is that all children and their families:

- Have the opportunity to participate in economic growth; and
- Benefit from economic growth.

Economic growth and equality of opportunity are important goals for their own sake, but they can also be complementary in their achievement. Inclusive growth recognises the relationship between growth and inclusion; namely that inclusiveness can support growth, but that growth is also a prerequisite for addressing inclusiveness. Importantly inclusiveness and growth are also important to increasing stability.

One commonly used summary measure of income inequality is the Gini coefficient. A Gini coefficient of 0 represents perfect equality (every person has the same income), while an index of 1 implies perfect inequality (one person has all income). Therefore, the closer to zero, the more equal the income distribution, the closer to 1, the more unequal. The chart below show that not all countries have the same starting point when it comes to inclusive growth on this measure. Some countries such as Germany, Korea and France do relatively well, while others such as the US, Brazil and South Africa face a more significant challenge.

Gini measure of inequality



Source: OECD Stat Extracts (OECD countries); World Bank, World Development Indicators (non-OECD countries)

There are several ways to potentially measure inclusive growth. Some focus on equality of opportunity, others on incomes and wealth. All are inter-related but differ in emphasis. For example:

- International Monetary Fund (IMF) staff have issued a working paper on a single measure of inclusive growth that combines the usual measure of economic prosperity, GDP per capita, with income distribution data[14].
- The World Bank has a dual focus of poverty reduction and shared prosperity which includes tracking whether incomes of the bottom 40 percent are growing faster than the average[15].
- The International Labour Organization (ILO) has emphasised the need for job-rich growth and tracking gaps in employment and job quality[16].
- The Asian Development Bank (ADB) Framework for Inclusive Growth Indicators in the Asia-Pacific region includes 35 indicators across areas such as education and employment outcomes, access to infrastructure and social protection coverage[17].
- The Organisation for Economic Cooperation and Development (OECD) Framework for Inclusive Growth proposes a multidimensional assessment of living standards that includes risk of unemployment and health status alongside household income.[18]
- Oxfam has called for a reduction in extreme economic inequality, including as measured by the share of wealth going to the richest 1 percent.[19]

We encourage the G20 in the coming years to investigate and agree appropriate measures of inclusive growth.

In the meantime, following the logic of the G20's two percent growth target, we argue the G20 should monitor the following target right now:

> **In each G20 country, incomes of the poorest 20 percent grow by at least 2 percent above trend in real terms by 2018.**

Why focus on the bottom 20 percent of the population? Compared with some of the other indicators outlined above, this target is more closely linked with reducing absolute poverty.

Kaushik Basu (now Chief Economist for the World Bank) has also previously shown that this income quintile (specifically the growth rate) has many attractive properties for analysis including the fact that it correlates more strongly than average income with non-monetary indicators of well-being such as greater life expectancy and higher literacy.[20]

We must acknowledge that a focus on lifting the incomes of the bottom 20 percent alone will not necessarily address inequality if the incomes in higher quintiles increase faster than the suggested additional two percent. To achieve a real reduction in inequality, growth in incomes of the bottom 20 percent needs to be considered in the context of other income groups.

The suggested focus on lifting the incomes of the bottom 20 percent by two percent is a first step in avoiding a widening gap in income inequality.

We start with a focus on lifting the incomes of the bottom 20 percent to ensure they at least share in the benefits of any growth. It is worth noting that in some countries where the Global Financial Crisis hit hardest, poorer households either lost more income from the recession or benefited less from the recovery.[21] The pain was not shared evenly. Can we be sure that the gains will?

What impact could sharing the gains have?

The overall G20 target of lifting GDP by two percent above trend by 2018 is expected to generate over USD2 trillion dollars in additional global income. If everyone in the world received exactly the same amount, this equates to about USD280 per person. But who needs the money more? The world's billionaires, or someone living on USD1.25 a day?

We have calculated that if G20 leaders committed to inclusive growth by ensuring incomes for the bottom 20 percent of households also increase by at least two percent, this means by 2018:

- Around 950 million of the poorest people in G20 countries would be better off with increased incomes over USD800 per person on average.
  - Most of the increase (USD700 per person) comes from ensuring that the bottom 20 percent receive their share of economic growth already projected for the G20.
  - An additional USD100 per person is derived from sharing in the two percent lift in GDP by 2018 (assuming current income shares remain the same).

