

Chapter 1

Change and Development

Introduction

1.1 When Commonwealth Ministers of Finance asked for the establishment of our Group in September 1989, they did so against a background of widely felt concern that the circumstances facing developing countries had changed significantly in the course of the 1980s; and that, in spite of adjustment and reform by many, economic growth remained elusive for most. They therefore called for an examination of how recent changes in the world economy were affecting the development process; and what implications these carried for the management of debt, adjustment and growth.

1.2 These concerns found expression again, a month later, when Commonwealth Heads of Government met in Kuala Lumpur. They believed that while there was broad agreement on the principles necessary to bring about sound development, the developing countries continued to face grave resource constraints in applying those principles; and that at the same time, collective arrangements were inadequate to address these issues. Heads of Government called for greater global solidarity in responding to the new challenges and for a special effort to improve development cooperation. They also considered that the Commonwealth might have a particular role to play in taking matters forward and asked our Group to identify an agenda as a basis for doing so. They left open the possibility of a political initiative, as proposed by Mr Manley, to bring about a meeting of a representative group of Heads of Commonwealth and non-Commonwealth governments.

1.3 It is in furtherance of these objectives that our Group was constituted. The relevant paragraphs in the Communiques of the

meetings of Finance Ministers and Heads of Government respectively (reproduced in Annex 1 on pp.147–149) constituted our terms of reference.

1.4 The changing context for development is thus one of the principal themes of our Report. How economic policy-making at the national level and policies and institutional arrangements at the international level might be improved so as to support the reform process in developing countries, and assist in resolving major problems such as the poverty and environmental degradation facing these countries, is another.

1.5 We have conducted our deliberations against a backdrop of unusually rapid change in world affairs. Some of these changes—for example the reduction in East-West tensions—were only beginning to become significant when Finance Ministers called for the establishment of our Group; and some others—such as the Gulf crisis and its aftermath—could hardly have been foreseen. The implications of change for the development process and its policy requirements have become an even more relevant issue than might have been envisaged two years ago.

Change

1.6 Our concern is not with world change as such but change as it affects development. We are concerned with the special problems which emerged in development in the last decade or so. By change we do not mean only new developments but include also changes in trends which have already become evident. Technological change, for instance, is not new but recent times have witnessed revolutionary changes in a number of areas—information, new materials, biotechnology—which amounted to a new industrial revolution with pervasive effects for the whole world economy, including those countries which remain relatively untouched by this revolution.

1.7 A number of changes have had substantial effects on important economic factors such as trade and investment. The changes concerned arise from major shifts in basic political and economic circumstances as well as in policies.

1.8 Some of the more important changes affecting the development process are:

- (i) the rise in the burden of developing country indebtedness, aggravated by high interest rates and notwithstanding the increasing adoption of debt relief measures;

- (ii) a sharp decline in net financial flows in real terms to developing countries;
- (iii) a decline in the world savings rate and the greater competition for available funds as a result of restructuring in Eastern Europe and the Soviet Union and rehabilitation in the Gulf;
- (iv) the ending of East-West tensions and the increased scope for reduction in military expenditures, with favourable effects on the availability of funds for other purposes, including the promotion of development;
- (v) the reversal in some developing countries of previously improving trends in standards of education, health and nutrition, in a world economy whose increasing technological orientation makes human resource development vital to sustained economic growth;
- (vi) the intensification of international economic linkages, spurred by technological change, economic liberalisation and financial deregulation; and changing patterns of trade characterised by the declining use of raw materials in production and the growing importance of services and technology-intensive products in world trade;
- (vii) the growth of regional integration especially involving developed countries and the mix of opportunities and dangers this could pose to multilateralism and to market access for third countries, particularly in the developing world;
- (viii) the emergence of small groups of major countries, meeting to coordinate economic policy and decision-making in a global economy of increasing interdependence and growing complexity in management, and the threat this poses for multilateralism and the interests of others whose economies are thereby affected;
- (ix) the changed orientation of domestic economic policies, towards market forces, privatisation and deregulation, especially in developed countries, and the repercussions this has had for international development policies and on notions of equity and aid as a public good;
- (x) the worldwide movement towards democratisation of government and participatory development, and against statism and centralisation;
- (xi) the increase in environmental degradation and of awareness of the mutuality of interest in and need for conservation and sustainable development;
- (xii) the high growth of world population and the increasing need for

