CHANGE FOR THE BETTER

Global Change and Economic Development

Report by a Commonwealth Group of Experts

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Report by a Commonwealth Group of Experts on the Impact of Global Economic and Political Change on the Development Process

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London SW1

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Foreword by Commonwealth Secretary-General

We are today witnesses to momentous change in the international order. The end of the Cold War is ushering in a new era requiring adjustments to long-held perceptions and patterns of international behaviour. Change is evident in all aspects of human life—political, economic, social and environmental. Technological and economic change is heightening the interdependence of nations. There is a growing awareness of humanity's capacity for inflicting global damage as it persistently lays waste the environment; and of a corresponding and urgent need to pursue policies of sustainable development, both nationally and through international cooperation. The basis of political and social organisation is fast changing as appreciation grows of the positive role of market forces and of pluralistic political structures.

These changes present the international community with both problems and opportunities. And they come at a time when large parts of the developing world are burdened by the legacy of the 1980s, when external indebtedness emerged as a major barrier to economic growth and spreading poverty punctured the hopes of earlier decades. If many developing countries are to be able to make use of the available opportunities, they urgently need help. But, as many of them are increasingly coming to recognise, it will be help in support of the crucial role that must be played by the developing countries themselves.

The persistent constraint upon development is not only a source of widespread human suffering and environmental degradation. It holds back human creativity. It also threatens global peace and security; for peace can neither be achieved nor sustained when vast numbers of humanity are falling deeper into poverty.

What then can the world community do to help revive development? And what can the developing countries themselves do? These are some of the questions which were uppermost in their minds when, following initial

consideration by Commonwealth Finance Ministers, Commonwealth Heads of Government, in 1989, requested the Secretary-General to establish an Expert Group to pursue these issues.

The Commonwealth has been fortunate in being able to secure the services of a highly distinguished group of people, under the very able and experienced Chairmanship of Arthur Brown, Governor of the Bank of Jamaica and former Deputy Administrator of UNDP. All members served the Group in their individual capacities. Representatives of the UN, UNCTAD, IMF and World Bank also participated in the Group's work.

The Group's Report points to the danger of further increase in the existing disparities, if action is not taken urgently by the developed and developing countries as well as the world community as a whole. It points to the mutuality of interest which makes action a necessity; and to the opportunities presented by change, such as the peace dividend, the greatly enhanced technological capacity to tackle problems of all kinds, and the creative energy and ingenuity arising from accumulated human resource development, market-oriented economy and political pluralism. But effective action will only be possible if there is ready acceptance that the challenge of development cannot be ignored; and that current piecemeal efforts are not the answer. International understanding and cooperation will be a critical requirement.

It is my hope that this Report will help to mobilise international partnership to meet the challenge of development which I believe to be one of the most important challenges currently facing the world community. I therefore have great pleasure in commending the Report to Commonwealth governments and in making it available to the international community.

Emeka Anyaoku

Letter of Presentation

Marlborough House
London

31 May 1991

Chief Emeka Anyaoku,
Commonwealth Secretary-General,
Marlborough House,
London SW1Y 5HX

Dear Secretary-General,

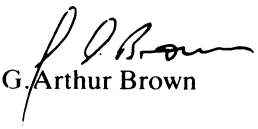
In accordance with the wishes of Commonwealth Finance Ministers and Heads of Government, you appointed us as a group of independent experts to examine and report on global economic and political change and its impact on the development process. You will recall that the Chairman's Interim Report was forwarded to you for presentation to the September 1990 Commonwealth Finance Ministers Meeting. This summarised the main points for consideration and set out our approach to the further work which would be needed. We now present our Report, which we have signed in our personal capacities and not as representatives of the governments, organisations or countries to which we belong.

We are in no doubt that this period of economic, political and indeed philosophical change presents great problems and opportunities to all concerned with the development process. We are also convinced that the developing and industrialised worlds have common interests at stake. We believe that the time is ripe to direct international attention to the impact of the changes we have identified on development and the developing countries. And we believe that the Commonwealth is well-placed to take the lead in bringing this about.

In our discussions we have benefited from the participation of Mr.Stanley Fischer and Mr. Jean Baneth of the World Bank, Mr. Rattan Bhatia of the IMF, Mr. Iqbal Haji of the United Nations and Mr. Roger Lawrence of UNCTAD. We are grateful for their contributions.

We are grateful also to you for the confidence you showed in asking us to undertake this task, and to your staff for the very willing drafting, administrative and technical support they have given us from first to last.

Yours sincerely,



G. Arthur Brown

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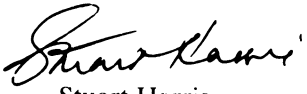

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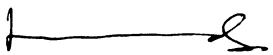

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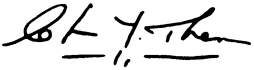

Clive Thomas

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Executive Summary

Change and Development

Our Group was established in 1989 against a widely felt concern that the circumstances facing developing countries had changed significantly in the 1980s; and that economic growth remained elusive for most of them. Global political and economic change and its impact on the development process, together with ways to improve development policies—domestic and international—are the principal themes of our report.

2. The main elements of changes in the 1980s which affected the development process include:

(i) the rise in the burden of developing country indebtedness;

(ii) a sharp decline in net financial flows to developing countries;

(iii) a decline in the world savings rate and the greater competition for available funds;

(iv) the ending of East-West tensions and the increased scope for reduction in military expenditures;

(v) the setbacks to progress in education, health and nutrition, in many developing countries;

(vi) the intensification of international economic linkages; and changing trade patterns;

(vii) the growth of regional integration;

(viii) the increased salience of small groups of major countries, such as the G7, in global economic management;

(ix) the changed orientation of domestic economic policies, especially in developed countries, towards market forces; and the repercussions this has had for development cooperation and notions of equity and aid as a public good;

(x) the spread of the democratic process; and the worldwide movement against statism;

(xi) the increase in environmental degradation and of awareness of the mutuality of interest in arresting it;

(xii) the increasing need for population policies;

(xiii) the increase in cross-border migration into both the developed and developing countries;

(xiv) the growth of drug trafficking; and

(xv) the increasing emphasis on the need for greater gender equity.

3. These changes have brought both opportunities and problems for development. They have generally increased interdependence and made stronger the mutuality of interest in sustainable development. They have led to a search for greater economic security; but they have also complicated international management, and been accompanied by a reduced commitment to multilateralism and development assistance. A new approach to international cooperation is needed if the opportunities provided by change are to be used beneficially to promote development and overcome immiseration and poverty.

The Starting Point

4. The 1980s were marked by increasing economic disparities. While the industrial countries enjoyed their longest period of sustained growth since the Second World War and some developing countries, particularly in Asia, also did well, most developing countries in Africa and Latin America were caught up in acute economic difficulties: physical and human capital deteriorated and malnutrition spread. Despite adopting wide-ranging adjustment programmes, at the end of the decade most developing countries were left with a reduced capacity to withstand economic shocks.

5. The prospect for much of the developing world continues to be bleak. There is a danger that immiseration, acute poverty, famine and environmental degradation will increase. This is in stark contrast to the industrialised world and a few developing countries which can look forward to growing prosperity in the 1990s.

Changes in National Systems

6. Growing economic adversity and political discontent in the 1980s led to an increasing search for improved national systems in most of the developing world as well as in Eastern Europe.

7. In parallel with these developments and inextricably linked to them have been changes in political perceptions. There has been growing appreciation of good governance, based on democracy and pluralism, sound administration, the rule of law, protection of human rights and decentralisation in decision making.

8. Wide-ranging reforms have been adopted, which on the economic side have been directed towards more open, flexible and market oriented policy stances.

9. The relationship between governance and development is complex. But it is apparent that diverse inputs are needed for development to be sustained. This diversity is facilitated by good governance, although there is no universally valid prescriptive model.

10. During the 1980s, despite their growing poverty and weakening human resources, many developing countries adopted measures conducive to good governance. But sound policies are not sufficient by themselves. Without adequate external assistance, national efforts will not succeed over any reasonable time period. There is need for greater technical and financial co- operation and a reformed international system.

The International System

11. The establishment of the United Nations and the Bretton Woods institutions were major landmarks. But the current system is inadequate to cope with the new realities of international relations.

12. Increased interdependence carries a necessary surrender of national freedom of action and recognition that many economic and other benefits can only be obtained and harmful effects avoided through closer cooperation. Better structured international institutions and mechanisms, including an emphasis on consensus building, can help the process.

13. The ending of the Cold War provides new systemic opportunities for this as well as new challenges. The United Nations can, for example, promote a more comprehensive concept of security that takes into account economic and social development, environmental change, human rights and migration.

14. In the economic sphere a widening gap has emerged between the practices of the IMF, World Bank and GATT and the evolving global management needs. The major industrial countries established small groups for increased consultation and co-ordination. But their successes have been limited. Of great concern to developing countries has been

the inadequate attention paid to the international implications of the major economies' national policies. The IMF can play an important role in rectifying this through enhanced surveillance, for example in ensuring that adjustment is symmetrical. There is in addition need to ensure better provision of safety nets and compensatory mechanisms for countries whose economies are particularly vulnerable to external shocks, for example to marked increases in energy prices.

15. The economies of most developing countries remain very vulnerable to exogenous shocks. These can be particularly severe in the case of commodities, whose prices show inherent instability. The present arrangements to provide compensatory finance in respect of sharp falls in receipts from commodity exports and sharp rises in costs of cereal and petroleum imports should be strengthened. There is a need to strengthen the IMF's Compensatory and Contingency Financing Facility.

16. To help solve the commodity problem rather than merely alleviate it, greater support should be given to measures aimed at diversification and commodity development. New arrangements are needed to compensate debt-distressed low-income countries from the impact of sharp increases in short-term interest rates.

17. Among developing countries, there is concern that the international system fails to support adjustment in a longer time period and a more growth-oriented framework. The system's ability to meet the needs of development finance is also being increasingly questioned. The capacity of multilateral financial institutions should be enhanced and bilateral ODA expanded to remedy this. There is also concern regarding global liquidity. Against a background where commercial banks remain reluctant to lend, there is case for increased liquidity to facilitate development through a further allocation of Special Drawing Rights or an increase in IMF quotas.

18. The trade and other links that draw countries together have dramatically changed, and require a strengthening of the GATT, not least to administer effectively the results of the Uruguay Round.

19. A particular Commonwealth concern is the vulnerability of small states. The international community has a moral obligation to develop mechanisms which would respond speedily to requests from those under economic or other threat.

Human Resources

20. Much greater investment in education and training will be required if developing countries are to benefit from recent technological changes.

Investment is becoming increasingly oriented towards new and sometimes more complex technologies whose absorption requires skilled labour. Almost all developing countries need more scientists and technologists, both to develop indigenous technologies and to adapt imported ones. A more technologically-oriented education curriculum can help.

21. The global population is still expanding too fast; only well into the next century will there be a significant drop in the size of annual increases unless there is some cataclysmic event such as an AIDS pandemic. More than three-quarters of the world's population live in developing countries and the proportion is still increasing. If the needs and aspirations of these countries are to be met, population growth will have to fall substantially. That, in turn, will depend inter alia on increased access to family planning services and improvements in education, health, women's position in society and economic progress itself.

22. The emigration of the most able and enterprising deprives many societies, particularly those in developing countries, of some of their most valuable human resources, and considerably constrains their development. Renewed efforts are needed to reduce the brain drain by voluntary means. An increasingly distressing phenomenon of the 1980s and early 1990s has been the marked rise in refugees of all kinds—economic, political and environmental. These have been especially apparent in the transborder movements of Africa and Asia. A multifaceted approach is needed, rooted in measures to alleviate poverty and environmental degradation, and mechanisms to reconcile differences based on ethnic or religious groupings and political ideologies.

Finance

23. The 1980s ended with the developing countries receiving significantly less external funds than at the beginning of the decade. Some were making large transfers to major industrial countries at the very time when they themselves required more finance.

24. With the end of the Cold War, and economic liberalisation, the Soviet Union and Eastern Europe have emerged as new claimants on global savings. There are also new needs arising such as from reconstruction in the Gulf.

25. The high priority given to monetary policies in the fight against inflation, combined with the accentuated global imbalance between the supply of and demand for savings, implies that interest rates are likely to remain high. This will increase the debt-servicing burden of developing countries. These countries will also probably continue to have difficulty

in attracting private funds, for which they are likely to face increased competition from Eastern Europe and as a result of German unification. The likely diversion of official and private flows not only to Eastern Europe and the Soviet Union but also to the Middle East is another cause for concern in many developing countries.

26. A reduction in defence expenditure in the industrial countries could however lead to increased assistance for developing countries, although there are many competing claims on any peace dividend. There is also considerable scope for a reduction in military expenditure in the developing countries themselves, particularly if restraint is shown by the armaments' exporters. This would release resources for development.

27. A substantial part of the additional resources which developing countries need can be found through improved domestic resource mobilisation. This requires appropriate macro-economic policies.

28. The international community should help by more effective measures to cope with the predicament of many debtor countries. Despite the relief introduced so far, the debt problem is worsening. While the Brady initiative may be bringing some middle-income countries nearer to restoring access to spontaneous capital flows, its overall impact remains limited. As for the official bilateral debt of low-income debt-distressed countries undertaking adjustment, the Toronto terms have brought only limited relief, although this has been increased in respect of those countries whose creditors have written off their debt. The Trinidad and Tobago terms, which seek to provide more substantial relief for these countries, should be adopted by the Paris Club creditors. There is also need to take action in regard to multilateral debt, which presents special problems. Approaches to debt should be comprehensive and governed by equitable burden- sharing between official and commercial creditors. One way of assisting all debtor countries with liquidity problems could be through an allocation of Special Drawing Rights or an increase in IMF quotas.

29. The decline in real net transfers to developing countries in the 1980s was due to the sharp contraction of private flows. While there has been some revival in such flows, it has been concentrated in a few countries. Wide-ranging action on several fronts is required to increase the number of countries able to attract private flows. Special efforts are needed to encourage repatriation of flight capital and remittances from migrants.

30. Given the political will, it should be possible for all developed countries to reach the agreed UN target for official development assistance of 0.7 per cent of GNP within a specified time frame. There is also need for greater transfers through grants and for a significant

increase in food aid. More effective use of official development assistance and further untying of commitments and relaxation of procurement procedures are highly desirable.

Trade

31. While the 1980s saw impressive growth in the total volume of merchandise trade, serious trading problems were encountered by many countries. Large parts of the developing world shared little in the growth.

32. Among the new elements affecting international trade were the increased globalisation of production caused by technological progress, the facilitation of foreign investment and greater corporate concentration; the pursuit of more outward-oriented policies by many developing countries; an acceleration of structural change; and the heightening concerns about the environment.

33. The policy response was seen in the increasing recourse to managed trade, to unilateralism and to regionalism. Multilateralism, as epitomised by GATT rules, came under increasing threat with grave consequences for the international economic system.

34. An improved environment will be required if international trade is to expand at a satisfactory pace and if all countries are to share in its benefits. Two elements are crucial: more open markets; and a stricter adherence to multilaterally agreed rules based on universally accepted principles of transparency and non-discrimination. If these criteria are to be fulfilled, it is essential that the Uruguay Round of multilateral trade negotiations is brought to a successful early conclusion. At present it is still in danger. A major hurdle is the agricultural stand-off between the United States and the European Community, whose resolution will depend in large measure on the timing and outcome of the EC's moves to reform its common agricultural policy. Substantive and balanced agreements are also needed on a number of other core issues such as textiles and clothing, safeguards and subsidies.

Technology Development and Transfer

35. Technological progress accelerated in the 1980s. While this occurred on a broad front, the effects of microelectronics, telecommunications and data-processing technologies were particularly pervasive, being both distinct and synergetic. Certain other new technologies are expected to have a similar impact in future years. They include biotechnology in agriculture, healthcare, energy, and the environment; new materials such as fibre-optics, special plastics, hardened ceramics and composite

materials; and new sources of energy based on renewable resources such as the sun.

36. The overall impact of these advanced technologies on economic growth and development has been very positive. However, adjustment in some countries and among some groups and making use of the benefits continue to pose problems. Restructuring and retraining are therefore crucial elements in the management of technological change, as is the building of indigenous technological capacity. To the extent that economies have successfully adopted new technologies, their output has increased and their international competitive positions have improved. For countries which are economically less developed, technological change has usually been more difficult to accommodate and manage. On the other hand, they can—and should—be assisted to adjust to these changes and thereby be in a position to take advantage of the new opportunities presented.

37. New technologies have already begun to affect the organisation of work. Within enterprises, former hierarchical structures are being replaced by more flexible group-based systems of operation. Most importantly, new technologies are already changing the international division of labour and influencing the pattern of world trade. They are increasing the tradeability of services and blurring the distinction between goods and services.

38. Mature technologies are also affecting developing countries in many ways, ranging from the production of goods to the use of energy. As developing countries industrialise, the latter will become increasingly important and means to increase their efficiency of energy transformation and utilisation should pay for themselves in reduced environmental and other costs of energy, whether imported or produced domestically.

39. A policy to enhance human resource development, especially education in the physical sciences, is now more crucial than ever to absorb technology and should be pursued assiduously.

Environment

40. All countries have contributed to the world's environmental problems, but their degree of responsibility varies considerably. In recent times, there have been profound changes in public perceptions of environmental issues which in many developed countries have moved high up the political agenda. But these countries have not yet succeeded in utilising resources in an environmentally sustainable way and thereby arresting environmental degradation. Their economic structures and lifestyles frequently have global implications—for example in the

threat of global warming caused mainly by fossil fuel consumption for industrialisation, transportation and other activities, and the depletion of the ozone layer through the use of chlorofluorocarbons. In the developing world, the effects are usually more local—soil erosion and desertification, caused by pressures on land resources and deforestation, for example—and have generally flowed from poverty. Rapid destruction of forests however has global implications as well as increasing emission of greenhouse gases and chlorofluorocarbons. Breaking this vicious interaction between poverty and environmental degradation will require major investments. Reducing the developed world's use of environmental resources will do likewise and will require fundamental changes in lifestyles as well.

41. Environmental problems have several dimensions and need to be tackled in a multifaceted manner. All countries need to intensify their efforts to deal with local environmental problems by integrating ecological considerations into economic policies and using economic instruments to promote sustainable development. Action at the national level alone is, however, insufficient. Some environmental problems pose a global threat to humanity, thereby underscoring the interdependence of nations and the growth of a strong mutuality of interest in sustainable development world-wide.

42. Although all nations have a common interest in safeguarding the future of the planet, there are serious differences between them on how global environmental problems should be treated. Agreement on this, and particularly on mechanisms for financing and facilitating technology transfer to help developing countries participate in the solutions, must be expedited. A consensus on burden-sharing in paying for the costs of environmental conservation will be essential in order to create the global partnership that is needed to secure humanity's common future. It is in the interest of the industrial countries to mobilise adequate financial resources to help developing countries achieve environmental and other developmental objectives, without imposing new forms of conditionality and diverting assistance from traditional development activities. The 1992 United Nations Conference on Environment and Development provides the international community with a unique opportunity for forging a global compact to meet the world's environmental challenges in a way that is consistent with development. The environment issue has the potential to catalyse a revival of multilateralism. It must not be allowed to become a source of North/South confrontation.