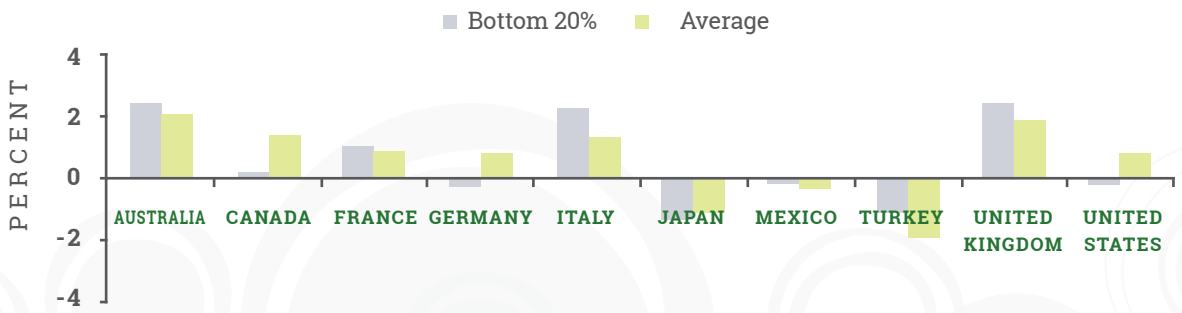
If incomes are growing overall, each G20 country can play its part by committing to at least a proportionate increase in incomes for the bottom 20 percent. This will at least ensure the poorest do not go backwards. This is particularly important as G20 nations commit to major structural reforms that will change labour and other markets.

As it stands, there are no guarantees this will happen.

For example, between the mid-1990s and mid-2000s average incomes among OECD countries grew by 1.8 percent a year whereas incomes for the bottom 20 percent grew by only 1.5 percent a year.[22]

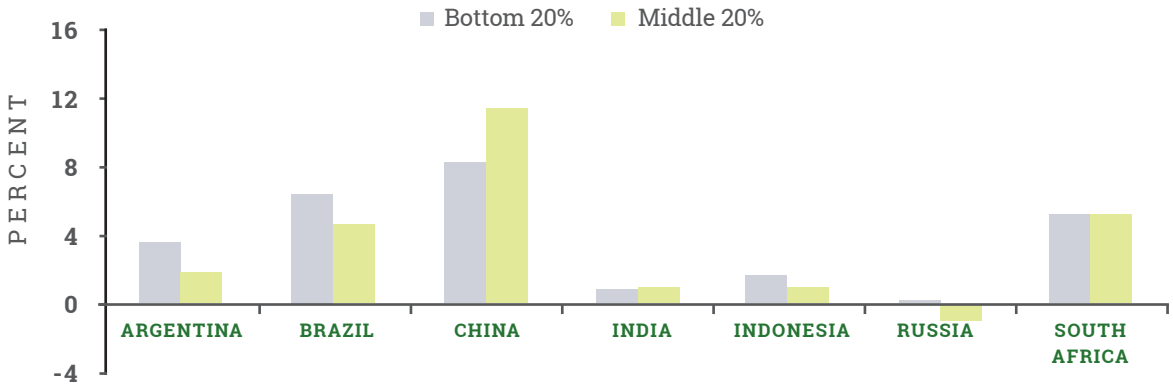
The charts below show the variable performance of the bottom 20 percent of households compared to the average in select G20 countries. Some countries delivered relatively good income growth for the bottom 20 percent (in some cases keeping apace with average income growth) whilst for others, income growth for the bottom 20 percent lagged behind. Note that the period shown pre-dates the Global Financial Crisis, after which there was great volatility in incomes both at the bottom and higher end. Going forward, income growth may return to more historical trends. Or, it may find a new 'normal' in the context of changing inequality. This uncertainty necessitates a focus on the income growth of the poorest.

OECD G20 countries: Average annual % change in household incomes
Mid-1990s to Mid-2000s



Source: OECD (2008) Growing Unequal Income Distribution and Poverty in OECD Countries, Table 1.1

Emerging G20 countries: Average annual % change in household incomes 2000 to 2008



Source: OECD (2011) Divided We Stand: Why Inequality Keeps Rising, Figure 0.3

Any proposed measure of 'inclusive growth' is likely to come with some limitations. We are mindful that the recommended measure here – additional growth in the household incomes of the poorest 20 percent in all G20 countries - also involves challenges and compromise.

These challenges are not insurmountable; nor do they outweigh the benefit of committing to an initial measure that will inform the discussion of inclusive growth.

Other measures, such as the Gini coefficient and new measures being developed by international organisations, will only build on this analysis and improve our understanding of the impact of growth over time.