- population policies as a means of helping to achieve sustainable development in a world where population growth rates showed little diminution in the 1980s;
- (xiii) increased cross-border migration into both the developed and developing countries of economic, political and 'environmental refugees; and of the more able and enterprising (the 'brain drain'); and at the same time, the growing resistance in many countries to the prospect of higher immigration;
 - (xiv) the growth of drug consumption and trafficking, which distorts product markets, disrupts capital markets, threatens the political stability of the countries of production and transshipment and, through its pernicious effects on health and its links with international terrorism, endangers life everywhere; and
 - (xv) the increasing emphasis on the need for greater gender equity.

Change Examined

1.9 Debt has emerged as a significant barrier to growth in many developing countries; and, despite the various relief measures taken so far, the debt problem has worsened, aggravated by high interest rates and depressed commodity prices. The burden of debt has become particularly onerous in Latin America and sub-Saharan Africa where the scheduled debt service payments exceed viable levels; and where countries are forced to compress their import levels in order to service debt.

1.10 Indebtedness and a sharp rise in interest rates in the early 1980s led to a steep fall in commercial bank lending to developing countries. Export credits and foreign direct investment also declined. Concessional flows showed some increase, though they are declining as a proportion of donor GNP. Net flows from multilateral development institutions have been inadequate. Foreign direct investment has picked up since the mid-1980s but its distribution is very skewed with most of it going to South-East Asia and to a few countries in Latin America. A dramatic change affecting development is thus a sharp decline in net financial flows in real terms to developing countries. Many countries began to sustain net outflows of finance.

1.11 All these changes have been taking place against a background of a decline in the rate of industrial country savings, and the emergence of significant trade and payments imbalances among major industrial countries. The United States has emerged as the largest borrower in world financial markets; the surpluses of Japan, some other East Asian countries and Germany have risen sharply. More recently, while there

has been some modest decline in the US deficit, there has been at the same time a sharper decline in the Japanese and German surpluses—the latter due to German unification. These developments, together with the new claims for purposes of economic restructuring in Eastern Europe and the reconstruction of the Gulf area, are increasing pressures on interest rates and on the flow of aid and private finance to developing countries.

1.12 There are, however, some grounds for optimism. The reduction in East-West tensions brings with it a promise of greater world peace and security. That should help to improve the security of nations whose conflicts have been rooted in East-West tensions. Despite the possibility that the withdrawal of super-power involvement may have the perverse effect of increasing tensions in some areas, the end of the Cold War, on balance, offers the possibility of realising a peace dividend that could be put to use for other purposes, including the promotion of development, through cuts in military expenditure both in industrial and in developing countries. A restraint on armaments exports will enhance these prospects.

1.13 Since the 1980s, a change of major concern has been the setback of development in many parts of the developing world. Perhaps the most worrying trends are in sub-Saharan Africa. Per capita incomes and per capita food production have fallen drastically, and food insecurity has increased sharply with growing dependence on food imports and food aid. Environmental capital is being used up in the form of soil erosion, deforestation and desertification. Civil wars and natural disasters have brought repeated crises. Poverty and unemployment have increased in many countries, and the formal or modern sector has steadily lost ground to an informal sector, with declining social conditions. Previously improving trends in standards of education, health and nutrition have been reversed. Some of these developments, including the deterioration in human and capital resources, have also been evident in many other parts of the developing world, such as Latin America and the Caribbean, and Asia, though less dramatically.

1.14 The world is experiencing great scientific and technological changes, which are altering the nature of much economic activity. They are affecting the pattern of production, exchange and consumption as well as the demand for labour. They increase the range of technological options and scope for increasing productivity while simultaneously raising new concerns about equity in the distribution of benefits and costs of these changes. Established notions of comparative advantage are now in question. The role of raw materials in production and consumption has been steadily declining. At the same time, these changes offer opportunities to tackle underlying economic, social and environmental problems. The capacity to utilise new technologies has become an

important benchmark of growth and development. But the setback in human resource development—in nutrition, health, education and training—experienced by many developing countries in the 1980s has compounded their disadvantage in absorbing the new technologies. Countries which are unable to take advantage of these technologies will fall even further behind in the future.