Conclusions, Recommendations and the Way Ahead

43. Certain salient points emerge from the above summary. They show that in the 1980s, political, economic and intellectual or philosophical

changes had profound effects on economic growth and on development—broadly defined. Many of these changes affected the external economic environment of developing countries; others their political/security position; all had repercussions on the patterns of global management and on the international economic system. Every change was in some way linked to every other. They emphasised not only the interdependence of nations and issues but the new dimensions to the mutuality of interest and commonality of concern between the North and the South. A global approach is needed in order to tackle them.

44. In the final chapter of the Report we present our main recommendations grouped according to whether they require action by the developing countries of the South, the developed countries of the North, or the world community in the international system. We conclude that they provide a formidable agenda whose consideration will require initial discussions both in specialised fora and intersectorally. Thereafter there is need to carry forward the process and endeavour to give it higher salience and enhanced support through exploring the possibility of a summit meeting, representative of a cross-section of the global community.

45. Our last recommendation is therefore that the Commonwealth should take the lead in bringing these issues to the attention of the international community. In doing so, it should emphasise the global approach needed to solve them and the universal interest of humanity in doing so, expeditiously and effectively. We briefly sketch out the way in which such a process might be started.

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.

Chapter 2

The Starting Point

2.1 The developing world started the 1990s against a backdrop of change that is likely to have a significant impact on the development process. But it also started the decade with problems of economic weakness and vulnerability flowing directly from the events of the 1980s.

The 1980s

2.2 The 1980s began with recession in the world economy. Growth was soon resumed in the developed countries and, overall, output in these countries grew on average by 3.1 per cent per year during that decade (see Table 2.1 overleaf).

2.3 In the developing world also, some countries achieved impressive economic growth during the 1980s. Output rose on average by 7.9 per cent per year in East Asia, and 5.3 per cent in South Asia. But growth was limited to a few countries. A dozen or so countries, populous ones such as China, India and Indonesia among them, experienced a significant increase in per capita incomes in the 1980s. But elsewhere the growth in output generally failed to keep pace with population growth, and per capita incomes fell. In 54 out of the 84 developing countries whose economic performance was monitored by the UN Department of International Economic and Social Affairs, per capita incomes fell in the 1980s; in 14, per capita incomes fell by over 35 per cent. Despite a few significant exceptions, in most countries of sub-Saharan Africa living standards fell to levels last seen in the 1960s; and those of millions of people in Latin America and the Caribbean are now lower than in the early 1970s. There was also continuing profound poverty in countries where per capita incomes grew (e.g. India, Bangladesh).

2.4 The seeds of this setback lay in the imbalances that emerged in the 1970s following the two oil price surges, and the build up of inflationary pressures in the developed countries. In the wake of the second oil price rise, the decision by major industrial countries, particularly the United States, to tighten monetary policy sharply as a means of fighting inflation pushed international interest rates sharply upward. (Dollar interest rates rose from 8.7 per cent in 1978 to 16.5 per cent in 1981.) This

Table 2.1
Real GDP Growth Prospects

	Real GDP Growth Rates			Real GDP Per Capita Growth Rates		
	1965-80	*1980-89*	*1990-2000**	*1965-80*	*1980-89*	*1990-2000**
Industrial countries	3.7	3.1	2.9	2.8	2.6	2.5
Developing countries	5.8	4.0	4.9	3.3	1.9	2.9
Sub-Saharan Africa	4.3	1.8	3.2	1.5	–1.4	0.5
Excluding Nigeria	3.9	2.4	3.3	1.0	–0.8	0.4
East Asia	7.3	7.9	6.7	5.0	6.4	5.3
Excluding China	7.7	6.4	6.8	5.1	4.3	5.2
South Asia	3.7	5.3	4.7	1.2	3.0	2.6
Excluding India	3.9	4.6	4.8	1.2	1.8	2.1
Eastern Europe	5.2	1.4	2.7	4.4	0.8	2.3
Middle East, North Africa & other Europe	6.3	3.5	4.0	3.9	1.0	1.7
Latin America & the Caribbean	6.1	1.7	3.8	3.4	–0.4	2.0
Excluding Brazil	4.7	0.8	3.9	2.0	–1.3	2.0
Memorandum						
Asian NIEa	9.7	8.6	6.4	7.5	7.1	5.5

* Forecast

a Includes Hong Kong, Korea, Singapore, and Taiwan (China).
Note: Aggregated using constant 1987 prices and exchange rates.

Source: World Bank, 'The Developing Countries and Global Economic Prospects, 1991'.

has had manifold consequences. Industrial country output and world trade stagnated and volumes shrank in 1982. The developing countries were suddenly confronted with an unprecedented deterioration in their economic environment: between 1980 and 1982, commodity prices fell by a quarter and export earnings collapsed by $ 100 billion (in current prices); and on top of this, the rise in interest rates increased the debt service burdens sharply. These events were to result in waning confidence among commercial creditors, whose reduction in lending precipitated the debt crisis.

2.5 Since then the external economic environment has remained unpropitious for the majority of developing countries. Interest rates continued to remain high, and by 1986 commodity prices, in real terms, fell to their lowest level since the Great Depression of the 1930s. Debt became a major obstacle to economic growth. Private flows fell sharply, with many countries experiencing net outflows. The need to service large amounts of debt, weak economic structures and inappropriate policies exposed many countries to difficulty. They were forced to undertake deflationary adjustments in order to generate the trade surpluses needed to service debt. Many of them experienced capital flight and the emergence of parallel markets in goods and foreign exchange. Per capita import levels fell drastically in many of these countries, further weakening their production base and their capacity for economic recovery and growth.

2.6 By the end of the 1980s, a large number of developing countries were thus caught up in acute economic difficulties. Many had experienced declines in gross investment per capita. Physical and human capital resources had suffered and malnutrition spread. Improvements in indicators such as life expectancy and infant mortality slowed down and in some countries even recorded an absolute deterioration. Educational and health programmes had been adversely affected by economic difficulty and by the need to cut sharply public expenditures as part of adjustment programmes. In some countries, structures of administration and governance, often already weak, had become fragile. While certain developing countries did make great progress during the 1980s, most saw the advances achieved in the 1960s and 1970s slow down or even reversed.

2.7 In some parts of the developing world civil wars and regional conflicts added to economic difficulties. In many areas, settled agriculture became impossible and infrastructure was grievously damaged. Military expenditure consumed an increasing share of public resources. Even if political stability returns, these countries will have to resume the task of development from a much weakened base.

2.8 The adoption and implementation of structural adjustment pro-

grammes by many developing countries in response to the events in the 1980s have not yet succeeded in making them materially stronger. The low level of development itself made it difficult for some of them to exploit the opportunities produced by the liberalised policies; material resources for the additional investment in infrastructure and human resources required to make use of the new opportunities were lacking. Inflation remains a persistent problem. In many countries, acute and increasing poverty and underdevelopment now constitute a major cause of social and political strain, and important obstacles to rational economic management. Business confidence, as viewed by internal and external investors, continues to be weak. External assistance has become crucial to much needed recovery.

Vulnerability

2.9 Despite the adjustment programmes, many developing countries were thus left at the end of the 1980s with a reduced capacity to withstand any further internal or external shocks. The events of the decade reduced the cushion several countries have had to withstand shocks of any kind. A drought now results in famine much more quickly and with greater severity, as countries operate with smaller reserves of food grains, weakened infrastructure, and reduced capacity to import. Marginal changes in external factors such as interest rates or in the price of imported energy or exported commodities now have a more significant impact than they had a decade ago. This increased vulnerability arises not only because of the changed domestic economic circumstances but also because many countries now have less access to external finance to provide cover for problems created by sudden changes in external or domestic circumstances. Because of the absence of cushioning resources, adverse changes in balance of payments now require immediate adjustment. This in turn damages prospects for sustainable economic growth, making it more difficult to achieve stability and confidence. The political and social turbulence that accompanies economic difficulty adds to these countries' vulnerability.

2.10 Although the Gulf crisis was in many senses a one-off event, its consequences came at a time when many developing countries had little capacity to withstand them. By contributing to the recession underway in some developed countries, the crisis further depressed global economic prospects. And it affected many developing countries more directly through higher oil import bills, a narrowing of export markets in the Middle East and loss of remittances from migrant workers. The World Bank estimates that the size of the external shock on all affected countries in 1991 is about $20 billion. The action taken so far through the international financial institutions has not fully offset these losses.

Bilateral aid has been significant, but very narrowly focused; and it may have been at the cost of some aid diversion (see Annex 2 on pp.150-156).

2.11 With the conclusion of the Gulf War, oil prices have returned to near pre-crisis levels, where they are likely to remain for some time. That has already improved the global economic outlook. But the losses already sustained impose deadweight costs on future economic growth.

Prospects for the 1990s

2.12 Given all these difficulties, the economic prospects for many developing countries in the 1990s are bleak. Even before the Gulf crisis, the World Bank projected, on the basis of best assumptions of policy improvement in industrial and developing countries and greater external assistance, per capita growth for sub-Saharan Africa at only 0.5 per cent per annum and for the severely-indebted middle-income countries at 2.0 per cent. For sub-Saharan Africa, it is expected that in the first half of the decade per capita incomes may remain largely stagnant and that the number of people in absolute poverty would increase further by the year 2000. By the end of the century, per capita incomes would still not have recovered to the levels of the early 1980s. The current downturn in the OECD countries and the effects of the Gulf crisis are likely to make this already grim picture worse. Low economic growth and high interest rates constitute a difficult global environment for development.

2.13 Yet not all is gloom in the developing world. Countries in East and South Asia are projected to increase per capita incomes by a significant margin, albeit at a slower rate than in the 1980s. Some individual countries in other regions are also expected to do well. But despite this favourable outlook for some, the overall prospects are sombre. Large countries such as China and India, and some others, which withstood the crisis in the 1980s and managed to increase per capita incomes, seem now to be less well placed to sustain growth. And there is little evidence to suggest that the large number of developing countries which experienced poor economic growth in the 1980s will do markedly better in the 1990s. The polarisation in growth seems set to continue. There is a danger that immiseration, environmental degradation, acute poverty and famine will increase in many countries and that most will fail to make significant progress towards prosperity. All this is in stark contrast to the industrial countries, which experienced substantial gains in per capita income during the 1980s and are set to experience further growth in the decade ahead. Despite the marked progress made by a few developing countries, in the world as a whole, the rich got richer, while the poor got poorer; and the unfolding prospects for the 1990s do not suggest a reversal of this trend.

2.14 Yet periods of great change present opportunities as well as problems. Governments, bankers and business leaders have innumerable preoccupations as they seek to come to terms with new and unanticipated political and economic issues. There is nevertheless a case for serious reconsideration of the problems and opportunities for development. We consider some specific areas for attention in the following chapters.

Chapter 3

Changes in National Systems

3.1 The nature and structure of national systems of government and economic organisation in most developing countries changed considerably during the course of the 1980s when two themes of debate tended to converge. One concerned the spreading recognition of the importance of good governance. The other concerned the circumstances conducive to effective development. By the end of the decade it was widely recognised that the qualities collectively known as 'good governance' were both desirable in themselves and usually crucial for effective development. In this chapter we review some of the changes which occurred, put them into historical context, and try to assess their impact on development.

Historical Context

3.2 During the immediate post-independence period and frequently well into the 1970s many developing countries shaped their political and economic structures so as to have a large degree of direction and control. Authoritarian, one-party states, often of a military composition, became commonplace in much of Latin America and Africa, and in large parts of Asia too. Many governments were inclined towards interventionist economic policies, with a large element of central planning, a prominent role for the public sector, and a development bias towards capital-intensive production, import-substitution and urban populations. Their use of market disciplines was correspondingly sparing.

3.3 However well-intentioned these policies may have been, it is a matter of record that for a variety of reasons, the political and economic systems they spawned often did not work well. Politically,

the hopes to which they gave rise were frequently disappointed, leading to disillusionment and a failure of governments to get popular backing for many of their measures. On the economic side the policies and structures which arose were in varying but often large measure the cause of slow growth and lack of balanced development in the countries concerned. They also proved unable to cope effectively with the deterioration in the external environment which accompanied the slower growth in the global economy, and the higher inflation that had already become apparent by the early 1970s and was to be exacerbated by the oil crises of 1973-74 and 1979-80. Their failure led not only to slower economic growth in the countries concerned but also to unsustainable deficits, both internally on the budgetary account and externally in the balance of payments position. The latter were exacerbated by large-scale capital flight and in many countries by widespread currency substitution, overvalued exchange rates and large underground economies in foreign exchange.

3.4 The official external assistance needed to accommodate these deficits was only forthcoming when accompanied by a commitment by the governments concerned to undertake structural adjustment policies and programmes. In line with the fundamental reappraisal of economic regimes in much of the developed world, where changes of governments in the United States, the United Kingdom and elsewhere led to greater use of market-oriented mechanisms and supply-side policies, the international financial institutions increasingly encouraged governments in the developing world to reorient their own economic policies and their countries' economic structures. The debt crisis of the early 1980s provided the catalyst for a basic reassessment of the kinds of economic philosophy developing country governments should follow.

3.5 Reform policies have been widely adopted and are being refined in the light of continuing assessment and historical and comparative experience. Market mechanisms have been given freer rein—not only for products (raising the relative prices of foodstuffs, for example) but for production factors as well (raising interest rates and reducing real wages in the public sector, for instance). Trade policy is becoming more outward looking and overvalued exchange rates have been realigned. Parastatals are being dismantled and other elements of the public sector have shrunk with the drive towards privatisation. Decentralisation has got underway and deregulation begun. Resources have been reallocated to secure a better balance between the public and the private sectors, between industry and agriculture, and between import-substituting activities and export-oriented ones.

3.6 In parallel with these changes in economic policies and structures, and inextricably linked to them, in terms both of cause and effect,

have been changes in political perceptions and forms of governance. There have been, in particular, lively debates on what constitutes good governance and the role of democracy as a necessary prerequisite for its implementation.

Governance, Pluralism and Democracy

3.7 The concept of good governance may be difficult to define but the experience of an increasing number of countries indicates that several related elements have been fundamental. They include a system of government able to give expression to democracy and pluralism; a public administration which is efficient, predictable, transparent and accountable; sanctity of the rule of law and security for individual citizens; and protection of human rights, civil and political, economic and social. A further element in the eyes of many is a certain degree of devolution or decentralisation, in recognition of the experience that the nearer to the grass roots it is possible to take certain kinds of political decision, the more likely they are to be conducive to the public good. The countries concerned have brought together these elements and others in an effective legal, political and economic framework within which political, social and economic activity have flourished. At the same time they have recognised the need to strengthen public institutions against excessive demands by particular or vested interests in society, and some of them have set up arrangements to safeguard the interests of the most vulnerable members of society.

3.8 Democracy is fundamental to pluralism. Its origins are too diverse to draw definitive conclusions on the preconditions needed to establish it, but we can suggest a number of conceptional elements necessary for its survival. One is obviously a respect for human rights of all kinds. Another is the development of political parties. A third is the guarantee of freedom of information. And a fourth is a policy to share available resources more equitably, with a view to eliminating poverty and deprivation. Such concepts are not peculiar to Western developed countries, societies and cultures. Most developing countries have had their own democratic traditions, values and norms at one level or another; and many of them returned to or were moving towards democracy before the more widely publicised change in political systems within Eastern Europe in recent years.

3.9 Throughout the world, democracy, like good government, has been brought into sharper focus in recent years. Besides renewed recognition of the importance of open systems of governance in the Third World, two developments have been particularly important. One is the largely peaceful revolution which has taken place in much of Eastern Europe, with representative government replacing single party,

communist governments. As we write, it remains possible that the Soviet Union may follow the same route. These events, linked with the collapse of the command economy model in the formerly communist countries and elsewhere, have aroused widespread interest. The other development, which surfaced around the same time and has become a centre of debate, is the belief of many donors that development assistance has a greater impact in countries where good government is respected. On the one hand, it has aroused fears of political conditionality; on the other, the force of the argument has been increasingly recognised.

3.10 But even in the absence of such external influences, the 1980s saw increasing recognition in developing countries that pluralism has a universal value and that civil and political liberties, freedom of expression, tolerance and respect for minorities, and the ultimate subordination of policy to the will of the people at large are good in themselves, independent of other objectives.

Governance and Development

3.11 The concept of development is an imprecise one. To some people it is almost synonymous with the diversification and growth of an economy. But here we mean something much wider, a concept which embraces political, social and human as well as economic development. We have in mind development of political pluralism, cultural values, and education and training, for example, as well as the ability to generate increased savings and investment needed to provide for higher material standards of living. And also within the economic sphere, the development of economic security through sustained development and the creation of safety net arrangements for the most poor and vulnerable.

3.12 The relationship between governance and development is complex and difficult to assess. The world's economies and societies have grown from very different historical and cultural roots. And they are at very different stages of development.

3.13 In the past, it appeared that authoritarian governments, without an active opposition, could perhaps promote development faster than more democratic systems. In a few countries this view remains valid, but in most it has proved illusory and the development it brought became unsustainable, largely because the governments concerned almost always became increasingly restrictive of the free flow of information and of human aspirations and initiatives.

3.14 At the same time, it has been increasingly obvious that excessive centralisation of decision-making inhibits the assumption of responsibility by individuals, the full reflection of their interests and the full use of local

knowledge and experience. Excessive regulation from the centre also stifles productive energies. There is a need to delegate economic decision-making as far as possible. Such themes parallel many of those developed in the good governance debate. These arguments find empirical support in the fact that countries in which governments have divested most of their production activities, have allowed market mechanisms to reign, and have developed dynamic private sectors, have fared better than those which have not.

3.15 Having said that, and while recognising that the current contraction of the public sector is appropriate for many developing countries, it is clear that governments and public sector enterprises continue to have an important economic and social role in all societies. Only governments can determine the broad policy framework in which an economy will operate; and they usually provide most of the basic infrastructure. Directly or indirectly, governments must provide at least the basic education, training and health services which are prerequisites in mobilising for development the energies of society at large, and thus making possible a broader based participation in economic activities and decision making. In addition governments generally have to play a substantial role in integrating economic and environmental decision making to bring the environmental impacts of any decision or action within a market framework. Only governments can set and maintain the characteristics of a stable policy environment which attracts private investment. And only governments can ensure that a truly competitive and ethical environment sets free the energies of individual entrepreneurs and workers. Finally, despite the increasing strength of the private sector in many developing countries, many projects and activities are still beyond its capacity. Help may be needed, for example, in securing investment or in developing export markets. In all such circumstances there will be a continuing role for governmental or parastatal initiative: public sector expenditure can stimulate growth and is complementary rather than competitive with private sector investment.