By committing to a '2 percent inclusive growth target' G20 countries would be agreeing to consider the impact of their policies on inequality and can reflect their relative need to address this challenge based on their domestic circumstances. Having the proposed measure will ensure inequality and inclusiveness are considered in the development of policies as part of the G20's two percent growth target.

Recommendation:

Ensure growth benefits the poorest households with a 'two percent inclusive growth target'

Australia's growth record: Everybody better off except for the most poor?

Australia's unprecedented 23 year continuous run of economic growth is second only among developed economies to the Netherlands (26 years over 1981-2008)[23].

In the June 2013 Economic Roundup, Australian Treasury officials explored the issue of income inequality in Australia against the backdrop of sustained growth. They found that from 1994-95 to 2011-12, Australia experienced strong real income growth across the distribution. While the biggest gains went to the middle and top

income deciles (around 60 percent increase), income in the lowest income decile also increased by almost 50 percent.[24]

That is, on average, everyone was better off. But, some more than others. At the same time Australia, like other OECD nations, experienced an increase in inequality. Yet, how much inequality is too much? Treasury officials suggest focusing the debate on what is happening for those at bottom of the income distribution.

The Bankwest-Curtin Economics Centre estimates in 2011 there were more than one million people living in severe income poverty (30 percent of the national median)[25]. This equates to around 5 percent of Australia's population. For a couple with children it can mean making do with income of AUD261 each week after housing costs, with many surviving on less. Moreover, around 10 percent of Australians report that they cannot afford to buy enough food and this share has increased somewhat in recent years.[26]

Economic growth is benefiting Australians, however there is still a need to ensure the most disadvantaged are not excluded. The recent experience of ensuring income inequality did not worsen in recent years in Australia, including during the mining boom – an event that would otherwise be expected to benefit the highest income earners and owners of capital – reflects well on Australia's capacity to share the benefits of growth across the economy. However, as the income generated from the mining boom slows, the labour market continues to change and other sources of growth emerge, we need to ensure policies remain in place to ensure the poor are not left behind.

This includes policies like access to universal healthcare and quality education, investment in skills and training for the labour market of the future, and measures that address youth unemployment and deliver opportunities for all people.

Assessing the distributional impacts of economic reform measures

As part of the G20's commitment to a two percent lift in GDP by 2018, countries have proposed 900 growth measures, of which around 700 are new[27]. These initiatives are yet to be made public so limited detail on the growth strategies are available.

The IMF has been tasked with analysing the impact of these initiatives on G20 output. To date, with major caveats, the IMF has found that the proposals are projected to achieve an additional 1.8 percent growth over five years, or close to USD2 trillion dollars over 5 years[28].

When it comes to measuring the impact of these initiatives, we call on the G20 and IMF to also consider their distributional impact on household incomes. Such analysis will not only inform discussion of the impact of the initiatives, but also ensure attention is given to the impact of growth on low-income households and contribute to the challenge of addressing inequality.

Including analysis of the distributional impact of the proposed 900 initiatives would clearly be a significant undertaking. However given the large number of initiatives it is reasonable to anticipate that many will be relatively small. As such, the proposed distributional impact could be undertaken on the major initiatives considered

to make the largest contribution to the growth target (which is expected to be a far smaller number, perhaps 10-20, compared to the total 900 initiatives).

This analysis could take the form of an 'inclusiveness test' that would involve asking whether, in addition to raising incomes, the measures would lead to more or less income equality. It is proposed that the distributional impact is measured and monitored alongside the growth measures to broaden and inform the wider discussion of inclusive growth.

Recommendation:

Assess the distributional impact of major economic reform measures proposed as part of the two percent growth target

What could inclusive growth policies look like?

G20 leaders could adopt a range of reforms that support the achievement of more inclusive goals. Many policies that are known to promote inclusive growth are also consistent with the current G20 agenda, but require a more focused commitment to ensuring the reforms achieving the distributional impact sought for the bottom 20 percent of the population.

An inclusive growth agenda should expand both growth and opportunity. This could be achieved in a range of ways, with perhaps the optimal policies being those that combine the achievement of growth and opportunity:

- **Growth policies**: for example, public investment in productivity enhancing infrastructure.
- **Opportunity policies**: programs designed to increase participation amongst specific groups (e.g. apprenticeships targeted at marginalised groups); redistributive policies through the tax-transfer system.
- **Policies that directly contribute to both growth and opportunity**: for example, investment in equitable access to quality early learning and higher education.