1.15 A major change affecting the management of economic policy and the development process is growing interdependence in the world economy. In recent decades, the world has seen the globalisation of markets and industrial production. The ratio of trade to GDP has increased world wide. Spurred on by deregulation, international financial transactions have risen greatly. Since the 1980s, there has been a sharp increase in foreign investment concentrated in the triad of the United States, Europe and Japan. The internationalisation of communications, transport, financial and other services has both intensified and altered the character of global interdependence, leaving no country immune from the benefits or costs of this change. While these economic linkages in the world economy through trade and financial flows have become more intense, at the same time the inter-relationships and impacts of major events have become more complex. Increasingly, greater interdependence has put limits on national freedom of economic action.

1.16 In world trade, although protectionism has been increasing, expansion has occurred at a reasonable pace. Within that total growth, the share of raw materials has fallen, while that of manufactures and services has increased markedly. Intra- industry purchases and trade in technology-intensive products has become much more important, reflecting the growing significance of new technologies, economies of scale and product differentiation. Trade within and between the major trading blocs of the developed world has increased rapidly. Many developing countries have not benefited from this expansion in world trade, reflecting among other things, both their dependence on undynamic commodity exports and the influence of discriminatory practices against their labour-intensive manufactured exports. The striking gap in the world economy between massive North-North trade and relatively light South- South trade has widened further.

1.17 The declining use of raw materials per unit of final output caused by technological change and difficulties in diversifying away from primary products have contributed to the tendency for the real price of commodities to fall over long periods, affecting the export earnings of many developing countries. This puts in question the long-run prospects for prices of primary commodities and earnings from their exports, as well as the ability of developing countries to service their debt.

1.18 There has been an increased trend towards regionalism. The contributory factors have included increased rivalry in markets, technological change and increased costs of research and development, and the constraints facing multilateral trading arrangements. The movement towards a single market in Europe (1992) and the decision to establish a free trade area in North America are among the major shifts towards greater regionalism. Regionalism can be favourable to world economic growth and prospects for development if it does not stand in the way of multilateralism. However, if it is inward looking, it will threaten market access for third countries. Among developing countries also, there has been a marked desire to strengthen regional economic co-operation.

1.19 In the face of increased interdependence and complexity in economic relations in recent years, the major countries have been seeking solutions for problems of co-ordination in smaller groupings rather than in multilateral institutions. In the developed world, the Group of Five (G5)—and later the Group of Seven (G7)—and the European Community achieved steadily increasing salience, while the Bretton Woods institutions became relatively less important. Understandings between major countries, unilateral action and bilateral pressures increasingly began to replace multilateralism. There was a diminished regard for collective interests.

1.20 The decreasing commitment to multilateralism, and the increased dominance of small groups of developed countries in global economic management, left most of the developing countries—and some small developed countries—in a weaker international position. The economic weakness of many developing countries and their difficulty in finding a common voice contributed to this process.

1.21 In the industrial countries, there had been a profound change in economic philosophy and in attitudes towards economic management. The control of inflation became a primary objective of economic policy; and reliance was placed on monetary policy, rather than fiscal policy, in the fight against inflation. Overall, countries adopted policies which emphasised market forces, enterprise and profit, and stressed the need to reduce the sense of dependency on the state and promoted self-help. This also led to the view that the role of state intervention in development has been exaggerated, and the failure to reach targets for official development assistance or to support development through government policy came to be seen as less of a moral failure, than in the 1950s and 1960s.

1.22 In the developing countries too, there is increased recognition that greater reliance on markets and the private sector will promote economic performance. However, in the developing world where capital is scarce, technology and human resource development are at low levels,

and infrastructure is poor, market processes alone will not achieve much unless an appropriate enabling environment and the necessary institutional framework are provided. A crucial immediate requirement is that reduced public expenditure in adjustment programmes should not impair the basic requirements for development.

1.23 The increased movement towards liberalised economic policies in the developing world has also been accompanied by a process of democratisation in many countries. The wider use of democratic political processes will, we believe, also promote stable development in its wider sense, though there may be some difficulties in the short run in reconciling the economic compulsions of development policy with the democratic process. Diverse inputs are required to sustain development. Good governance facilitates coping with this diversity, although there is no universally valid prescriptive model for it.