3.16 We conclude that in the present world environment, a diversity of inputs are needed for development to proceed and be sustained. This diversity can only occur in an environment committed to good governance and pluralism. It usually also requires an effective multiparty democracy. We believe all three are good for development, in so far as they help build the consensus needed to preserve political stability and encourage governments to formulate policies which reflect more closely the interests and needs of the people. There is, however, in our judgment, no single, universally valid prescriptive model. Rather, each society will need to evolve its own, dependent on its stage of development and values. In some countries this may require restructuring the form of government, from a unitary model to a federal or even a confederal one.

3.17 During the 1980s many developing country governments adopted political and economic policies which were much more conducive to good governance, pluralism and development than those of the 1970s. But as we have noted, the external environment in which they were trying to implement these policies was often more hostile than it had been in earlier decades. This adverse external situation had an immediate impact on the internal resource position as well.

3.18 Developing countries trying to instil good governance and pluralism into their societies in order to promote development therefore faced many problems. These are still continuing. Inadequate human resource development is one obvious example. Good governance demands efficient mechanisms to formulate socially equitable policies, to translate them into economic programmes and measures, and to carry them out effectively. All this requires educated and trained personnel. Small states and least developed countries face special human resource difficulties, but in most developing countries the sheer poverty of many of the people makes good governance difficult. In some of them the highly unequal distribution of income and wealth results in social imbalances and tensions which militate against democracy and development. Equally fundamental problems are faced in implementing political pluralism in societies whose cohesion is threatened by social, cultural or religious divisions, or by the scourge of drug trafficking (see Annex 3 on pp. 157-160).

3.19 Like development, the practice of good governance and pluralism therefore requires encouragement and support. National efforts and sound domestic policies are essential; but by themselves they are not sufficient. Without adequate external assistance these efforts will not succeed over any reasonable timescale, and disillusionment and reaction will follow.

3.20 In Eastern Europe, a good deal of assistance has already been given, mainly by the European Community but also by the international financial institutions, and the European Bank for Reconstruction and Development has been established to further the process. But there is equal need for all developed countries and for the international institutions, especially the United Nations, to show their concern for good governance and pluralism in developing countries by giving much greater assistance to them as well. This is all the more necessary in view of the setbacks to human resource development and institution building which many of these countries suffered in the 1980s.

3.21 The need is for greater technical cooperation (especially in human resource development), more financial cooperation (increased resource flows, debt relief etc.) and for a reformed global economic and political system. We consider issues related to the international system in the next

chapter. Here we merely note that while a broadly symbiotic relationship between good governance and development is apparent on prima facie grounds and cannot be overlooked, its precise nature in terms of cause and effect has yet to be established and there are examples where rapid development has occurred under fairly authoritarian regimes. Restraint is therefore called for in any further attempts to introduce political conditionality into aid distribution which is already highly politicised in some donor countries.

3.22 Finally, we note that while in this chapter we have said much about the need for good governance and greater democracy within countries, we must not let the opportunity pass of emphasising the need for movement towards a more democratic international system which would be more reflective of the interests and concerns of developing countries. In the next chapter we elaborate on the systemic issues involved in this, of the need for multilateralism and greater acknowledgement of the necessary dilution of sovereignty in an interdependent world.

Chapter 4

The International System

4.1 There is rightly an increasing emphasis on the importance of good governance in developing countries and a growing consensus on its components. However, there is a need for equal emphasis on what might be called 'global governance' or 'international governance'.

4.2 The establishment of the United Nations after the Second World War was a major landmark in world history; so was the establishment of the Bretton Woods institutions, and the various technical cooperation and assistance agencies within the aegis of the United Nations and other bodies. However imperfect these bodies may have been, they represented an unprecedented degree of international cooperation; and we believe there remains much in the international system that the world cannot afford to lose.

4.3 But we also recognise that an international system out of step with current realities and needs ill-serves the world; and an efficient international system is a public good that enhances the welfare of all. Yet individual countries pursuing their own national interests will not necessarily succeed in achieving the best international system. We believe that the new conjuncture in world political and economic relations reveals a critical need and presents an opportunity to improve the present international system.

Global Security

4.4 The development issue cannot be separated from the issue of global security and ways of promoting it. Peace is an essential pre-condition to prosperity; and prosperity tends to promote peace and stability.

For forty years the United Nations' achievements fell far short of the huge expectations originally envisaged for it. In particular, its role in the promotion of collective security was undermined by the East-West conflict. Nevertheless, the charter of the United Nations endured, and provided guidance for the international community in the search for global peace and security. The United Nations, as an institution, contributed to the political process of decolonisation; provided a means of conflict resolution and pioneered techniques of containment such as the use of peace-keeping forces; effected a conceptual and moral revolution in the defence of human rights; contributed to the development and extension of international law; developed mechanisms for the mobilisation of emergency relief for people in distress and of assistance for refugees; and provided a means of mobilising world concern and action on a range of global problems such as the environment and drug trafficking.

4.5 While this is an impressive record, peace remained fragile for much of that period. Conflicts and threats to national security were an ever menacing reality in many countries, particularly in the developing world.

4.6 Many reasons have been offered for this failure: institutional weaknesses and lack of leadership and political will are some. A basic problem, however, is that while the causes and effects of most major challenges are international, the authority for dealing with them remains vested with nation states. And major countries have been unwilling to see a dilution in their dominance of the international system. This puts the United Nations in an ambiguous role. Its effectiveness has been shown to be limited to cases of agreement among its major members—very rare until recently, now fortunately more numerous. The many countries not in the category of 'major members' have often felt sidelined and powerless.

4.7 The nature of conflict in the world has also been changing in such a way that the distinction between domestic and international conflicts is being increasingly blurred. Civil wars, terrorist campaigns and attacks on civil authorities by powerful groups receiving support from external sources have become frequent sources of instability. Religious passions know no boundaries. They often fall outside the primary scope of action envisaged by the founders of the United Nations.

4.8 The ending of the Cold War provides new opportunities as well as new challenges to the United Nations. By easing tensions it could lead to greater emphasis on multilateral bodies for problem-solving of all kinds, including security. The growth of multi-polarity could also support movement towards a more democratic decision-making process

which takes greater account of the 'public good' nature of an efficient international system.

4.9 Thus, at present, the international community has an opportunity to define better the role of the United Nations and make it a more effective instrument for problem-solving. The Security Council's role could be enhanced by making more use of it for consensus building, behind the scenes negotiations and opening up of and posing alternatives to parties in conflict. It could also serve a useful function by taking on new roles such as determining damage and compensation due as a result of conflicts. But this requires a greater recognition on the part of the world community that in an increasingly interdependent world, global—and regional—institutions have a greater role to play, at the expense of national freedom of action; and that strengthening the United Nations is in the best interests of all.

4.10 The United Nations could also enhance its security-promoting role through projecting in the international community a more comprehensive concept of security that takes into account economic and social development, environmental change, human rights and migration. It could undertake more forward-looking analyses in this respect and provide early warnings of impending threats to global security. It could also contribute to world security through greater capacity and involvement in the monitoring and verification of disarmament agreements and compliance with internationally agreed bans on the production of, and trade in, armaments.

Economic Issues

4.11 As in the political field, the world community has achieved much in the economic sphere in terms of putting in place global institutions for co-operation. The establishment of the IMF and the World Bank—and the GATT in place of the stillborn International Trade Organisation (ITO)—provided in the post war decades a remarkable degree of monetary stability and a framework for economic co-operation and trade liberalisation. These were to underpin a remarkable period of growth in output and trade.

4.12 The Bank and the Fund responded to changing needs through a number of developments: the establishment of IDA, the increased importance given to non-project lending, the creation of Special Drawing Rights, the establishment of the Compensatory Financing Facility, the two Oil Facilities, the Trust Fund and, later, the Structural Adjustment Facility and its enhanced version. The role of these two institutions in attempting to contain the debt crisis in the 1980s also reflects a similar responsiveness to a changing situation.

4.13 In international trade, although the institutional arrangements fell short of original expectations, the GATT was instrumental in achieving a more liberal approach to market access. It has not, however, been able to prevent spreading threats to multilateralism and growing pressures of protectionism which could undermine world trade expansion.

4.14 These efforts at monetary, financial and trade cooperation were supplemented by technical cooperation and programmes of technical assistance to developing countries. The development of new varieties of seeds which made possible the 'Green Revolution', the elimination of diseases such as smallpox, the establishment and growth of a multilateral food aid programme, the provision of technical assistance through the various UN and other international bodies were all examples of multilateralism. Many developing countries themselves played a significant part in this process.

4.15 These were substantial achievements. The global institutions underlying them need to be preserved, and indeed strengthened. We are concerned, however, that in recent years the spirit of cooperation and the commitment to multilateralism and the development objective—which underlay the post-War vision—have increasingly come under threat, and that at a time when global economic and political changes require increased, not diminishing, cooperation. While the institutions themselves have undergone much change, and have acquired much valuable experience, there is a widening gap between them and the management needs called for by the present global situation and problems. Global change has also given rise to a need for co-operation in areas in which the world had hitherto not developed adequate mechanisms. For example, the environment has become a major international issue affecting all countries. Increasingly, drug trafficking is having major health and social impacts in many countries, and in some it is threatening to undermine basic legal and political institutions (see Annex 3 on pp.157-160). We believe that the international system should be strengthened to meet these new needs. We review some possible measures below.

Money, Finance and Macro-economic Policy Co-ordination

4.16 In recent years, the increased interdependence of the world economy has been accompanied by a growing role for markets in the determination of major currency exchange rates and interest rates. Under the impact of technological change and the dismantling of controls on capital flows, financial transactions have increased immensely in importance. There has also been a growing interrelationship between monetary, financial and trade issues. Under these conditions, consistency and appropriate policy mixes between monetary, fiscal and other

instruments in major industrial countries have assumed a new importance, not only for the stability and growth of their own economies but for the world economy.

4.17 These countries responded by establishing groups such as the G5 and the G7, which have as their objective increased consultations and better coordination (see Box 4.1 on pp.40-41). We recognise that these groups—and the OECD—have acquired a salience in this regard and play a useful role. Through intensified consultations, the G7 has in recent years achieved a degree of monetary cooperation and exchange rate intervention; underpinned governments' resolve to implement micro-economic reforms and adjustment; and helped develop common stances to issues such as developing country debt, the environment, and changes in Eastern Europe.

4.18 It remains the case, however, that these powerful groups are prone to reflect the domestic concerns of their members even though the participation of the IMF Managing Director in the G7 meetings is meant to bring a wider perspective to its discussions. The absence of well established mechanisms to ensure follow-up action to commitments, and a monitoring of the policy actions within agreed time-frames and well specified targets also limits the value of these consultations. The present procedures largely rely on the application of peer pressure for follow-up action. Even in the proclaimed key areas of foreign exchange rate stability and interest rate policy, success in harmonisation has been clearly limited.

4.19 The developing countries have also responded to the evolving situation by establishing their own country groupings— such as the G24 and G15—though they have yet to acquire a comparable degree of organisation in cooperation and coordinating their affairs (see Box 4.2 on pp.42-43). There is no Third World Secretariat corresponding to that of the OECD although a modest South Centre has been established to serve the G15. The UNCTAD, which has been traditionally under Third World leadership, has to some extent fulfilled the role of a 'think-tank' for the developing countries. However, in recent years, its influence has declined. In this context, it is noteworthy that the Commonwealth straddles the North and the South and has been able to maintain the dialogue between its members from both groups of countries. It may be able to serve as a catalyst for change in the international system.

4.20 Notwithstanding the cooperation that has been achieved through intensified consultations in the industrial country forums, the international implications of national economic policies continue to receive inadequate attention. G7 countries have yet to give due consideration to the effects of their policies on the developing world. And the global

economic environment continues to be characterised by the risk of significant malfunction due to lack of sufficient coordination.

4.21 We believe that the IMF has a central role to play in this regard, through enhanced multilateral surveillance. It should, in particular, assume its intended role in ensuring that global adjustment is symmetrical, with surplus as well as deficit countries undertaking adjustment; and in promoting contra-cyclical policies in order to bring about more stable world economic conditions. This is in line with the mandate given to the IMF at Bretton Woods.

4.22 While improved multilateral surveillance and better coordination by the G7 should reduce the risks of a significant malfunctioning in the global economy, such risks cannot be eliminated altogether. It is clear that national circumstances and priorities will ultimately have a significant weight in the formulation of policy. Fiscal and monetary policies in the developed countries, through resulting high interest rates or unduly onerous claims on world savings, can have severely adverse external effects. In addition, shocks arise from other circumstances such as the impact of war on oil supplies, crop failures and natural disasters. What is necessary is to ensure an international system that provides adequate safety nets and compensatory assistance to countries to mitigate the effects of shocks.

4.23 International economic events tend to have a disproportionate effect on developing countries, arising from such circumstances as poorly diversified production and export structures, debt overhang, limited access to commercial finance and poor cushioning capacity to withstand shocks due to the low level of incomes. The objectives of the international system and national policies should be twofold: to reduce the propensity to shocks on the one hand, and to mitigate the vulnerability to shocks on the other. There is a need to provide safety-net arrangements for weaker countries so that the position of the world's absolute poor is not made worse by external cyclical downturns and shocks. Other than the Compensatory and Contingency Financing Facility (CCFF) of the IMF and the Stabex scheme of the European Community (limited to ACP and least developed countries), there are at present no significant standing mechanisms in place that provide support to developing countries in periods of downturn in world economic activity. But even the CCFF and Stabex have limited capacity to provide support. The CCFF has, over the years, lost its automaticity and become more conditional. We believe that it needs to be strengthened to meet the needs of member countries more adequately. There should be larger access under it; it should provide assistance on terms of less stringent conditionality, longer maturity and lower cost. It must emerge as an effective instrument for contra-cyclical financing with low conditionality.

Box 4.1

Economic Cooperation Among Major Industrial Countries

G5 and G7 Cooperation

The collapse of the Bretton Woods System and the Smithsonian Agreement, as well as the oil price shocks, posed new problems in the 1970s. Industrial countries were confronted with the phenomenon of stagflation: the coexistence of inflation and unemployment at higher levels than in previous years after the Second World War. The efforts of the Committee on the Reform of the International Monetary System and Related Issues (the Committee of Twenty) to build an alternative rule-based system did not bear fruit. However, as macro-economic problems became more acute, the major countries began to search for ways of consulting in limited fora. These issues occupied the attention of the Bonn Western Economic Summit (1978).

Since then, the institutional framework for cooperation among the major economies is based on the Annual Economic Summits and bi-annual meetings of Finance Ministers and Governors prior to the meetings of the Interim and Development Committees. Additional ad hoc meetings are held when the situation warrants it. The Tokyo Economic Summit (1986) requested the Group of Five Finance Ministers (Britain, France, Germany, Japan and the United States) to include Canada and Italy (making it into a group of seven) in their meetings on global economic and financial issues.

The emergence of significant imbalances among major industrial countries and growing concerns about the misalignment of exchange rates in the mid-1980s led to increased willingness on the part of these governments to coordinate their economic policies. However, translating this into substantive action at the national level has proved difficult and the commitment to macro-economic coordination has receded. Action remains spasmodic rather than continuous, with little or no monitoring of follow-up action to commitments. Economic cooperation has also relied too heavily on currency intervention.

Important developments include the following:

Plaza Agreement (September 1985): The G5 launched a coordinated programme to manage a soft drive down in the value of the US dollar so as to enable exchange rates to better reflect economic fundamentals.

Tokyo Summit (May 1986): It was decided that Finance Ministers of the G7 would work together more closely and meet more frequently between the annual economic summits. Ministers, in conjunction with the Managing Director of the IMF, would review their governments' national economic objectives and forecasts at least once a year, taking into account indicators such as GNP growth, inflation, interest rates, unemployment, fiscal deficit ratios, current account and trade balances, monetary growth, reserves and exchange rates.

Louvre Accord (February 1987): Finance Ministers of the G5 and Canada declared that the US dollar, which had fallen about 40 per cent from its 1985 peak, had declined enough. They agreed on steps to stabilise the dollar within a range, which they did not announce. Countries with external surpluses agreed to stimulate domestic investment and consumption so as to increase their absorption levels. The United States agreed to fiscal contraction to reduce its external deficit. Japan launched a major plan to recycle part of its surplus to developing countries during the following three years.

Toronto Summit (July 1988): The G7 reached a consensus on rescheduling the official debt of the poorest countries, particularly in sub-Saharan Africa. They also emphasized the undesirability of excessive fluctuation of exchange rates.

Houston Summit (July 1990): The G7 stressed the need to contain inflation and make further progress in adjusting their countries' external imbalances. Additionally, action was recommended to conclude successfully the Uruguay Round of trade negotiations by inter alia major agricultural policy reform. Commitments were made for global action to protect the environment. Longer repayment periods were urged for official debt of lower middle-income countries undertaking strong policy reforms. The G7 also called for increased aid for developing countries undertaking political and economic reforms.

BIS and OECD

Important operational cooperation among the central banks of the industrial countries and support for the stability of the international monetary system is achieved through the Bank for International Settlements (BIS), set up in 1930. Governors of Central Banks meet regularly at the BIS to coordinate international monetary policy and to ensure orderly conditions on international financial markets.

A broad-based form of cooperation among industrial countries takes place through the Organisation for Economic Cooperation and Development (OECD). The OECD Council meets annually at ministerial level, immediately prior to the G7 Summit, and examines economic policy requirements for individual members in the context of the interests of the OECD as a whole. The OECD also provides useful links between the major economies and trading blocs as well as among virtually all individual industrial countries. It has recently embarked on a dialogue with 'dynamic' Asian economies. There is also important functional cooperation on matters of interest to individual members and to the OECD as a group, which helps to identify areas for joint action and to formulate common positions on contentious issues. In addition, coordination of industrial country export credit subsidies is effected under the OECD aegis.

4.24 Petroleum is a significant component of the total imports of many developing countries, and fluctuations in petroleum prices tend to have a large impact on their balance of payments. The sharp rise in these prices at the start of the recent Gulf crisis illustrates the problem. The CCFF is temporarily (November 1990 to December 1991) covering petroleum. We propose that this coverage be made permanent.

4.25 There is a widespread concern among developing countries that because of financial constraints and an unstated preference for a short-leash approach on the part of creditor countries, the assistance available from multilateral financial institutions in support of stabilisation and

Box 4.2

Developing Country Fora

Like industrial countries, developing countries have also established their own fora. However, the progress made in cooperation and the degree of organisation in the coordination of their affairs has been limited. They also do not have a Secretariat analogous to that of the OECD.

The Group of Seventy-seven (G77)

The Group of 77 was set up in 1963 and given concrete organisational form at the end of the first United Nations Conference on Trade and Development (UNCTAD I) in 1964 when 77 developing countries decided to act together to promote their economic interests. Since then the Group has played a vital role in developing and coordinating the positions of developing countries on international economic issues; in presenting a united front at multilateral negotiations with the developed countries, particularly in the UN fora; and in promoting cooperation among themselves. Membership of the group has now grown to over 125.