Policy measures that could support more inclusive growth for high-income G20 countries could include[29]:

- Reforming the **tax-transfer system** to address rising inequalities, including better targeting of benefits and curbing aggressive tax avoidance practices.
- Promoting **inclusive labour markets**, including facilitating access to employment for under-represented groups, such as young people, older workers, women and migrants.
- Investing in the **human capital** of the workforce by ensuring access to affordable vocational and higher education and investing in the critical early years of pre-school education where the gap between rich and poor children starts and only grows wider.

Policy reforms that could promote inclusive growth middle-income G20 countries could include[30]:

- Better incentives for **formal employment** - labour market policies complemented by product market reforms to expand formal sector.
- Targeted **social assistance** – including conditional cash transfers that link income support with investment in children and health, for example.
- Spreading the rewards from **education** – addressing inequalities in access to quality education.
- Preparing to **finance** more social spending – strengthening the tax base.

With a change in the policy mix, even greater gains may be made in terms of reducing poverty and inequality. We encourage leaders to prioritise these issues at the next G20 in Turkey.

Conclusion

In the public statement following the September G20 Finance Ministers' Meeting, there was no reference to inclusive growth.

Yet, there has never been a more urgent imperative.

We call on G20 Leaders to commit to:

- Reaffirm the undertaking at the St Petersburg Summit in 2013 to pursue inclusive growth.
- Ensure growth benefits the poorest households with a '2 percent inclusive growth target'.
- Assess the distributional impacts of economic reform measures proposed as part of the G20's two percent growth target.

Inclusive growth is the precursor to sustained economic prosperity, security and social progress. The wellbeing of the poorest households is far too important to ignore - for all of our futures, and especially our children.

Country by country findings

	Income share of bottom 20%	Projected number of people in bottom 20% (million)	Average Income per person in bottom 20% (USD)	Projected income per person in bottom 20% (AUD)	Increase per person in bottom 20% (USD)
	2009-2012	2018	2013	2018	2018
ARGENTINA	4.6	8.8	2,686	3,152	466
AUSTRALIA	7.9	4.9	25,342	29,938	4,596
BRAZIL	3.4	41.4	1,863	2,227	364
CANADA	7.3	7.4	18,933	21,715	2,782
CHINA	4.7	279.0	1,544	2,216	672
FRANCE	8.7	13.0	18,701	20,680	1,979
GERMANY	8.4	16.2	18,460	20,146	1,686
INDIA	8.5	265.5	601	831	230
INDONESIA	7.6	53.2	1,329	1,809	479
ITALY	7.0	12.3	11,868	12,851	983
JAPAN	8.0	25.1	15,728	17,032	1,304
KOREA	4.8	10.3	5,721	7,092	1,371
MEXICO	4.9	24.9	2,750	3,345	595
RUSSIA	6.5	27.8	4,866	5,878	1,012
SOUTH AFRICA	2.5	6.5	856	1,030	174
TURKEY	5.8	11.0	3,116	3,916	800
UNITED KINGDOM	7.7	16.1	15,034	17,001	1,967
UNITED STATES	4.8	13.2	12,549	14,990	2,440

Excludes Saudia Arabia. Results for European Union also not reported

Technical note

In 2014, G20 nations were issued with a challenge to deliver growth strategies to lift collective GDP by at least two percent above current projections over the next five years.

To model the impact of individual country growth strategies on G20 output, the IMF created a G20 General Equilibrium model. Only commitments assessed jointly by the IMF and OECD as new and as having a significant GDP impact are included in the quantification. The IMF has signalled it will publish a paper on the model but this is not yet available.

The IMF has said the reforms will raise world growth by around 0.5 percentage points per year (in real terms) over the next five years (that is, by 2018). This is against the baseline of the October 2013 World Economic Outlook.

Given 2014 is well underway with below trend growth, we have assumed an additional 0.25 percentage point increase in country growth rates in 2014 followed by a 0.5 percentage point increase thereafter (2015-2018). This percentage point increase in growth rates has been uniformly applied to each of the nineteen G20 countries plus the EU[31]. This simplifying assumption is necessary in the absence of information on the contribution of each country to the lift in G20 output over 2014-2018.

Importantly, our static projections assume all other variables remain constant including share of income of bottom 20 percent and no changes in taxes or transfers.

Our numbers are not intended to be a precise forecast of the future but rather an illustration of what is possible if leaders prioritise inclusive growth.

Increase in incomes

To calculate the total increase in incomes for the lowest income quintile, firstly we take the income shares of the bottom 20 percent of households[32] and convert these to implied income per person as follows:

$$y = \overline{y} \times \frac{x}{0.2}$$

where y = average income per person in bottom 20 percent, $\overline{y}$ = GDP per capita and x = income share of bottom 20 percent.