1.24 A number of new issues have emerged which have reinforced the need to have a broader perception of global peace and stability and to treat development as a public good: these include the environment, migration, population policies and AIDS, drug trafficking, and the role of women in development.

1.25 Internationally, the 1980s saw an increased awareness of the deterioration of the global environment, its links with the development process and the need to integrate economic and environmental decision-making, in order to move towards sustainable development. In particular, there was recognition of a threat of a global nature through the depletion of the ozone layer and the potential for global climate change. There was also an increased awareness that much of the world's remaining biological and genetic resources, critical in meeting future food and medicinal needs, were to be found in developing countries. Continued development in these countries was essential to overcoming many environmental problems; but this could increase the demand for energy and add to greenhouse gas emissions unless these countries are assisted to move to energy-efficient technologies and alternative receivable source of energy. Solutions to global environmental problems would, therefore, require the close cooperation of the developed and developing countries. This cooperation will make demands on developing countries which they will only be able to meet if they are assisted both financially and through access to the required technologies.

1.26 Global population, although growing at a declining rate, is still expanding too fast. Population pressures continue to impair prospects for development in many countries. They are also of increasing environmental concern, as they challenge hopes of sustainable development. The link between poverty and population growth is well estab-

lished. However, the urgency of the situation requires that general developmental efforts are supplemented by increased access to family planning services. Allied to this is the need for improvements in other decisions which affect family size: education, health and women's position in society. Population policies also constitute a major means for combating AIDS. They need to be fully integrated into economic development strategies and supported externally. Another demographic trend of note is the ageing of the population and the increased dependency ratio in industrial countries. This has significant implications for savings mobilisation, resource allocation and the brain drain from developing countries.

1.27 In many parts of the world the intensification of diverse problems—political pressures, the inadequacies of resources and continued environmental degradation—is compelling millions of people to migrate. Large movements of economic, political and 'environmental' refugees present significant problems as cultural, linguistic and ethnic differences can exacerbate difficulties in absorption, housing and employment, particularly in the light of the growing resistance in most receiving countries to the prospect of much greater immigration. In addition, the emigration of the most able and enterprising deprives many developing countries of some of their most valuable human resources. This constrains development in these countries. A multifaceted approach is needed to address the problem of international migration. It should incorporate measures to alleviate poverty and mechanisms to reconcile differences based on ethnic or religious groupings and political ideologies.

1.28 The world has also witnessed a great increase in drug-taking and, associated with it, drug-trafficking. This issue has both health and security dimensions. The drug habit endangers life and the growth of drug trafficking can threaten the political stability of countries involved in production and in transshipment, with its links with international terrorism. It can also affect trade and investment flows. The problem of eliminating the drugs menace is linked to development since production is encouraged by a shortage of alternative economic opportunities.

1.29 There has been a significant change in perceptions regarding women's role in development. The adjustment programmes in developing countries have placed disproportionate burdens on them in the vital roles they play in the family. Women are not only an important productive resource; they are also crucial for effective population policies and they play a major role in the achievement of good health and adequate nutrition. There is increasing appreciation, therefore, of the need to give priority to their needs in the fields of education and training and the importance of securing sexual equality generally. But this will require

a redirection in policy and public expenditure, at a time of restricted budgets.

The Need for Action

1.30 All these changes point to both problems and opportunities for development. But, as we point out in the next chapter, they come at a time when much of the developing world is in a debilitated state, and highly vulnerable to external events. Many countries need assistance if they are to benefit from positive changes in the international environment in the form of expanded markets for manufactured goods and services and the widening range of technologies which are becoming available; and in taking forward the spread of market-oriented policies and democratisation, that will unleash the creative energies of the people. Also, the global economic and political changes carry important implications for global management and cooperation. Two critical issues for the 1990s are whether global institutions and processes will evolve in a manner that corresponds to need; and how to ensure that the development objective is again seen as a priority matter for collective international responsibility. We believe that many of the changes and new issues which have come to the forefront in recent times greatly increase the mutuality of interests between industrial and developing countries and provide a good foundation for a renewed commitment to multilateralism and development cooperation.