The Group of Twenty-four (G24)

The Group of Twenty-four, formally known as the Intergovernmental Group of Twenty-four on International Monetary Affairs, was established following a decision by the Group of 77 in 1972. Its main objective is to review the international monetary and financial situation and assess developments in international relations in these areas, particularly as they affect the interests of developing countries. Members of the Group are drawn equally from Africa,

adjustment is cast in too short a time-frame, forcing them to rely more on demand management measures than on structural adjustment (see Box 4.3 on pp.44-45). The weaknesses of such an approach are being increasingly acknowledged. Forced adjustment necessitated by short-term balance of payments arithmetic and the resulting import compression renders it impossible to make the investment required for recovery and diversification of the economy; and it inflicts an unnecessary loss of output and pain on developing countries. The contraction in developing country markets also means significant losses to industrial country exports and employment. We consider that much of this could be avoided by enabling the international system to support

Asia and Latin America. The Group usually meets twice a year, at ministerial level, in advance of the meetings of the Interim and Development Committees of the IMF and the World Bank.

The Group of Fifteen (G15)

The establishment of a Summit-Level Group of Developing countries, also known as the Group of Fifteen, was announced at the Non-Aligned Summit in Belgrade in September 1989. It was envisaged that the Group would serve as a forum for regular consultations among developing countries and for formulating and monitoring the implementation of programmes of cooperation among them. Its major tasks would be to review the world economic situation and the state of international economic relations affecting developing countries, especially in critical areas such as development, debt, finance, money, trade, science and technology, and the environment; to suggest strategies which developing countries could use to cope with emerging challenges; and to propose initiatives that might be taken in South-South and South-North fora. The results of consultations within the Group would be made available to other developing countries at suitable fora such as the Non-Aligned Movement and the Group of 77. At its first Summit meeting in June 1990 in Kuala Lumpur, the Group agreed on a specific programme of action consisting of 12 projects to advance cooperation among themselves, and set out its views on several issues of current concern to developing countries.

In November 1990, a Technical Support Facility was established to assist the Group. The Group will hold annual Summits, the next being scheduled for Caracas, Venezuela, in June 1991.

Box 4.3

Structural Adjustment in Developing Countries: Main Features

Over 50 developing countries are currently undertaking structural adjustment programmes. These programmes are a response to protracted crises which have affected many developing countries, and are adopted at the instance of the Bank and the IMF. They entail two types of policy response. The stabilisation component of adjustment is designed to bring domestic absorption (consumption and investment) into line with available resources. If, as is often the case, the impetus for adjustment stems from an 'external shock', this involves reductions in domestic expenditure to levels which are commensurate with the lower level of external resources available. The structural reforms in adjustment programmes entail changes in relative prices and institutions designed to make economies more market oriented, and thereby generate sustainable long-term growth. They also aim to mobilise more domestic savings and promote investment.

Structural adjustment programmes typically include the following features:

Stabilisation Measures

- Monetary policies
  - positive real interest rates
  - increases in reserve ratios
  - more vigorous open market operations
  - credit controls (these are not favoured by the IMF)
- Re-alignment of the exchange rate to a near market-determined rate (depreciation)
- Reduction of budgetary deficits
  - increased revenue mobilisation efforts
  - reductions in expenditure, including cuts in subsidies
  - reviews of public investment priorities and identification of a core programme of investment
- Deregulation of administered prices

- Real wage restraint
  - removal of formal indexation arrangements

Structural reforms

- Promotion of private sector (domestic and foreign)
  - definitive political commitment
  - rapid improvement in infrastructure
  - improvement in regulatory regimes
  - facilitation of investment approval procedures
- Commercialisation of public enterprises
  - improvement in operational efficiency
  - privatisation programmes
- Financial sector reforms
  - movement to market-determined interest rates
  - capital market development, including promotion of stock exchanges
- Liberalisation of trade regime
  - removal of import and exchange controls and progress towards lower and less dispersed bands of tariffs
- Price flexibility
- Tax reforms
  - reduction of distortionary effects on resource allocation
  - increased elasticity of tax system
- Administrative reforms
  - reduction in size of public service
  - increased pay and pay differentials to attract and retain trained/technical staff
  - 'Safety net'
  - well-targeted programmes of transfers to vulnerable groups
  - training, credit and employment programmes for vulnerable groups.

adjustment in developing countries in a longer time-frame and in a more growth-oriented framework. But that would call for a change in the attitudes of creditor countries; they should be more willing to vest the multilateral institutions with greater financial resources, and increase aid flows.

4.26 Present arrangements regarding the creation and growth of global liquidity are also a matter of concern. Industrial countries have taken the view that the growth of international capital markets, and their ability to provide finance to creditworthy countries, obviates the need for any formal arrangement for liquidity creation; and that the creation of unconditional liquidity, such as through Special Drawing Rights, could be inflationary and undermine the discipline required for adjustment. Such a view, however, ignores on the one hand the uncertainties surrounding the operations of the current multiple currency reserve system and the fact that the growth of liquidity depends in part upon reserve currency countries' willingness to run balance of payments deficits; and on the other hand the fact that commercial banks have become increasingly risk-averse regarding sovereign lending. As a result, even some creditworthy developing countries are having difficulty in obtaining access to sufficient liquidity. This strengthens the case for providing international liquidity from official sources. A related issue in this context is the extent to which the use of national currencies as reserve assets may have weakened policy discipline and coordination in the major industrial countries.

4.27 We believe that there is a case for examining these issues more fully; and for strengthening the role of Special Drawing Rights, both as a reserve asset and in providing liquidity during difficult times for the world economy. There have recently been rapid shifts in the surpluses of traditional surplus countries as a result of political events such as the Gulf war and German unification, which also call for new instruments of global management and sources of liquidity.

4.28 The increased weight of funds from capital markets in global financial flows also raises several systemic questions. Exchange and interest rates are now influenced as much by transactions on the capital account as on the trade account; and, often, restrictive trade practices are encouraged by such market-determined capital movements. The IMF, as it operates at present, is ill-equipped to deal with this situation. We believe that greater coordination of policy, including a more integrated approach to trade and monetary questions, is needed.

4.29 There was also a sharp increase in foreign direct investment in the 1980s. Much of it was driven by technological change and globalisation of production and markets, and it was concentrated in the triad of the United States, European Community and Japan. It meant that, in

effect, technological progress is causing economic performance among nations and regions to diverge further. While it is helping significantly to increase productivity and open up new opportunities for trade, it is also affecting the balance of competition. New disciplines and rules on capital flows and technology transfers are under consideration in the GATT and elsewhere. We believe that the international system should be strengthened to deal with these new challenges. (We discuss issues related to the international trading system in paras.4.32-4.35.)

4.30 The recent experience of developing countries raises serious doubts about their ability to attract the kind of capital flows required for financing their development. The balance of payments positions of traditional surplus countries are undergoing a major change, and many new claimants on global savings are fast emerging. Under these conditions, the ability of the international system to meet the needs of development finance on a stable and long-term basis is coming into question. We believe that steps are needed to improve the international system in this regard. One way by which this could be achieved is to enhance the capacity of the multilateral financial institutions—the World Bank and the regional development banks —in the provision of development finance through larger capital increases and replenishment of concessional resources; another is to expand bilateral official development assistance. These two approaches are, of course, by no means exclusive and in practice both should be pursued. We believe that both the industrial and the developing countries could also do much more to promote private capital flows to developing countries. (We discuss some possible measures in Chapter 6.)

4.31 Over recent years, there has been a growing overlap in the activities of the IMF and the World Bank, with the Fund increasingly tying its credits to structural adjustment reforms and the Bank paying more attention to balance of payments financing needs. To some extent this is inevitable. But it has brought fears of cross-conditionality; and because of the differences in the two institutions' mandates, operational time-frames and areas of competence, negotiation and implemention of programmes have become more complex. The Bank and the Fund have sought to strengthen their collaboration and settle their differences by the establishment of conflict resolution mechanisms. We believe, however, that there is need for further clarity in this area; and that the distinct character and independence of the two institutions should be maintained. A re-invigoration of the Fund's role in multilateral surveillance—particularly of major currency countries—would also help to delineate their respective roles more clearly.

Trade

4.32 The international trade, financial and technological links that now draw countries more closely together have dramatically changed the policy context for governments, multilateral agencies and transnational corporations. For many reasons, the member countries have constrained the extent to which the GATT can respond to the increasingly rapid process of change in the international economy. GATT's credibility has also been undermined since the early 1970s as its inability to deal with what came to be known as the new protectionism became increasingly apparent. The Tokyo Round Codes have helped in addressing a number of problems arising from change. But they apply only among signatory countries and membership varies from code to code. The fragmentation thus introduced has moved the GATT system away from its fundamental principle of multilateralism. Moreover, as structured, the system could not also address the strains in international trading conditions which arose during the 1980s from the significant expansion in foreign investment flows and from the rapid pace of technological change.

4.33 Given all the changes, what was required was a significant strengthening of the GATT to enable it to deal with what was, in effect, an erosion of its authority, to tackle the new protectionism, and to address the issues relating to foreign investment, technology, intellectual property rights, and services. As a result, several systemic issues, including the functioning of the GATT system, were included in the Uruguay Round of multilateral trade negotiations. We welcome the progress made so far in this area. Instituting a Trade Policy Review Mechanism, agreeing on biennial ministerial meetings and improving the dispute settlement procedures are very worthwhile developments. But achieving a fundamental improvement "in the overall effectiveness and decision-making of the GATT system", as envisaged in the Punta del Este Declaration launching the Round, will require much further progress. Completion of substantive agreements on services and trade-related aspects of intellectual property rights would also raise complex questions, institutional and other.

4.34 In order to administer the Uruguay Round agreements effectively and strengthen the institutional framework for the international trading system, some governments have proposed the establishment of a World Trade Organisation. Most developing countries, however, would prefer consideration to be given to the establishment of a development-oriented international trade organisation to deal both with trade liberalisation and with other issues having a bearing on trade and development, such as restrictive business practices, transfer of technology, trade financing, and the inter-relationships between the international monetary, financial and trading systems.

4.35 We believe that further strengthening of the institutional framework of the multilateral trading system is essential for several reasons, not least to administer the Uruguay Round agreements effectively, particularly the new issues (see paras. 7.45-46). A stronger institutional base would also help a trade organisation to increase its contribution towards achieving greater coherence in global economic policy-making through strengthening its relationship with the international organisations responsible for monetary and financial matters. There is a need to address these important institutional issues also.

Small Developing Countries

4.36 A particular concern of the Commonwealth is the vulnerability of small states. The growing interdependence of the world economy, the continuing absence of an established collective security system at the United Nations, and the escalation of regional, ethnic, religious and other conflicts which the world has witnessed in recent years, have continued to expose these states to great risks. We consider that the international system has not yet adequately responded to their needs.

4.37 Small states are particularly vulnerable to security threats. In recent years these threats have included open aggression, as well as destabilisation caused by terrorism and attacks supported by outside groups. The international community has an obligation to develop mechanisms to respond speedily to the requests of small states under threat. We believe that there is a special role for the UN Secretary-General in this regard. As a Commonwealth Consultative Group recommended some years ago, in cases of incipient and low-level security threats the Secretary-General should respond positively by sending missions to the concerned states at their request.[1] The Secretary-General should also regularly monitor developments in relation to the security of small states and forewarn of any possible dangers.

4.38 We consider that the establishment of new norms of conduct and a new order which provides security to smaller nations and supports their sovereignty is vital if security and defence concerns are not to pre-empt concerns about development.

4.39 The international system should also take into account the particular economic vulnerabilities of small states. These arise from the larger role of trade in their economies, and the dependence on a small number of activities in economic production. Their primary

[1] See Report of a Commonwealth Consultative Group, 'Vulnerability: Small States in Global Society', Commonwealth Secretariat, 1985.

products export sector is sometimes dominated by one or two powerful transnational corporations. In many instances, migrants' earnings and other invisible flows form a large part of the national economy. The small size of domestic markets deprives them of the advantages of economies of scale, and their frequently narrow resource base makes diversification difficult. Natural disasters are harder to cope with in small states. Such states also have a smaller reservoir of administrative and technically trained personnel compared with larger countries, making management of the economy that much more difficult.

4.40 We believe that the multilateral financial institutions should pay special attention to these particular vulnerabilities. They should do so in the provision of assistance under facilities such as the IMF's Compensatory and Contingency Financing Facility; in the design of adjustment programmes; by adopting more flexible criteria in graduating the small states from concessional funding facilities (such as the IMF's Enhanced Structural Adjustment Facility, or IDA); and by improving access to their resources. Special efforts should also be made to strengthen the disaster preparedness of the small states, and put in place mechanisms for the provision of international help in a predictable and speedy manner. Small states should consider pooling their administrative, research, and negotiating resources through regional arrangements to overcome the shortages in these resources.

Sovereignty

4.41 The increased political, economic and technological interdependence which we have stressed earlier in this Report, carries with it a necessary surrender of national freedom of action.

4.42 In many countries, particularly in the developed world, there is now a widespread appreciation of the need to co-ordinate economic policy; there is also a wide recognition that integration within regional groups brings benefits which outweigh the resultant constraints to independent action, even though within some of them it has produced very real political and economic tensions. In other countries there has been a sense that the weaker members of a group have been obliged to give up a greater degree of freedom of action than their stronger partners. There is, in particular, a feeling in many developing countries that the international financial institutions have intruded into domestic policy-making; and that in practice these institutions no longer exercise effective surveillance over the policies of industrial countries which impinge on the developing world. Whether right or wrong, such feelings tend to undermine the credibility of these institutions; and adversely affect the follow-up action agreed in global forums. Yet it remains the case that in an increasingly interdependent world many

economic and other benefits can only be obtained and harmful effects avoided through closer integration and the surrender of some freedom of action. Better structured international institutions and mechanisms can help individual countries to come to terms more willingly with the need for closer integration.

4.43 In this context we believe that the world community should explore the scope for strengthening the role of the United Nations, which remains a pivotal global institution. It is also important to restore to the IMF, in matters that affect the world economy as a whole, some of the influence it has lost to groups like the G5, G7 and G10; and to preserve the relative position of developing countries in the decision-making bodies of the IMF and the World Bank (see Annex 4 on pp. 161-166).

4.44 Where possible, emphasis on consensus-building would also enhance the sense of wider participation in global management. A particular case in point is the design and monitoring of Bank and Fund adjustment programmes, whose implementation has tended to suffer from perceptions of real or imagined unfairness. We believe that the full confidence of the political authorities implementing the programmes is critical to success; and it could be greatly enhanced by exploring ways of reaching decisions more by genuine consensus. We see merit in the suggestion that associating independent experts in technical analyses and monitoring of implementation could assist the process of consensus-building. In this context, we see a role for an independent Institute, or possibly the strengthening of an existing institution, whose focus would be on providing policy-oriented technical support, and on bridging the gap in negotiations and implementation between the adjusting countries and the Bretton Woods institutions.

Solutions for New Issues

4.45 There is an increasingly urgent need to find international solutions for new issues, ranging from drugs, through the environment, to democracy; and for others, like trade, where there seems to be a consensus that more international authority is necessary to enforce and supervise agreements. The international community therefore has to find an enduring and well specified mechanism to raise new issues, and then to negotiate new international agreements.

4.46 One area to explore is the possibility of a greater role for regional organisations, not merely to realise the advantages in trade or payments that have been traditionally perceived as their main raison d'etre, but to provide a way of adequately representing the smaller and weaker countries within the international system, and mediating between them and the larger and stronger countries. Such organisations could also

have a role in the environmental regulation needed among neighbouring countries. This could prove one way of effectively promoting regional organisations which could later take a more active role at a global level.

4.47 The principal need is to find an enduring framework within which countries can identify new needs for international cooperation or regulation, whether because of the emergence of new or newly-realised subjects, as in the case of the environment, or dissatisfaction with the present forums, as in some of the monetary, finance and trade areas. The moves in this direction that have occurred, by using adaptations of present organisations, like the Global Environment Facility or the new Trade Policy Review Mechanism of the GATT, show that countries at all levels of development do agree on some of the new problems, and also on the need for intervention. The present international system, which dates largely from the then revolutionary innovations and surrenders of sovereignty of the 1940s, needs to be reinvigorated in order to enable it to respond to new issues.

Chapter 5

Human Resources

5.1 All forms of development are—or should be—aimed at satisfying human needs and wants. But human beings are not only the recipients of development; they are of course the creators of it as well. Only people can identify economic and social opportunities and organise activities in such a way as to satisfy human needs and desires.

5.2 Human resource development is therefore fundamental to economic and social progress. Certain basic levels of health, nutrition, shelter, education and training are prerequisites for starting development, and a certain degree of improvement in each of them is necessary for sustaining it. The relationship between the four elements and development is however a symbiotic one, as it is between each of them and population growth.

5.3 This has always been the case. What is new, and the reason for having a chapter on human resources in this Report, are three major developments. The first is the accelerating pace of technological change and, accompanying it, the increasing importance of knowledge-based activities in the development process, thereby putting a premium on education and training. The second is the growing pressure of population on resources, which draws attention to the importance of population policies, not only in relation to health, nutrition and shelter but to the whole concept of sustainable development. And the third is the changing nature of international migration. Here the main features are the diminishing opportunities, especially among the unskilled of developing countries, for movement from the South to the North, and the increasing amount of transborder migration, especially of economic, political and environmental refugees in Africa. Both draw attention to the

need for balanced development in all countries. What governments have to recognise is that societies which use their human resources effectively can establish a virtuous circle, retaining people with vital skills, permitting sustainable development and enabling the satisfaction of human needs.

Population

5.4 There was some optimism in the mid-1980s that the rate of growth of the world's population was slowing, as birth rates continued to fall faster than death rates in every region except Africa and South Asia (see Annex 5 on pp.167-171). However the demographic position now looks less optimistic, as progress in reducing birth rates has been slower than expected. Revised projections by the United Nations now indicate a world population of 6,251 million by the year 2000, compared with its 1986 projections of 6,122 million (see Box 5.1 below). Only well into the next century will there be any significant drop in the size of annual increases unless there is some cataclysmic event such as an AIDS pandemic (see para. 5.7).

5.5 These global figures obscure significant and growing divergences at a more disaggregated level. During 1985-90, for example, the population

Box 5.1

Demographic Indicators

World population, which rose from 2,515 million in 1950 to 4,854 million in 1985, is projected to reach 6,251 million in the year 2000 and 8,467 million in 2025. Its average annual growth accelerated from 1.8 per cent in 1950-55 to 2.1 per cent in 1965- 70, due largely to a fall in the death rate from 20 per 1,000 people in 1950-55 to 13 per 1,000 in 1965-70. A sharp decline in fertility in the 1970s led to a marked decrease in the birth rate, and population growth slackened to one and three-quarters per cent. In the 1980s population growth is estimated to have fluctuated around this same rate as a result of a slow-down in the decline of both the birth and the death rates (see Annex Table 5.1 on p.168).

While population growth rates were static or declining in other regions, the rate in Africa continued to increase during the 1980s, to an estimated 3 per cent per annum in 1985-90. But it should trend downward soon, as fertility and birth rates, though still high, have declined for some 20 years.

growth rate of developed countries was under a quarter of that of developing countries, a much greater differential than thirty years earlier. But whereas in the 1950s and 1960s the population growth rate among developing country regions diverged only narrowly, it now does so much more widely. These disparities may increase still further in the 1990s. Birth and fertility rates have fallen markedly in Asia and Latin America, whereas in Africa they have declined only marginally. With mortality rates falling significantly, population growth in Africa accelerated almost throughout the 1980s, in contrast to that in Asia and Latin America.