Although this method involves using both microeconomic data (income shares from household surveys) and macroeconomic data (national accounts), it has been adopted by researchers[33] as an approximation. Inter-country comparisons in this area are challenging due to different sources, definitions and methods in estimating income (or sometimes consumption) shares. Going forward, a greater commitment from G20 countries to collectively track these indicators should drive improvements.

Using the IMF projections in the October 2013 Outlook, we calculate projected GDP growth rates over 2014-2018 for each country with and without the G20 commitment to boost growth for each G20 country and the EU (using the uniform additional percentages growth described above).

The average income for a person in the bottom 20 percent of each G20 country[34] and the EU is then multiplied by the same rate that overall GDP is expected to increase. Finally, the income per person is multiplied by the number of people in the bottom 20 percent to arrive at the total.

Footnotes

1 IMF (2014) World Economic Outlook, October 2014
2 Commission on Growth and Development, The Growth Report: Strategies for Sustained Growth and Inclusive Development, 2008
3 As above
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5 Inclusive Capitalism: Creating a Sense of the Systemic, Speech to the Conference on Inclusive Capitalism, London, 27 May 2014.
6 Perspectives on Inequality and Opportunity from the Survey of Consumer Finances, Speech at the Conference on Economic Opportunity and Inequality, Boston, 17 October 2014
7 As reported in the Sydney Morning Herald, 19 October 2014.
8 BRICS = Brazil, Russia, India, China, South Africa
9 Crawford Australia Leadership Forum, Keynote Address, 30 June 2014
10 For references, see Ostry J, Berg A, Tsangardies C (2014), Redistribution, Inequality and Growth, IMF Staff Discussion Note, SDN/14/02
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26 OECD (2014) Society at a Glance 2014 Highlights: Australia OECD Indicators
27 IMF (2014) Quantifying the Impact of G-20 Members' Growth Strategies
28 The IMF also noted the high degree of uncertainty entailed in quantifying the impact of members' policies as well as implementation uncertainty.
29 Recommendations adapted from OECD (2014) All on Board, Making Inclusive Growth Happen IMF(2014) Fiscal Policy and Inequality, IMF Policy Paper, January 2014
30 Recommendations adapted from OECD (2011) Divided We Stand: Why Inequality Keeps Rising Special Focus – Inequality in Emerging Economies
31 The EU countries that are also individually members of the G20 (France, Germany, Italy and the UK) are then subtracted from the overall G20 total so they are not double counted.
32 Income shares for developing G20 countries are sourced from the World Bank PovcalNET database as reported in the World Development Indicators. For developed G20 countries, income shares are taken from Eurostat (European Countries), Luxembourg Income Study (Australia, Canada, US) and national data (Japan, Korea) as reported in the UNU-WIDER (2014) World Income Inequality Database (WIID3.0b), September 2014
33 For example in Dollar, Kleineberg and Kraay (2013) Growth is Still Good for the Poor, World Bank Policy Research Paper 6568
34 Excluding Saudi Arabia for which no data on income shares is available

About the Australian C20

The Australian C20 Steering Committee is comprised of people with diverse backgrounds and experiences. The Australian Government appointed the Members of the Steering Committee in their own right due to their relevant and diverse experiences and talents, and/or because they also lead major Australian civil society organisations.

The Australian C20 Steering Committee has drawn on the networks, talents, concerns and wisdom of the international as well as Australian civil society in developing its policy approaches and in drafting its recommendations. Within the context of the G20's agenda, it is concerned primarily with promoting inclusive and sustainable growth.

Tim Costello	Chair, World Vision Australia
Cassandra Goldie	Deputy Chair, Australian Council of Social Service
Kelvin Alley	Salvation Army
Joseph Assaf	Ethnic Business Awards
Frank Brennan	Australian Catholic University
Jody Broun	Aboriginal Advocate
Ian Callinan	High Court, retired Justice
Tara Curlewis	National Council of Churches of Australia
Julie McKay	Australian National Committee for UN Women
Dermot O'Gorman	WWF
Rob Moodie	Melbourne University
Marc Purcell	Australian Council for International Development
Bills Scales	Swinburne University
Sally Sinclair	National Employment Services Association
Rauf Soulio	Australian Multicultural Council
Helen Szoke	Oxfam Australia
Greg Thompson	Transparency International Australia
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The C20 (or 'Civil Society 20') is a platform for dialogue between the political leaders of G20 countries and representatives of civil society organisations