5.6 These demographic divergences result from many factors, health, nutrition and education among them. The net result, however, is that population pressures on resources are still impairing economic growth and the prospects for development in most developing countries. These pressures may be apparent even where populations are not in themselves large; for if a country's area is very small, as in micro states, the people:land ratio can still be high. Similar pressures occur in countries where much of the land is unsuitable for human habitation or where the hinterland is very inaccessible. All these situations make the attainment of development more difficult. They are a major cause of poverty, especially among large families whose children are particularly vulnerable. They are also of increasing environmental concern, challenging as they do hopes of sustainable development. And they can increase social and ethnic tensions.

5.7 Future trends in fertility, birth and death rates, and therefore in population growth, will be affected by many factors which are not easy to predict. But in a scenario where most rates are slowing down, one—mortality - may rise in at least some countries for a while. In a recent study the WHO estimated that during the next 10 years some 8 to 10 million people globally will contract HIV, which causes AIDS. The study also showed the alarming spread of HIV among women and children in sub-Saharan Africa and Asia, predicting that life expectancy in many sub-Saharan cities might fall by about six years. Infant and child mortality could be as much as 30 per cent greater than would otherwise have been expected. Adult mortality rates are also expected to rise. Developing countries will continue to need assistance in dealing with the problem, particularly as regards education and the taking of preventive measures.

5.8 In broad terms, even at reduced rates of growth the global population is likely to double before the middle of the next century. More than three-quarters of the world's people live in developing countries; the proportion will be still higher by 2050 as some 95 per cent of the increase in population now occurs in the Third World. If

the needs and aspirations of the peoples of the developing world are to be met, economic activity overall will have to grow very much faster than at present. And if the global environment is to be protected this massive increase must be achieved by sustainable rather than exploitative development.

5.9 Another aspect of the population issue which is presenting a variety of problems and pressures on resources is the changing age structure. This is affecting the balance between the proportion of the population of working age (15-64 years) and that which is dependent (viz. children and the elderly). It has profound implications for mobilising savings and for resource allocation: for example the provisions necessary to meet the needs of each group, and how best to develop and utilise the human capital potential of the working population. In developed countries, the continuing low fertility and birth rates have meant that the proportion of younger people is declining while that of the elderly (aged 60 or over) has risen. It has also risen in developing countries, but far less markedly and from a much lower base. In these countries it is the increase in size of the youth population which is expected to continue to put pressure on jobs, housing, education and training establishments, health facilities etc., as well as intensifying the trend towards urbanisation.

5.10 The world's resources are not infinite and eventually an almost stationary population may be essential even to sustain life, let alone achieve and maintain a tolerable standard of living. Population policies and programmes are required. We know these face cultural, religious and social inhibitions. But they are necessary if humanity is to have any chance of lifting the poor of the developing world out of their present deprivation. The need to control fertility is clear. The desire to do so is also apparent, at least among some of those most involved. In 23 out of 38 developing countries covered by the UN's World Fertility Survey, more than a quarter of the women had larger families than they desired and up to half of those aged 40 to 49 years had not wanted their last birth. The proportion of unwanted births was 10 to 20 per cent overall. Recognising the close link between population issues and socio-economic matters including education, health, the environment and perceptions about the role and status of women, we believe more action must be taken in this area.

5.11 We recommend that access to family planning services is increased and that information on them is made available to everyone who wants effective contraception. Allied to this is the need for improvements in other decisions which affect family size: education, health, and women's position in society. We deal with some of these below. Here we merely note that there is a strong correlation between the level of a mother's education and health and the degree of her political, economic and social

emancipation on the one hand, and the size of her family on the other. Finally, we should stress that effective population policies need to be fully integrated into economic development strategies.

Health and Nutrition

5.12 During the three decades to 1980 the average levels of health and nutrition in most developing countries improved markedly (see Box 5.2 on p.58). In developing countries as a whole, life expectancy at birth increased by two-fifths while the infant mortality rate was more than halved. As a result, and in contrast to the widening income gap, the North-South gap in life expectancy narrowed substantially. But once again, regional divergences widened. Improvements registered in much of Asia were not replicated in Africa. This growing differentiation is a development of the past 30 years. In the early 1950s, there was little difference in life expectancy rates between babies in South Asian and African countries. But African countries found improving the health of their people more difficult to achieve than did those in low income South Asia or in Latin America.

5.13 The 1980s saw some slackening of progress in health and nutrition indicators in an increasing number of developing countries, especially in Africa. In a few there was even retrogression. Between 1980 and 1988, life expectancy at birth declined in several countries while maternal mortality rates increased, sometimes sharply. In developed countries these indicators, already much better than in developing countries, improved still further. As regards nutrition, per capita dietary energy supplies in Africa fell during the first half of the decade, by which time over a quarter of the population was suffering from malnutrition despite increased food aid and commercial imports. And the situation has deteriorated further since. It is much less bleak in most of Asia and Latin America, although there has been some deterioration in one or two of the most debt-distressed countries. A new development is the increasing incidence of the HIV virus which causes AIDS. As has been noted, this is already having a dramatic impact on several developing countries. Besides the human suffering, it is placing a heavier burden on already weak health services. Drug dependence is having similar effects (see Annex 3 on pp.157-160).

5.14 There were many causes of these setbacks in the 1980s: political instability and civil strife, misguided and weak administrations, population growth, adverse weather conditions and environmental degradation were among the more important. But in addition the harsh necessities of economic adjustment programmes, which were often inadequately supported by external programmes. There were as a result swingeing cuts in already weak healthcare and nutritional programmes.

Box 5.2

Human Resource Indicators

Health and Nutrition

Between 1950-55 and 1975-80, proxy indicators for health in developing countries all showed marked improvements: life expectancy at birth increased by more than a third; infant mortality rates were nearly halved; and death rates were more than halved (see Annex Tables 5.1-5.3 on pp.168-169). In the 1980s, however, the improvement in health indicators slowed down, particularly in Africa. Comparing the first and second halves of the decade, for example, maternal mortality rates rose sharply in some countries, including Mauritius, Senegal, Zambia and Zimbabwe in Africa, and Haiti in the Caribbean.

Average levels of nutrition in developing countries had increased markedly in the 1960s and 1970s, more so in Asia and Africa than in Latin America (see Annex Table 5.4 on p.169). But again the improvement slowed down in the 1980s and in Africa there was retrogression. Towards the end of the decade it was estimated that 35 per cent of pre-school children in sub-Saharan Africa suffered from acute protein energy deficiency compared with 16 per cent in south Asia and 4 per cent in Latin America.

The lack of strong administrative structures made targeting the poor less effective. In some of the countries the effects on low income consumers were intensified by price decontrol and devaluation. But it must be recognised that in many cases the deterioration in health and nutrition indicators not only predated the adjustment programmes but could have been much worse under conditions where budgetary expenditures on social provisions were cut without any external support.

5.15 Moreover the generally discouraging picture of stagnation or even retrogression in health and nutrition during the 1980s has to be set against the continued progress achieved in some developing countries. Several of the most populous in Asia have made considerable progress towards overcoming population pressures and achieved significant improvements in health and nutrition. So have a few countries in Africa and Latin America. Their achievements show what can be done if lessons are learned and appropriate measures adopted.

Education and Training

For developing countries as a whole, enrolment rates at the primary school level rose from 75.9 per cent in 1960 to 94.9 per cent in 1980 (see Annex Table 5.5 on p.170). In Africa the rate increased from 42.3 to 79.5 per cent, in Asia from 84.9 to 96.7 per cent and in Latin America from 72.7 to 104.8 per cent. Enrolment rates at secondary and tertiary levels also rose in all regions but remained lowest in Africa.

In the 1980s, the increases in enrolment slowed down at all levels. Enrolment at primary schools declined for some years in Africa and between 1980 and 1987, it dropped by 7 per cent for males and 1 per cent for females. In certain countries, including Nigeria, Somalia and Tanzania, the fall was over 20 per cent. In Africa as a whole, the growth in secondary enrolment merely levelled off. But in over a dozen countries in Africa it fell in at least one year during the decade. A similar position was apparent, albeit at a much lower level of enrolment, in tertiary education; and in one African country enrolment at that level in 1987 was only a third of that in 1980. In several others, including Rwanda, Somalia, Sudan and Tanzania, adult literacy levels also fell.

Moreover, enrolment figures alone understate the deterioration. In recent years the falling quality of teaching staff, and poor equipment and teaching materials have resulted in lower standards of education among the enrolled.

5.16 This requires changed priorities, internal reorganisation, and greater external support. The first essential is to try to make sufficient food and medical supplies available. As far as food is concerned, the change in orientation of economic policies in many developing countries, especially in Africa, is now helping to increase the incentives to produce food; but actual output remains dependent also on the availability of associated inputs such as land, water and fertilizers, which in many cases is inadequate. It also depends on climatic factors and on an absence of civil strife. These two factors are in large measure the cause of the appalling nutritional situation in a few countries—notably Liberia, Ethiopia and Sudan. We believe the position there to be so desperate that renewed attention should urgently be given to enhancing the procedures under which emergency food relief is distributed, so that when stability is restored, adequate action can be taken immediately. This may also mean enlarging the capacity of the International Emergency Food Reserve and improving food stocking arrangements in developing countries.

5.17 As regards medical supplies, the stock of many developing countries' preventive facilities and of the basic medicines themselves badly needs replenishing. With seemingly ever rising populations and with the spectres of AIDS and drug use hanging over a growing number of countries, both will be needed in increasing amounts in the 1990s.

5.18 The second condition is that food and medicines should be affordable by the poor, either through their own earnings or through government programmes. We believe there is still a case for food and primary healthcare subsidy schemes provided they are targeted to the most needy groups—to households with pregnant women and children, for example, or to the poorest families. Alternatively, more food-for-work schemes can be introduced, with payments made in money or in kind to people employed in, say, building physical infrastructure for transport, irrigation, drainage, flood control, soil conservation and slum clearance. We also consider it important to enlarge the provision of food storage facilities and transport networks, so as to increase the capacity to carry stocks and distribute food efficiently.

Education and Training

5.19 In broad terms much was achieved in education and training within the developing world during the two or three decades up to 1980 (see Box 5.2 on p.58). Education enrolment rates and literacy levels rose markedly. Africa performed particularly well and by 1980 its overall enrolment rate at primary school level was approaching that of Asia, indicative that literacy is not merely a by-product of economic development but also a result of government policies. At secondary school level, too, most developing countries made considerable progress and between 1960 and 1980 the overall enrolment rate more than doubled, although that of girls remained generally low. At tertiary level, enrolment rates also rose, almost doubling during the 1970s; but, again, that of girls lagged far behind boys.

5.20 As in other social sectors, the education situation deteriorated in the 1980s, particularly as regards primary school enrolment in Africa. By contrast the South Asian countries were able to continue to increase their primary school enrolment rate, which by 1987 exceeded that of sub-Saharan Africa. East Asia was the only region to raise its secondary school enrolment rate during the 1980s. At tertiary level, too, there was a little further progress in Asia although in some countries retrogression occurred. In Latin America and the Caribbean primary school enrolment rates rose for both males and females in the 1980s and gains were also made at the secondary and tertiary levels despite retrogression in some countries. This region had the distinction of being the only one in the

developing world where female enrolment rates at secondary levels were higher than those for males.

5.21 The setbacks in education and training in the 1980s were due to domestic as well as external factors. Rapid population growth in developing countries created a need for greater investment in the sector at a time when export earnings were stagnant or falling and other economic problems were intensifying. Government policies on education and training often did not take full account of the priority the sector deserved, and inadequately supported adjustment programmes exacerbated the situation.

5.22 School building was often stopped altogether and maintenance reduced drastically; purchases of teaching materials were cut back to such an extent that, by the mid-1980s, according to the World Bank, annual expenditure on text books per student in low income countries as a whole amounted to only $1.80 and in sub-Saharan Africa much less—$0.60, compared with a minimum of $5.00 it considered necessary. There was in addition a deterioration in the student teacher ratio as teachers were either made redundant or, more frequently, left of their own volition as a result of poor pay and conditions. In many countries the quality of teachers and teaching equipment also deteriorated. It was hardly surprising that academic standards fell. According to a recent UN report, in some developing countries only one in five students entering primary school emerged literate.

5.23 Governments need to change their priorities to ensure maximum benefits from limited resources. Much greater investment in education and training will be needed if the above trends are to be reversed and previous levels restored, let alone improved upon. For example, the World Bank has estimated that the achievement of universal primary schooling in Africa would require an increase of expenditure on education from 1.4 to 2.5 per cent of GDP, an investment of over $2 billion per annum. A few African countries might be able to finance such an increase, even in a period of budgetary stringency, if they felt able to reduce defence expenditure. But for most the scale of the problem is too great and their capacity too weak.

5.24 The benefits of educational development are clear. The World Bank has calculated that in developing countries the rates of return on investment in education are among the highest of any sector: around 25 per cent for primary education, 15 per cent for secondary education and 12 per cent for tertiary education. If young people are to have the skills and thus the productivity which are prerequisites to earning decent livelihoods, they will have to be educated and trained. Such persons are essential for strengthening national economies and providing a base from

which development can lift society out of the poverty trap. In some countries, technical and vocational skills are in particularly short supply and are causing immediate bottlenecks to economic growth.

5.25 The requirement for increased investment in education and training is particularly great in those developing countries seeking to exploit technological change as a stimulus to development. As we discuss in Chapter 8, the rate of advance in these fields is such that any weakness in training will directly affect economic competitiveness. The international flows of investment needed to boost development are becoming increasingly oriented towards more complex technologies whose absorption needs labour skilled in these techniques of production. Almost all Third World countries, irrespective of their stage of development, need more scientists and technologists, both to develop their own technologies and to adapt those which are imported. The need is particularly great in Africa where increased investment in science and technology teachers and equipment is urgently required.

5.26 Here, as elsewhere, the weaker developing countries need extra assistance if they are not to fall further behind in their efforts to keep pace with change. In view of the high costs of establishing and operating centres of excellence in imparting skills in science and technology, such countries could, however, help themselves by setting up these types of institutions on a regional basis. The same is true of universities, as small states have found, for example in the Caribbean.

5.27 A particular problem in most developing countries is that the education curriculum is not as technologically oriented as it should be to promote economic growth, with the result that skills relevant to immediate economic needs are often in short supply. Productive enterprises have a special role to play here, especially where the training required is job-specific, and they should be encouraged through incentives to do so. More generally, there is a need for countries to reorient their educational systems. It is crucial for all of them to provide adequate facilities for adult education and retraining, for only by taking advantage of such facilities will people be able to adapt to the dynamic world of change. Encouraging entrepreneurship is especially important.

5.28 Governments and multilateral agencies need to take a longer-term view of the benefits of education and training and not allow investment in the sector to be an early victim of budgetary stringencies, within structural adjustment programmes or in other circumstances.

5.29 The role of women is particularly important in human resource development. Emancipated and educated women are not only a vital productive resource constituting potentially up to half the population

of working age, but they can help build effective population policy programmes, and thus contribute to the achievement of good health and adequate nutrition. Their needs deserve special attention in the fields of education and training, where so often traditional social mores have depressed their position. Sexual equality before the law may be a necessary prerequisite. More generally their multiple roles have prevented them from taking full advantage of existing opportunities and have put especially severe demands on them in times of economic difficulty. In that respect we stress the necessity of providing women and girls with the supportive facilities needed to ease the pressures on their time and energies, thus enabling them to participate more fully in economic and social activities and to improve their skills in doing so.

Migration

5.30 The above outline shows that the human resource problems of the developing world are enormous, even in societies where people continue to live and work in the same place. For people on the move, for whatever reason, the difficulties are frequently much greater. And the problems of migration will present increasing challenges in the coming years. Political, economic and other changes—at all levels—will continue to affect the number of migrants and the direction in which they wish to move. We believe the underlying factors as well as the incidence of migration deserve a higher place in the hierarchy of concern of governments and international institutions.

5.31 Most of the historical reasons for migration persist; but the circumstances that encouraged and facilitated movement between countries in many instances no longer exist. In other words, the push of need continues in many parts of the world, as a result of political, ethnic or religious pressures, or economic difficulties caused by the inadequacies of resources and continued environmental degradation. But today the pull of opportunity is less apparent, particularly in Western Europe and especially for the largely unskilled populations of the poorer countries.

5.32 During the 1980s migration caused difficulties even within national boundaries, as the urban sprawls of the large conurbations demonstrate. Too high a level of population density is a cause of squalor and degradation, leading to poor health, crime and pressures to emigrate. Much urban drift has been intensified by agricultural failures, but even if these lessen, the pressures of urbanisation will continue, and certain recent developments may even increase them. In South Africa, for example, if all aspects of apartheid are abolished, several very large urban centres are likely to develop from the movement of Africans from the Bantustans looking for new economic opportunities in the cities. It

has been projected that South Africa might have the world's highest rate of urban growth in the 1990s.

5.33 Governments have tried a number of policies to reduce or reverse urban drift, ranging from the agricultural settlement schemes undertaken in parts of Africa, to public works programmes intended to provide the basic infrastructures which rural areas need to sustain productive activities. But useful as some of these have been, they are by themselves far from sufficient. What is needed in our view is not only higher rates of economic growth, but a more labour-intensive route to sustainable development and more open markets for the exports of developing countries. Major sectors for absorbing surplus population in rural areas include agriculture, informal activities, and infrastructure. But however many jobs are created at home, the rapid increases in population and the income and other disparities between developed and developing countries, and within the developing world itself, mean that the pressures for emigration will remain.

5.34 During the last decade there was a substantial, though unquantified, movement of workers from developing to developed countries, mainly in North America and Europe. Others went to other developing countries, particularly the oil producing countries of the Middle East. A large number of them attempted to bring their families and many have settled permanently. Migration to African destinations has been more temporary or in some cases seasonal, while in Latin America and South Asia patterns are mixed. In general, the migrants are young (aged 15 to 35 years), and many of them are better educated than those who stay behind.

5.35 Large numbers of immigrants present problems to most societies, as cultural, linguistic and ethnic differences can exacerbate difficulties in absorption, housing, employment, etc. But immigrants can and do bring new skills or entrepreneurial qualities, or add to the social product by being prepared to do the jobs the indigenous inhabitants shun. The remittances which they send back to their countries of origin are often a vital source of income for those who remain. The source of such remittances may not always be a lasting one, however, as the recent Gulf crisis graphically showed. Elsewhere, some countries in southern Africa which depend on income from migrant labour are likely to face problems in the 1990s if the elimination of restrictions on the movement of indigenous labour within South Africa eliminates the need to bring in mining labour from neighbouring states.

5.36 Conversely, the emigration of the most able and enterprising deprives many societies, particularly developing country ones, of some of their most valuable human resources (the 'brain drain') and thus constrains their development. The problem is likely to be exacerbated

in future by the decline in developed country labour forces and the shortage of skilled personnel, indicative of the link between demography, technology and migration. We believe every effort should be made to reduce the brain drain by increasing the attractiveness of remaining in one's own country. Among the items which are of importance in this respect are the adequacy of remuneration of scientists and other professional people in developing countries compared with developed countries (a less progressive tax regime would help here); the facilities available for scientific work and professional development (liberal import and foreign investment systems would be helpful, as would regionalism in promoting viable centres of academic excellence); and academic freedoms.

5.37 In the immediate future the human fall out of the Gulf War will be an important factor. Around two million migrant workers from Yemen, Egypt, India, Sudan, Bangladesh, Sri Lanka, Jordan and other countries were working in Kuwait, Iraq and Saudi Arabia at the outbreak of the crisis in August 1990. Most of them had to return to their home countries where their prospects of productive employment are not good. And since the cessation of the war the internal situation in Iraq has added to the number of refugees.

5.38 The nature of migration is changing. Apart from the traditional types of flow sketched out above, transborder movements of refugees and others have increased considerably as a result of civil wars, ethnic and religious tensions, and environmental degradation. Between 1980 and 1987, for example, the number of refugees in Africa rose from 2.7 million to 3.3 million, in Asia from 1.2 million to 6.3 million, and in the Near East from 1.8 million to 2.2 million. Although we hope that sources of conflict and tension will diminish, we have to recognise that the outlook is mixed. Moreover if there are significant changes in the global climate (see para.9.6), the international movement of environmental refugees could become more substantial and add to these other movements.

5.39 Nor is the problem confined to the developing world. Any break up of the Soviet Union or seriously adverse developments in Eastern Europe could also increase the desire for migration. It is estimated that in the Soviet Union restructuring or a collapse in the economy could lead to unemployment of 30 million people or more, some 10 million of whom might be expected to try to emigrate, many to European Community countries. In the 1990s and beyond there seems little prospect of absorbing migrants on such a scale within Europe.

5.40 These are massive problems and there are no easy solutions. In the long run the achievement of environmentally sustainable economic development throughout the world will be a necessary prerequisite, but

will not of itself solve all the problems of migration. In countries with 'surplus' populations, labour- intensive strategies are required. But more specific solutions are also called for. In the current Uruguay Round of multilateral trade negotiations, for example, the developed countries could be more accommodating by allowing the freer movement of labour services from developing countries. This might enable the latter to accept a more general liberalisation of trade in services.

5.41 On a wider scale, reducing the incentive to emigrate will require examining the factors which lie behind it. More liberal economic policies may allow the incomes of skilled persons or others in great demand to rise nearer to international clearing levels, on a 'take-home' basis, too, if tax profiles are made less progressive. More provision for higher education—if necessary on a regional basis—would reduce the attraction for students to study abroad, never to return; while better intra-developing country educational exchange arrangements might also reduce the Third World's brain drain. We recommend consideration of them all: but in doing so, we recognise that other factors are important—including social and political factors. We also acknowledge that in the freer, more open societies to which all our countries aspire, people should not be prevented from leaving their countries.

Conclusions

5.42 Summarising our views on human resource development, we are pleased to note that developing country governments do now seem to be giving greater priority to this dimension. Many of them are now trying to implement sensitive but active population policies; are seeking to enhance the education of their countries' children and the skills of the labour force; and are attempting to ensure that their peoples are better fed and healthier than hitherto. All this is good for development. But it cannot be achieved entirely from within indigenous resources. The international community has a role, and a responsibility, too, in providing assistance and not constraining economic opportunities. We believe it is vital that developed country governments and the international institutions fully discharge their duties in this respect. It is particularly important that as aid donors they seek to encourage the enhancement of human resources and do nothing which would lead to a deterioration in the quality of what must lie at the heart of the development process.

Chapter 6

Finance

6.1 By the end of the 1980s a perverse situation had developed in international financial flows. The developing countries were receiving significantly smaller amounts of external finance than at the beginning of the decade and were in fact making large financial transfers abroad, while the United States and some other industrial countries were absorbing large amounts of capital from abroad. For much of the developing world the reduction of financial flows occurred at a time of increasing import stringency—that is, at the very time when more finance was required. Greater resources will be required to raise investment levels, to restore the infrastructure and to sustain the economic expansion needed to accommodate increases in per capita consumption levels that have fallen seriously in the 1980s. Increased domestic saving will need to play a crucial role in meeting these additional demands. But there will also be a need for additional balance of payments support to deal with the poor state of current balances, as a consequence of weak export earnings and onerous debt-service obligations, and to meet the additional import requirements arising out of structural adjustment programmes. However, several economic and political developments are likely to preempt the global savings which developing countries need to revive growth. Concerted action is required to ensure that current developments do not impede the provision of adequate external finance to developing countries.

Financial Flows in the 1980s

6.2 In the last decade, there were significant changes in the volume and composition of financial flows to developing countries. The broad picture is that net financial flows fell by half by the mid-1980s and stabilised thereafter (see Table 6.1 on p.68). The major contributory factor was

Table 6.1
Total Net Resource Flows to Developing Countries[a]

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1981	1985	1989
	Current $ billion									Per cent of total		
I. OFFICIAL DEVELOPMENT FINANCE (ODF)	**45.5**	**44.2**	**42.4**	**47.7**	**48.9**	**56.3**	**61.6**	**66.0**	**69.0**	**33.1**	**58.0**	**62.5**
1. Official Development Assistance (ODA)	36.8	33.9	33.9	35.0	37.3	44.5	48.3	51.6	53.1	26.8	44.2	48.1
of which: Bilateral disbursements	28.9	26.3	26.3	27.2	28.8	34.9	38.2	40.3	40.5	21.0	34.2	36.7
Multilateral disbursements	7.9	7.6	7.6	7.8	8.5	9.6	10.1	11.3	12.6	5.7	10.1	11.4
2. Other ODF	8.7	10.3	8.5	12.7	11.6	11.8	13.3	14.4	15.9	6.3	13.8	14.4
of which: Bilateral disbursements	3.0	3.7	1.3	4.5	3.7	4.0	6.6	7.9	9.0	2.2	4.4	8.2
Multilateral disbursements	5.7	6.6	7.2	8.2	7.9	7.8	6.7	6.5	6.9	4.1	9.4	6.2
II. TOTAL EXPORT CREDITS	**17.6**	**13.7**	**4.6**	**6.2**	**4.0**	**–0.7**	**–2.6**	**–0.5**	**1.2**	**12.8**	**4.7**	**1.1**
1. DAC Countries	16.2	12.7	3.9	5.2	3.4	–0.9	–2.9	–0.9	1.0	11.8	4.0	0.9
of which: Short-term	2.9	3.0	–3.5	0.3	3.2	3.0	4.1	2.0	1.0			
2. Other Countries	1.4	1.0	0.7	1.0	0.6	0.2	0.3	0.4	0.2	1.0	0.7	0.2
III. PRIVATE FLOWS	**74.3**	**58.2**	**47.9**	**31.7**	**31.4**	**28.2**	**34.5**	**40.4**	**40.2**	**54.1**	**37.2**	**36.4**
1. Direct Investment	17.2	12.8	9.3	11.3	6.6	11.3	21.0	25.1	22.0	12.5	7.8	19.9
of which: Offshore Centres	4.1	4.1	3.7	3.8	3.7	6.8	13.5	9.9				
2. International bank lending[a]	52.3	37.9	35.0	17.2	15.2	7.0	7.0	5.8	8.0	38.1	18.0	7.2
of which: Short-term	22.0	15.0	–25.0	–6.0	12.0	–4.0	5.0	2.0	4.0			
3. Total bond lending	1.3	4.8	1.0	0.3	5.4	2.7	0.5	0.4	1.0	0.9	6.4	0.9
4. Other private	1.5	0.4	0.3	0.3	1.3	3.9	2.5	4.9	5.0	1.1	1.5	4.5
5. Grants by non-governmental organisations	2.0	2.3	2.3	2.6	2.9	3.3	3.5	4.2	4.2	1.5	3.4	3.8
TOTAL NET RESOURCE FLOWS (I+II+III)	**137.4**	**116.1**	**94.9**	**85.6**	**84.3**	**83.8**	**93.5**	**105.9**	**110.4**	**100.0**	**100.0**	**100.0**
Memorandum items:												
Total net credits from IMF	6.6	6.4	12.5	5.4	0.8	–1.4	–4.7	–4.0	–3.2			
Interest and dividends paid by LDCs	–86.4	–95.3	–84.2	–94.5	–95.6	–83.2	–79.0	97.9	–107.7			
	At 1988 prices and exchange rates											
Total Net Resource Flows	201.9	174.5	143.0	131.7	128.3	103.4	100.3	105.9	111.5			
Total Official Development Finance	66.8	66.4	63.9	73.4	74.5	69.5	66.1	66.0	69.7			
Total ODA receipts from all sources	54.1	51.0	51.1	53.8	56.8	54.9	51.8	51.6	53.6			
Total DAC ODA (bilateral and multilateral)	37.6	41.8	41.6	44.2	44.8	45.3	44.6	48.1	47.4			

[a] Flows from all sources, i.e. including DAC, Eastern Europe, and Arab and other developing country donors. Excludes Taiwan.

Source: Development Co-operation, Report by the Chairman of the Development Assistance Committee, OECD, December 1990.

the precipitous decline in private flows. This resulted largely from the virtual collapse of commercial bank lending, with the onset of the debt crisis. Private investment flows also fell sharply. Official development finance remained stable in real terms, but export credits recorded a sharp decline. As a proportion of total flows, those of international capital markets fell from 40 per cent in 1981 to 9 per cent in 1989; and those of export credits from 13 per cent to 1 per cent in the same period. By the end of the 1980s, official finance accounted for nearly two-thirds of total flows, compared with one-third at the beginning of the decade. This composition of resource flows represented a return to the situation in the 1960s. The rise in the share of official flows reflected both a reduction in other flows and some increase in official finance as a result of the support provided for structural adjustment programmes and the debt strategy. While there was also some revival of total flows, much of this reflected capitalisation of interest arrears rather than new money.

6.3 In interpreting these aggregate figures, it is necessary to take account of differences between countries and regions. In some areas, such as East Asia, private flows were largely determined by demand factors, and the opportunities for investment. In others, such as Latin America, they shrank because of debt-servicing difficulties. In Africa, official finance expanded sufficiently to compensate for the falls in private flows, and the total remained stagnant.

6.4 The large and rising amount of interest payments meant, however, that net transfers[1] fell sharply. On an annual basis, developing countries received about $67 billion in net transfers during 1980-82. But from the mid-1980s interest and dividend payments sharply reduced or even eliminated the net receipts of these countries (see Table 6.2 on p.70). It is noteworthy that in 1989 debt-related net outflows amounted to $52 billion for the 111 developing countries which report their debt to the World Bank. It is estimated that over the period 1983-89, these countries transferred $243 billion to their creditors. While the highly-indebted middle-income countries suffered from the burden of commercial debt, the debt-distressed low-income and lower middle-income countries were seriously affected by servicing official debt, both bilateral and multilateral. A large number of developing countries started the 1990s from a point where private flows were depressed, and net transfers either negligible or negative. The prospects for financial flows for the rest of the 1990s are even more sombre.

[1] Net transfers are defined as net flows minus net outflows on account of interest and dividends.

Table 6.2
Aggregate Net Financial Transfers by Region[a]
$ billion at 1988 prices and exchange rates

	Average 1980-82	1984	1985	1986	1987	1988	1989
Sub-Saharan Africa	16	9	13	17	17	14	14
North African and Middle East	–11	–11	–6	–4	–6	–7	–6
Asian LDCs	11	11	15	14	17	17	9
Other Asia	5	–6	–9	–9	–11	–5	–1
Western Hemisphere	37	–17	–31	–19	–6	–17	–15
Other[b]	8	0	1	1	5	6	1
Total LDCs[c]	67	–14	–17	1	16	8	3
For reference.							
Least developed countries	14	14	15	14	14	13	13

[a] Net Financial Transfers are defined as total Net Resource Flows minus investment income payments (interest and dividends) by developing countries. Total net flows include official and private grants (including technical co-operation), direct investment and total long- and short-term loans minus loan repayments. For further explanation on Net Financial Transfers see Financing and External Debt of Developing Countries, 1988 Survey (Chapter VI), OECD, Paris, 1989.

[b] European LDCs, Oceania.

[c] Excluding Taiwan.

Source: Development Co-operation, Report by the Chairman of the Development Assistance Committee, OECD, December 1990.

New Developments

Eastern Europe and the Soviet Union

6.5 With the end of the Cold War, and economic liberalisation, Eastern Europe and the Soviet Union are imposing new demands on the stock of global savings. Their needs for finance to support the reform and structural transformation of their economies are immense. The international financial institutions and western governments have begun to assist the East European countries in a variety of ways. By the middle of 1991, it was estimated that over $28 billion had been committed in new credits, grants, technical assistance and credit investment guarantees to these countries. And it is expected that these amounts will build up substantially over the next few years. At the same time, increased relief for the heavily indebted East European countries, particularly Poland, is being conceded. In addition, the threat of economic and political instability in the Soviet Union seems likely to force the West to consider seriously the provision of substantial assistance to that country.

6.6 Eastern Europe and the Soviet Union offer considerable potential attractions to private capital: large potential markets, valuable resource endowments, including trained manpower and potentially cheap bases for production in close proximity to major markets. Private investment, which might otherwise have gone to the developing world, may flow to Eastern Europe. Private capital flows—direct and portfolio investment, bank lending and trade credit—have so far been relatively small but are likely to increase if economic and political conditions in Eastern Europe and the Soviet Union improve. The investment climate will be an important factor in determining the size of flows. With improvements in the investment climate which these countries are attempting to achieve, an increase in private flows may constitute a more important diversion than that in official flows.

6.7 Overall, therefore, Eastern Europe and the Soviet Union are likely to make a substantial and growing demand on official and private international flows of capital. Strategic and political considerations, and the threat of mass migration from the region, are likely to create the necessary political will in Western Europe to support such flows.

Unification of Germany

6.8 Unification is placing very large demands on German savings. It is conservatively estimated that the savings/investment gap in the eastern Länder may amount to about 10 per cent of total capital formation in the western Länder. The German Government can be expected to give

overriding priority to the needs of the eastern Länder, especially in the context of the current political dissatisfaction with rehabilitation progress there. Already the German fiscal deficit has risen sharply. German banking and industry will similarly prefer to look for opportunities in the east of the country. The result is likely to be a marked reduction in net capital outflows from Germany to the developing world and elsewhere. Overall capital outflows from west Germany, which were running at a rate of $50 billion per annum, may decline by more than half in the 1990s.

European Community

6.9 The completion of a single market in the European Community, together with other moves towards political and economic union, carries with it the potential, in the short- to medium-term, of attracting inflows of capital and leading to a greater deployment of European savings within the Community than hitherto. Taken together with the West European commitment to Eastern Europe and the Soviet Union referred to earlier, it seems likely that European investment in the developing world will be limited throughout the 1990s. There is also the risk that such a constriction in capital flows might not be compensated by increased exports, as the European single market may mean reduced access for developing countries' products, through trade diversion, unless it is accompanied by deliberate measures of trade liberalisation with third countries, especially for products of interest to developing countries.

Japan

6.10 In recent years, Japan has implemented important recycling programmes which have increased assistance to developing countries. Between 1986 and March 1992 such programmes will amount to some $65 billion. Japan is now the largest source of official development assistance. But the country's balance of payments surpluses, which at their peak in the middle-1980s exceeded $80 billion, have now declined to half that level, and are set to diminish further. The past four decades were dedicated to the establishment of Japan's trading and financial links with the outside world. However, there are now strong domestic demands for increased consumption, and for investment in physical and social infrastructure. These domestic pressures are reinforced by Western, particularly United States, pressure on the Japanese to increase imports. The ageing population and increased welfare expenditure also seem likely to limit Japanese savings and overseas investment in the long run. (See Annex 6 on pp.172-175 for a review of savings behaviour in industrial countries.)

United States

6.11 In the United States, the savings rate has fallen sharply since the early 1970s. During the 1980s, the US deficit constituted a major net demand on world savings, and over the decade the country became the world's biggest debtor. In 1989, the United States attracted an inflow of $124 billion from abroad, particularly from Japan and Europe.

6.12 The future demands of the United States for foreign savings will depend largely on how the Federal Government's fiscal position evolves. The IMF last year suggested that fiscal deficits were likely to persist for several years, pre-empting a large part of global savings and exerting upward pressure on international interest rates. Although the United-States made significant progress in reducing its balance of payments deficit during 1990, the Gulf crisis and the current downturn in the US economy have increased uncertainty regarding future progress. A significant recession could increase the budget deficit by raising the cost of deposit insurance, and reducing revenues.

The Peace Dividend

6.13 The ending of the Cold War led to hopes of reductions in defence expenditure. The agreement on conventional forces in Europe heightened these expectations; and some countries have already undertaken cuts in military expenditure. Recent developments, however, are less promising. Difficulties with the implementation of the Conventional Forces in Europe agreement point to the possibility of a retrogression in East/West relations. And the Gulf War, and the new security arrangements in the Middle East, may mean that the cuts in defence expenditure in the short run will be less than originally envisaged.

6.14 On balance, however, it seems possible that the developed world, in particular, will spend less on defence. The already agreed disarmament measures should create a sizeable peace dividend. Given the mobilisation of political will, a reduction in defence expenditure could lead to increased assistance to developing countries. Recent estimates suggest that a 10 per cent cut in the NATO budget could permit a doubling of aid to developing countries (see Box 6.1 on pp.74-75 and Annex 7 on pp.176-179).

6.15 It needs to be acknowledged, however, that there may be significant adjustment costs in redeploying resources from military to civilian use. There are in addition many competing claims on the peace dividend. One is the reduction in fiscal deficits in countries such as the United States. Another is the pent-up demand for funds to improve social services and infrastructure, neglected in the 1980s. But in so far as the

Box 6.1

The Peace Dividend

The end of the Cold War has raised the prospect of substantial cutbacks in military expenditures worldwide, although the need for new security structures in the Middle East and certain other parts of the world have raised some new requirements for military spending. The potential peace dividend that could accrue from cutbacks in military spending however, needs to be distinguished from the actual, or realised, peace dividend. The latter is the amount of resources released from reductions in military spending that are actually used for non-military uses, especially for meeting the social agenda. It is also not identical with the peace dividend for development, i.e. that part of the actual, or realised, peace dividend which is allocated as Third World aid. Questions therefore arise about the possible size of these various forms of peace dividend.

In fact, East-West detente and disarmament agreements have already set in motion a reduction in global military spending, which declined from $1,016 billion in 1987 to $950 billion in 1989 (or by about 3 per cent a year). The main reductions took place in the USA, USSR and Eastern Europe; spending also declined in developing countries from $173 billion to $146 billion (largely as a result of the cessation of the Iran-Iraq hostilities). In 1990 and 1991, however, the Gulf War is likely to result in increased military spending.

With the momentum maintained in the East-West understandings on disarmament, it is conceivable that annual reductions of some 2 to 4 per cent in armaments expenditure could occur during the 1990s. This means that the potential peace dividend would range from $200-$400 billion (in constant dollars) in the year 2000, with the USA and the USSR each cutting expenditure by about $50-100 billion. Total savings could be in the range of $1.5-2.5 trillion during the 1990s, with the USA, USSR and Eastern Europe each saving between $350 and $675 billion, and the other industrial countries between $270 and $570 billion. For East European countries in particular, with the new post-communist governments in place and the prospective collapse of the Warsaw Pact, the cuts could turn out to be much deeper than assumed.

There is, however, a basic question as to whether this potential peace dividend will get absorbed by the current budget-balancing exercises, or whether a whole or some part of it will become available for non-military uses. Given the sizes of fiscal imbalances

in the USA, USSR and East European countries, it is very likely that most of the cutbacks in military expenditure in these countries will be used to correct the fiscal imbalances.

But even here, in so far as cutbacks in military spending help to eliminate the need for cuts in pressing social programmes, or foreign assistance budgets, budget balancing is not a neutral exercise with regard to the social agenda. However, the situation will be different in industrial countries without fiscal problems, as they may be able to utilise a substantial proportion of the potential peace dividend for non-military uses. Equally, they may be tempted to reduce the taxation of their peoples.

A further question concerns the use of the peace dividend for development. In all countries, including those with fiscal problems, there would be strong pressures to increase domestic social spending. Accordingly, a higher priority for aid to the Third World would require a raising of public consciousness in industrial countries on the importance of enhancing aid as a means to promote a more peaceful and prosperous world. If it is assumed that half of the potential peace dividend in industrial countries (USA and other OECD countries) is actually realised, and a quarter of this is allocated to development, this would represent additional real aid of $12-25 billion (in 1990 prices) by the year 2000, over and above what would have resulted from increases at historical rates (i.e. about 2 per cent per annum).

It has also to be recognised that if deep cuts in armed forces and defence hardware were implemented, there would be significant adjustment costs in the industrial countries. These would be reflected in increased unemployment benefits, retraining costs for retrenched labour, loss of capital investment in production of military hardware, reduced production levels in, and export earnings from, defence-related industries, etc. However, the costs would be essentially of a short-term nature, and no different from those incurred in any other phase of adjustment.

In developing countries military spending increased from $24 billion in 1960 to $173 billion in 1987, i.e. at an annual rate of 7.5 per cent. Yet if military spending in the Third World were frozen in nominal terms, it would release $15 billion of resources annually for human development. That peace dividend would be sufficient to put all children in primary schools, implement a programme of universal child immunisation, eliminate child malnourishment and extend primary health-care facilities to all children.

peace dividend represents a rise in global savings—whether a part of it is diverted to developing countries or not—it will improve global economic conditions by reducing pressure on interest rates, from which all countries stand to benefit.

6.16 There is also considerable scope for the realisation of a peace dividend in the developing countries, where military expenditures have increased even more rapidly than in industrial countries in the last three decades. To the extent that the military build-up was a consequence of the Cold War tensions, the ending of the Cold War provides an opportunity to realise a peace-dividend in the South also. Improved global security arrangements and conflict resolution mechanisms are necessary for the realisation of a further peace dividend.

Implications for Developing Countries

6.17 All the developments described above have significant implications for the world economy in general and for the developing countries in particular.

6.18 The reliance by developed countries more on monetary than on fiscal policy to fight inflation contributed to an upward pressure on interest rates in the 1980s. The continuation of such a policy stance, together with an accentuation in the global imbalance between the supply of and demand for savings which current developments suggest, implies that interest rates throughout the industrialised world are likely to remain high in the medium term. Bond yields in Germany have already risen and this has put an upward pressure on West European interest rates. It is, however, encouraging that the German Government has sought to moderate such pressure by increasing taxes to fund the costs of unification and the Gulf War. The current global economic slowdown would argue for lower interest rates. However, the need to overcome continuing inflationary pressures, arising from the persistent savings/investment imbalance, presents a contrary requirement. Every percentage point on global interest rates amounts to a debt-service liability of $6 billion for the developing countries as a whole; and through the contractionary impact on industrial countries' growth, high interest rates also affect developing countries' prospects.

6.19 The developing world was able to attract relatively limited flows of private funds during the 1980s. It faces increased competition for such flows from the eastern Länder of Germany, Eastern Europe and the Soviet Union. Yet foreign private investment is an important element in the efforts many developing countries are making to attract greater external finance.

6.20 The prospects for official flows are also a source of concern for developing countries. Many donors have pledged not to divert official development assistance to Eastern Europe and the Soviet Union. However, in the absence of a real increase in overall aid budgets, competition from these two areas must remain a reality. A disintegrating Soviet Union, in particular, could occasion a large provision of funds, for strategic and humanitarian reasons and to avoid massive emigration to the West. A report on the Soviet economy suggested that aid in the range of $10-15 billion a year would be necessary to provide support 'during a time of difficult transition to integration of the economy of the USSR into the world economy'.[1] Press reports suggest that the Soviet Union may be looking for assistance of the order of $150 billion over the next five to six years from the G7. Adding in Eastern Europe would make the estimated requirements even larger. Assuming a diversion of even $10 billion a year in aid to the Soviet Union and Eastern Europe, there would be a reduction in flows of official development assistance (ODA) from member countries of the Development Assistance Committee (DAC) of about 20 per cent below their 1989 levels, if total aid budgets were to remain constant in real terms. At the very least, there is a danger that the requirements of the Soviet Union and Eastern Europe would prevent a real increase in aid flows to the developing countries. If that were to happen, flows of ODA to the developing world would fall to 0.27 per cent of the combined GNP of the DAC member countries by 1995, compared with 0.33 per cent in 1989, which was itself well below the agreed UN target of 0.7 per cent.

6.21 There is a similar danger that developments in the Middle East will result in a substantial diversion of official flows from other Third World countries for military, security and rehabilitation purposes. Short-term costs have already had an impact on the budgets of many donors. The United States, Japan, Germany, Saudi Arabia and other Gulf States are contributing heavily to Middle East countries affected by the crisis. In the longer term reconstruction programmes and security arrangements in the area could require grants, loans, investment and debt forgiveness. Kuwaiti capital now invested abroad would to a significant extent be repatriated. The Middle East could well rival Eastern Europe and the Soviet Union as a competitor for the donor countries' limited resources earmarked for development.

6.22 These developments, however, have to be set against increased trade opportunities that could arise from increased imports by Japan

[1] 'The Economy of the USSR', International Monetary Fund, World Bank, Organisation of Economic Cooperation and Development, and European Bank for Reconstruction and Development (Dec. 1990).

and the unification of Germany. Such improved opportunities may partly compensate for the reduction of Japanese or German surpluses for investment or aid.

The Developing World's Financial Requirements

6.23 By any assessment, the developing world's additional financial requirements are large. A consequence of the efforts to reduce domestic absorption in the 1980s was that investment levels fell sharply in many countries. The reforms implemented failed to revive private investment against a background of the continuing debt overhang, the shrinking domestic markets, threats of protectionism, and commodity price uncertainty and poor prospects for commodity exports. In sub-Saharan Africa, investment as a percentage of GDP fell to 15 per cent, compared with over 20 per cent in the 1973-80 period. In Latin America, the ratio fell to 15 per cent from nearly 25 per cent in the 1970s. In many instances, physical capital deteriorated and infrastructures fell into disrepair. Together with the shortage of imported inputs, this meant that bottlenecks became a common feature, and production was held back. A substantial revival of investment and an improvement in its quality is urgently needed to support capital rehabilitation and human resource development, if satisfactory economic growth rates are to be resumed and poverty and malnutrition reduced.

6.24 We believe that despite the difficult scenario we have sketched out for the 1990s, there is much that can be done to ease the financial stringency which confronts developing countries. There is scope for both domestic policy action and international efforts. We review the possibilities below.

Measures Needed

6.25 A substantial part of the additional resources must necessarily be found through domestic policy reform and mobilisation efforts. In many countries, there is considerable scope for such additional domestic savings. Private savings are at present diminished by lack of macro-economic stability; and by inadequate and ill-functioning financial markets. Inflation, unrealistic exchange rates and lack of transparency and predictability in economic policy also promote capital flight. Reform is needed in all these respects. Public savings can be enhanced by strengthening budgetary operations through both rationalising expenditure and mobilising additional revenue. Opportunities to cut defence expenditure and realise a peace dividend must also be seized. Sound management of public finance is crucial for improved domestic resource mobilisation. Conspicuous consumption based on 'rentier' incomes derived from control regimes diminishes

saving, misallocates resources, and sets a bad example to the less fortunate. Dismantling controls and better tax administration could help improve both public and private savings. Improved allocation of resources and productivity of investment constitute a source of growth and, in turn, of savings.

6.26 It must, however, be recognised that all the additional resources needed cannot be met from domestic sources alone. The consumption levels in many countries have already been cut to intolerably low levels. And any resumption of growth—from which additional saving and investment could be generated—requires, as a matter of urgency, the provision of additional balance of payments support to alleviate the poor state of current balances, and to meet debt service obligations that are now crippling recovery. Without such assistance, essential imports (spare parts of machinery, essential raw materials, food, energy, medicines, etc) will be at risk and the whole development process endangered.

6.27 Domestic policy reform and a stable economic environment should improve the climate for foreign capital inflows on a voluntary basis, and provide a part of the additional external finance needed. We believe, however, that the size of such additional voluntary flows will be limited—if not insignificant —for some years to come; and that not all countries will be in a position to attract such flows despite policy reform. We also believe that the international community should consider taking certain measures to provide the necessary additional external finance. In the ensuing paragraphs, we consider the contribution that can be made through debt relief and rescheduling, by all classes of creditors; by private flows—direct, portfolio and loan; and by official development assistance, bilateral and multilateral. Finally, we look to the question of more effective use of capital flows.

Debt

6.28 The first element of this international effort should be more effective measures to deal with the predicament of many debtor countries. The strategies adopted so far have had limited success and in many countries the debt situation has worsened dramatically. In the final analysis, the initiatives in place have not increased the capacity of debtor countries to repay. This raises serious questions about the debt management approaches that have been taken so far.

6.29 More recently, there has been greater recognition of the protracted nature of the problem. It is now increasingly accepted that many developing countries cannot service the whole of their external debts; and that more determined efforts need to be made to reduce the debt burden. In this context, it is useful to distinguish three types of debt,

each of which requires a different solution: commercial, bilateral, and multilateral.

Commercial Debt

6.30 About 60 per cent of the total debt of developing countries is commercial. This category of debt is concentrated in some 20 middle-income developing countries, even though it imposes heavy burdens on a wider range of countries, including some low-income countries. The Baker plan (1985) proposed that countries pursuing economic reforms should receive fresh funds to bring about a return to growth. It relied on a strategy of restoring normal creditor-debtor relations, through a combination of structural adjustment, rescheduling of debt, and additional official and private lending. While these measures were partly successful in containing the problem, it soon became clear that private banks were cautious in providing additional finance, and that growth in the concerned countries suffered. The hope that, with adjustment, debtor countries would be on their way to growing out of debt has been belied. It has now been recognised that in the absence of debt and debt-service reduction, even policy reform and a favourable international economic climate will not restore external viability in many highly indebted middle-income countries. Some countries sought to achieve such a reduction, albeit on a limited scale, by buying back debt at a discount. The Brady Initiative, which seeks to provide official financial support for market-based commercial debt-reduction programmes, takes this approach forward (see Annex 8 on pp.180-184). Five arrangements have so far been reached—with Mexico, Philippines, Costa Rica, Venezuela and Morocco - affecting a total of $78 billion of commercial bank claims. While there are indications that the strategy may be bringing some of these countries nearer to restoring access to spontaneous capital flows, the overall impact remains limited. Progress is slow and it is proving difficult to add other countries to the list of beneficiaries. Negotiations are fraught with difficulty. Establishing market valuation of debt, the treatment of current and overdue interest payments and the degree of debt restructuring required are matters of contention. Debt arrears in Latin America, for instance, have been increasing and the debt problems of many indebted countries in this region—Brazil and Argentina among them—are no nearer resolution.

6.31 Many proposals for alleviating the debt problem have been made by prominent bankers, economists and politicians (see Annex 9 on pp.185-187). These proposals include the following elements: measures to strengthen economic growth and export performance; a special facility or a new multilateral institution to buy and then restructure outstanding bank debt; a menu of options for debt and debt-service reduction; and credit enhancement.

6.32 While elements of these proposals have been incorporated in some of the existing initiatives, we believe that further action is needed.

6.33 It is vital that any such action recognises the need for economic growth in the debtor countries. They must lower future costs, not raise them; they must change the debt profiles from short-term to longer-term; they must allow a healthy expansion of productive capacities rather than only a painful squeeze of already low consumption or investment levels; and they must provide for a continued increase in the lending of commercial banks.

6.34 To meet these objectives it will be necessary to expand the scope of the Brady Initiative by enlarging the resources committed to it; by making the associated adjustment programmes more growth-oriented; and by improving the modalities for reaching agreement between the debtor country, the commercial banks and the World Bank and the IMF. We also believe that considerable relief can be provided through the commercial banks forgiving the portion of debt written down by them in their balance sheets. Similarly, much guaranteed export credit has been tacitly written off by creditor governments and a formal concession would involve no new funding. The reduction of debt overhang in this manner will contribute to the restoration of external viability and resumption of commercial lending to developing countries.

6.35 We also see merit in increased use of 'debt for nature' swaps and 'debt for equity' conversion, even though they need to be implemented keeping in view the domestic conditions. There is also merit in the establishment of a new mechanism such as the proposed International Debt Refinancing Facility (see Box 6.2 on p.82). Because this must have a developmental orientation, it could work primarily under the World Bank's leadership, with IMF cooperation.

Official Bilateral Debt

6.36 With regard to the official bilateral debt of the low income countries, prospects for external viability remain very bleak for many countries, despite the action taken so far. The Toronto Initiative has brought very limited benefit. It has been suggested that the Indonesian debt agreement of 1970, which provided substantial debt relief of up to 57 per cent, constitutes an appropriate model for the treatment of sovereign debtors, particularly those for whom a large proportion of their debt is owed to official bilateral creditors. More recently, the United States has written off 70 per cent, and other Paris Club creditors 50 per cent, of Polish debt. The Paris Club has also written off 50 per cent of Egypt's debt. These write-offs, largely motivated by political reasons, provide

significantly more relief than the 33 per cent usually written off under the Toronto terms for the poorest countries.

6.37 The Trinidad and Tobago terms, proposed by Britain at the Commonwealth Finance Ministers Meeting in September 1990, seek to provide substantial relief for countries undertaking adjustment. This initiative constitutes a major advance (see Annex 8 on pp.180-184). The terms entail simultaneously writing off two-thirds of a nation's debt and rescheduling the remainder over 25 years. In addition, the future course of repayments would be calculated to reflect an assessment of the country's ability to pay. We strongly urge adoption of the terms by the Paris Club creditors. We feel that the initiative should also be on the agenda of the 1991 Western Economic Summit with a view to reaching an agreement. We also welcome the debt write-offs so far agreed (listed in Annex 8) and endorse the proposal made by Jan Pronk, the Netherlands Minister of Development Cooperation, at the Second UN Conference

Box 6.2

Debt Refinancing

The increasing recognition that developing countries cannot repay the whole of their external debt reinforces the case for establishing a mechanism for debt refinancing which mobilises official resources. Several proposals have been made, which essentially involve debt purchase/conversion and take advantage of the discounts available in the markets. Some of these are given below.

James Robinson III (President of American Express) (1988) has proposed the establishment of an Institute of International Debt and Development to purchase existing loans at secondary market prices. The Institute would be an entity jointly operated by the World Bank and the IMF, with seed capital and contingent financial support from the major industrial countries.

Percy Mistry (Oxford University) (1987) has recommended the setting up of a Debt Restructuring Facility (DRF), as a World Bank affiliate, to issue long-term (25-30 years) bonds to be exchanged at a significant discount for developing country debt held by commercial banks. The DRF would be capitalised by the OECD countries at $30 billion (with a 10 per cent paid-in component) and would operate with a gearing ratio of 10:1, so that it could issue bonds up to a value of $300 billion.

on the Least Developed Countries (Paris, September 1990), to forgive all official debt—export credits and ODA—of the Least Developed Countries.

Multilateral Debt

6.38 Debt owed to multilateral institutions presents special problems for a number of countries carrying heavy burdens. Very little has, however, been done to tackle this aspect of the debt problem. It has been argued that the unique role of the Fund as a cooperative institution, and the revolving nature of its resources, prevent it from undertaking any debt and debt-service reduction involving obligations to itself. It has also been argued that the financial standing of the multilateral development finance institutions would be compromised if there was any rescheduling of debt owed to them. The fear is that they would lose their AAA credit

Dr Arjun Sengupta (formerly Executive Director, IMF) (1988) has suggested the establishment of an IMF Debt Adjustment Facility (DAF). Commercial banks could exchange a portion of their loans to eligible debtors for low-interest bonds issued by the DAF. The remainder of the debt would be written off. The debtor would also be expected to adhere to a new growth-oriented policy package that would be designed to upgrade the country's credit rating and attract new investment and lending.

Dr Mahbub Ul Haq (UNDP) (1984) has called for the formation of an IMF Debt Refinancing Subsidiary to provide resources for extending maturities and reducing interest payments to a specific proportion of export earnings, so as not to stifle growth.

The African Development Bank (S.G.Warburg & Co) (1987) has recommended the issuing of long-term (20-25 years) securities for the full face value of the loans, but carrying below-market interest. A Redemption Fund would be established for the securities issued, into which the debtor country would undertake to make annual payments of an amount sufficient to accumulate at maturity to the total of the securities outstanding.

Reference

Miller, Morris, 'Revolving Global Debt Crisis' (UNDP Policy Discussion Paper, 1989).

rating, thereby constraining their capacity to mobilise resources in capital markets and increasing the cost of their funds.

6.39 There have, however, been two narrowly circumscribed initiatives to alleviate the burden of multilateral debt. A portion of International Development Association (IDA) reflows is now set aside to help offset a part of the IBRD interest payment obligations of countries which were formerly eligible for IBRD loans but have now regressed to IDA resources only. In 1990, supplementary IDA credits were provided to offset a part of the annual IBRD interest payment of eleven countries which were pursuing IDA-supported adjustment programmes. We recommend that additional concessional resources are found to cover the whole of the IBRD interest payments of all IDA-eligible countries. A similar facility may also be extended by regional development banks.

6.40 In addition, the IMF has introduced a strengthened strategy for dealing with members in arrears—the new 'rights approach'. Under this scheme, a member's arrears are frozen when it embarks upon a Fund-monitored programme. The member is expected to be at least current during the Fund-monitored programme period and 'rights' are accumulated by implementing the programme. Countries are expected to receive assistance to meet the import needs and payments to the Fund through Paris Club rescheduling, Consultative Groups or support groups. At the end of the programme the country would have accumulated rights to future access to Fund resources, enabling it to clear the past 'frozen' arrears. The 'rights approach' is part of a collaborative effort to provide countries with support, in terms of policy advice and financing, to help them resolve their economic and financial difficulties. For the approach to succeed, the countries concerned will need adequate and timely bridging finance from the donor community to sustain the reform process. It is noteworthy that the 'rights approach' implicitly recognises the principle of refinancing obligations to the Fund. We believe that this approach should be extended to tackle the burden of multilateral debt in general.

6.41 These approaches do not however respond to the lower middle-income countries facing high proportions of official debt—bilateral and multilateral. Relief granted to Poland points the way for the Paris Club to recognise the need for debt and debt-service reduction. In the case of multilateral debt, an interest subsidy fund under the IMF would allow these countries credit from the IMF on concessional terms, thus increasing their debt-servicing capacity and encouraging the adoption of adjustment measures. A similar arrangement could be considered by the World Bank though a 'Third Window' type of facility on terms between those offered by IDA and IBRD.

Debt: Appraisal of Present Initiatives

6.42 Despite the relief measures introduced so far, the debt problem is getting worse, not better. Total debt has risen to over $1,300 billion, the highest since 1983. In a number of cases scheduled debt-service payments far exceed the debtor countries' current capacities to pay, and several of them are accumulating arrears. Few are in a position to attract voluntary capital flows. The present arrangements are inadequate to support a return to viability. Additional action is therefore required.

6.43 We believe that the approaches to the debt problem should be comprehensive and governed by equitable burden sharing. There is a case for official creditors providing relief to middle-income countries, commensurate to that expected from commercial creditors; and for commercial creditors to match the terms official creditors are offering to low-income countries. And for each debtor country, there should be a collective attempt to assess its debt-servicing capacity in the medium term, and tailor its debt-restructuring in the light of that capacity. The Trinidad and Tobago terms propose such an exercise in relation to bilateral official debt of low-income countries; we see the need for a wider application of such a course of action. This would be facilitated by the establishment of country-specific fora, analogous to the present Consultative Groups, in which both commercial and official creditors come together to discuss debt restructuring and equitable burden-sharing arrangements.

6.44 One way of assisting debtor countries across the board could be through an allocation of Special Drawing Rights (SDRs). This would increase their debt-servicing capacity, without running excessive current account surpluses and transferring real resources to the creditor countries. Further relief can be provided if the SDRs allocated to the creditor countries are placed in a Trust Fund to be used for various debt and debt-service reduction operations. In the present circumstances, we note that the Managing Director of the IMF believes that an SDR allocation would contribute substantially to stability in the international monetary system.

6.45 We are aware that action aimed at debt and debt-service reduction raises the possibility of moral hazard, whereby countries might attempt to create the conditions for debt restructuring and discounts on the market. While these concerns are not unreal, we believe that there are significant real costs which seem likely to deter the adoption of such a course of action by any country. Confidence, once disrupted, takes time to be restored. The economic dislocation caused by such a course of action could also be considerable.

6.46 There is also much concern in the industrial countries about the use of public monies for purposes of debt reduction, when authorities there are under pressure to economise. There are, however, strong grounds for using official resources for this purpose. In the 1980s, with the shift away from reliance on fiscal instruments in demand management, monetary policy has become the main instrument for economic stabilisation. This shift has led to historically high interest rates in world capital markets, with adverse implications for developing country debt; there are good grounds, therefore, for mobilising official resources to mitigate this effect. Furthermore, we believe that the case for supporting debt reduction is incontrovertible if development is accepted, as it must be, as an integral part of global peace and security. No development is possible, in large parts of the world, without a significant reduction in external debt.

Private Flows

6.47 As we have noted, the sharp contraction of private flows fully accounts for the decline in net transfers to developing countries. It is imperative, therefore, to find ways of making investment in developing countries attractive once again. For many countries such a recovery is likely to be a slow process and will depend crucially on the success of sustained efforts at macro-economic and structural adjustment.

6.48 While there was some revival in foreign direct investment in developing countries during the second half of the 1980s (it totalled about $22 billion in 1990), these flows were largely concentrated in a few countries, particularly in Asia and the Western Hemisphere. Bank lending, where it was not a reflection of the accumulation of arrears or a part of debt-restructuring packages, was also concentrated in a few countries which continued to enjoy good credit standing. Foreign investment, bank credits and export credits have generally moved together, reflecting market perceptions of a country's credit-worthiness and its investment climate.

6.49 We believe that a major challenge facing the world today is how to enable a wider set of countries to attract such flows. As noted earlier, macro-economic stability, an improved role for markets, and financial sector and trade policy reform, will mobilise domestic savings, and could encourage the return of flight capital and attract greater foreign private capital flows, with one reinforcing the other. The experience of East Asian countries in attracting foreign direct investment in the 1980s can be attributed to their comparative success in avoiding high inflation and maintaining an investment climate, good infrastructure and services.

6.50 Wide-ranging action on several fronts is necessary to attract private flows. It includes the establishment of investment approval procedures, exchange control and legislation related to the repatriation of capital and dividends, the tax regime, labour laws, and human resource and physical infrastructure development. Of these, the development of an educated and skilled workforce is particularly important so as to provide the managerial and technical skills necessary to attract foreign investment. In the final analysis, it must also be recognised that all the policy changes and special incentives are by themselves inadequate. There must also be an appropriate environment, in terms of attitudes towards private enterprise in general, and foreign investment in particular. In many instances, this entails challenging entrenched positions and vested interests within the polity and bureaucracy, and developing a positive view of the role of private enterprise in development. While host countries could be selective about foreign investment and expect foreign investors to transfer technology, develop national procurement and reinvest profits where appropriate, these issues need also to be seen in terms of attracting foreign financing.

6.51 We also believe that much can be done by the international community to promote private capital flows to developing countries. It can, for example, encourage the promotion of insurance against non-commercial risks for foreign investors. The official agencies can also play a catalytic role by attracting private capital co-financing, and by providing guarantees. The World Bank has already undertaken significant initiatives in this context, for example the Multilateral Investment Guarantee Agency, expanded co-financing and the Excel Export Credit Programme. We believe that these initiatives deserve support. They also suggest lines of approach for further initiatives. Above all, there is scope for action to fill the gap in knowledge that exists in many countries on how to attract private flows. A number of international organisations provide technical assistance in this area, but a great deal more can be done.

6.52 Portfolio investment through single country or multi-country funds has become another important vehicle for inflows of capital. Over the past five years, some 50 developing country funds have been launched, raising over $5 billion for investment in emerging markets. While these funds are geared mostly to investment in the successful economies of Asia, there is scope (such as the Commonwealth Equity Fund is trying to exploit) for a wider group of countries to attract equity flows. Such funds benefit the host country by augmenting capital, encouraging the development of domestic financial markets, and attracting a whole new class of institutional investors. There is increasing scope also for Funds (venture capital and other investment vehicles) providing, through equity

issues, development capital for business expansion. All these innovative ways of securing foreign investment should be fully considered.

6.53 We also believe that special efforts are needed to seek new opportunities to tap financial flows among the developing countries and from their migrants, as well as to repatriate flight capital. The pre-requisites for attracting such flows are similar to those needed to mobilise other forms of private finance. The rate of return and security of investment are more important determinants of the location of funds than subjective factors such as patriotism or familiarity with one's country. What is needed is a sense of security and opportunities for investment.

Official Flows

6.54 While a significant revival in private financial flows to developing countries from the present depressed levels will be beneficial, it is also very evident that the aid agenda has expanded to new areas (such as needs on account of environment and poverty alleviation) and official flows must be increased to cater for this expansion. In addition, the number of countries that have lost market access or cannot afford to borrow on market terms has increased. Financing required for reconstruction and rehabilitation in the Middle East and post-apartheid South Africa also argues for further expansion in official flows. As against these expanded needs, a few countries which have received development assistance in the past no longer require it (for example South Korea). However, the headroom created by this will be nowhere near enough to accommodate the enlarged aid agenda. Many countries will have severe difficulty in sustaining their reforms and making meaningful progress towards improving the living standards of their people without a significant increase in official flows. For many low-income countries, aid flows remain the major source of external finance.

6.55 Official flows can also play a critical role in enabling countries to create the climate necessary to attract private capital flows. At a time when private capital is costly and cannot be made available on any long-term basis, aid flows can be a source of leverage in providing at the World Bank a 'Third Window' type of facility, on terms which fall between those of commercial lenders and IDA. Expanded financial flows can also be secured through schemes of interest subsidy and co-financing.

6.56 We believe that there is value in multilateral institutions, such as the World Bank and Regional Development Banks, playing an enhanced role in the provision of official finance. They act as useful intermediaries in tapping private capital for development finance. These institutions have built up considerable professional expertise in assessing the needs

of developing countries, and in the provision of technical assistance. They also carry the assurance that aid flows will be untied, and more stable.

6.57 It is, therefore, disconcerting that both the IMF and the World Bank have become recipients of net resources from developing countries at a time when the institutions have been called upon to assist members in formulating and financing painful adjustment programmes. The Fund's Articles of Agreement require it to ensure that policies associated with its financing programmes are not destructive of national or international prosperity but, rather, promote the development of productive resources as well as the maintenance of high levels of employment and real income in member countries. In line with this there has recently been some re-orientation of Fund programmes and conditionality policies and practices. More is needed in this respect (see Chapter 4). It is also important that policy on access to its resources responds to the needs of the widest possible range of members facing payments difficulties.

6.58 With respect to IMF facilities, there is a case for making greater use of the Extended Fund Facility (EFF), rather than consecutive stand-by arrangements, since recourse to the EFF would stretch out repurchases and reduce front-loading of programmes. It is disappointing that, despite modifications, the EFF has remained inaccessible to all but a few countries. It is also a source of concern that the Enhanced Structural Adjustment Facility (ESAF) has proved to be slow disbursing, with inordinate delays in the negotiation of programmes. Conditionality policies and practices have also proved to be a deterrent. The Compensatory Financing Facility, which was one of the most promising Fund facilities, has been diluted. The new Compensatory and Contingency Financing Facility (CCFF) is designed to provide members pursuing Fund supported adjustment programmes with broader protection against unforeseen adverse changes in external economic conditions. However, in practice, conditionality has increased and effective access to the Facility, particularly the compensatory financing element, has been tightened significantly. It is also disappointing that the CCFF continues to be effectively out of range for SAF/ESAF borrowers. We believe that access under the Facility should be enlarged and made less restrictive.

6.59 We are concerned that net use of the Fund credit continues to be low. There seem to be two contributory factors: the high cost of Fund resources, and conditionality policies and practices. At a time when many adjusting countries cannot afford the high costs of using Fund resources, serious consideration should be given to lowering these costs by reducing the rate of remuneration to creditor countries and by arrangements for interest-subsidy to lower middle-income countries. There is also a need

to cast programmes in a longer time-frame and pay greater attention to the economic growth objective and distributional issues.

6.60 It is important that the World Bank Group plays a more positive role in mobilising new financial flows to developing countries through its direct lending, equity participation and catalytic role. It is a matter of serious concern that a number of countries are likely to experience negative transfers with the Bank in the years ahead. The Bank Group's programmes must not be hampered by problems of capacity. In this respect, we believe there must be early agreement on a substantial capital increase for the International Finance Corporation (IFC). An increasing number of developing countries are emphasising the role of the private sector in the development process, and the IFC is expected to play an important role in supporting the transformation to market-driven economies in Eastern Europe. We also believe that the competing claims on the Bank's concessional resources cannot be resolved satisfactorily without an expansion of IDA resources. In this connection, we call on some of the more prosperous developing countries which have not yet contributed to IDA's resources to do so.

6.61 As noted earlier, developing countries will face considerable competition for aid and official finance in the 1990s. A major effort will have to be made to overcome the financial stringency that has confronted much of the developing world in the last decade. The broader view that we advocate sees development as a sine qua non for global security, which as a public good is the joint responsibility of the whole community of nations. There is, therefore, a need to develop appropriate burden-sharing mechanisms to meet the various financial claims built into achieving a stable world. The developed world has been talking about reaching the agreed UN target for ODA of 0.7 per cent of GNP over two decades; far from moving towards this target, ODA as a proportion of GNP has been declining in recent years. We believe that the opportunity of realising a peace dividend and application of a part of it to development aid should enable the developed countries to reverse this trend. Given the political will, it should be possible for the developed countries to double their ODA and reach the agreed UN target by the end of the century. While some countries (Denmark, Netherlands, Norway and Sweden) have already exceeded this target, there are some major donors which have not yet even reached half the target (see Box 6.3 on p.92). At a minimum, the rise in ODA from DAC member countries should not fall below their GNP growth. We feel that the more prosperous developing countries should contribute to development assistance in a significant way. Within the overall flow of official finance, there is need for greater transfers on a grant basis, as many countries cannot shoulder any further interest-bearing debt. We also believe that there must be a

significant increase in food aid. The current annual flow of food aid, at 10-11 million tons, falls short of requirements.

6.62 Not only is it necessary to increase the volume of ODA and to change its composition, there is a need for more effective use of such flows. There should be a further untying of commitments and relaxation of procurement procedures to improve the real value and speed of aid disbursements. We welcome the increasing role of the World Bank in aid coordination. But there is scope too for more coordination through Consultative Groups and for better internal administration. Project appraisal needs to be developed more intensively and internal priorities should be more rigorously applied. Donors should avoid promoting their own projects which simply aid their own exporters. They should increasingly put their assistance through the multilateral agencies, which have a better overall view of requirements and of the effectiveness of resource use.

Conclusion

6.63 In conclusion, we believe there are a number of areas where concerted action is needed. More effective measures for debt relief have to be implemented and additional resources are needed for this purpose. There must be comprehensive and equitable burden-sharing arrangements among all creditors and debt must be restructured in relation to a country's debt-servicing capacity. It is also necessary to ensure that the emergence of new claimants on world savings (for example Eastern Europe, the Soviet Union) does not result in a diversion of official flows. It is vital that ODA is doubled by the end of the century to reach the UN target of 0.7 per cent of GNP and meet the expanded aid agenda which includes new needs on account of the environment and the spread of poverty. In this connection, every effort should be made to exploit the opportunities arising from the reduction in East-West tensions to cut military spending in both developed and developing countries and to ensure that a part of the resultant peace dividend is devoted to increase ODA. Developing countries for their part must pursue stable macro-economic policies and undertake structural reforms which will create the enabling environment necessary to make them creditworthy and attractive to investors, both local and foreign.

Box 6.3

Aid to Developing Countries from Member Countries of the Development Assistance Committee (DAC)

Official development assistance (ODA) by DAC countries amounted to $40.3 billion on average per year during 1980-82; by 1989, the latest year for which statistics are available, this stood at $47.4 billion. (All figures at 1988 prices and exchange rates.) This represents a growth of 2 per cent per year.

As a proportion of their combined GNPs, however, ODA declined from an average of 0.37 per cent in 1980-82, to 0.33 per cent in 1989. The current DAC ODA/GNP ratio is below half the level of the UN target of 0.7 per cent adopted in 1968.

The average ODA/GNP ratios conceal wide diversity in performance among countries (see Table 6.3 on facing page). ODA by Norway, Sweden, Denmark, and the Netherlands exceeds 0.7 per cent of their respective GNPs; at the other end of the spectrum, there are seven countries—namely, Japan, Britain, Switzerland, Austria, New Zealand, Ireland and the United States—whose ODA/GNP ratios fall below the current DAC average of 0.33 per cent. The rest of the countries have a ODA/GNP ratio of between 0.33 and 0.70 per cent.

Changes in ODA/GNP ratios also reveal a mixed trend. On the one hand, Norway and Denmark increased their aid ratios during the 1980s by 0.15 or more percentage points of their respective GNPs; on the other, the aid ratios of all those countries (except Switzerland and Japan) which had an ODA/GNP ratio of less than 0.33 per cent in 1989, showed either stagnation or decline. The ratios of Austria and Britain declined by 0.08 percentage points or more during the 1980s.

Table 6.3
Changes in ODA/GNP Ratios of DAC Countries

ODA/GNP Ratio, per cent, 1989	Country	Change in ODA/GNP Ratio During the 1980s[1]		
		Decrease >−0.02	Stagnant −0.02–+0.02	Increase >+0.02
Above 0.7				
1.04	Norway			+0.16
0.97	Sweden		+0.02	
0.94	Denmark			+0.15
0.94	Netherlands	−0.07		
0.33 to 0.7				
0.63	Finland			+0.31
0.54	France[2]			+0.07
0.46	Belgium	−0.11		
0.44	Canada			+0.05
0.42	Italy			+0.19
0.41	Germany	−0.06		
0.38	Australia	−0.09		
Below 0.33				
0.32	Japan			+0.03
0.31	United Kingdom	−0.08		
0.30	Switzerland			+0.07
0.23	Austria	−0.10		
0.22	New Zealand	−0.05		
0.17	Ireland		−0.01	
0.15	United States	−0.05		

[1] Based on a comparison between the averages for 1980-82 and 1987-89.

[2] Excluding DOM/TOM.

Chapter 7

Trade and Trade Policies

7.1 International trade has long been considered the engine of economic growth. For many years it has tended to grow faster than GDP or industrial production. There have been several reasons for this buoyancy and we discuss some of them below. But we should signal right at the start of this chapter the importance we attach to liberal trade policies. They are essential for maintaining the dynamism of international trade, based on comparative advantage, which encourages competitiveness and efficiency and thus economic growth and development. Liberalisation benefits not only a country's suppliers and its own consumers, but also its producers and, eventually, world trade and the world economy.

7.2 In a rapidly changing world economy, the liberalisation thrust of trade policy is needed to overcome the increasing protectionist pressures of those who resist change. This is vital as the protectionist path is not only self-defeating and inimical to development, but also reduces welfare by imposing heavy costs on consumers and taxpayers alike. Agriculture, where the support costs in OECD countries exceed $140 billion a year (or over £700 annually for each family in one of the countries involved—Britain), provides one example; textiles and clothing (where the Multifibre Arrangement costs each US household over $500 a year) provide another. The growth of international trade cannot be maintained unless protectionism is defeated. We have already mentioned (Chapter 4) the need to buttress the weak institutional framework in order to put a liberal multilateral trading environment on a firmer basis. Here we focus on the policy elements involved.

Trends in the 1980s

7.3 In global terms the 1980s were generally good for international trade, although without the intensification of protectionism they would have been even better. After stagnating in the first three years of the decade, the volume of trade grew thereafter at an annual average rate of 6 per cent, marginally faster than during the 1970s. In regional terms, the three most rapidly growing trade flows during the decade all involved Asia: its trade with North America rose on average by 12.5 per cent per annum; that within the continent by 11.5 per cent; and that with Western Europe by 11 per cent. Trade flows within North America (average growth of 8 per cent per annum) and within Western Europe (7 per cent per annum) were also buoyant. The fact that in the 1980s major segments of world trade expanded faster between regions than within them suggests that the system may be evolving more towards different growth 'poles' than towards 'fortress' trading blocs, a development that seems counter to the concern of many observers about the possible consequences of the European Single Market of 1992.

7.4 The generally encouraging pace of growth of international trade at the global level masks the serious problems encountered by many countries. Large parts of the developing world shared little in the growth. In volume terms exports from Africa fell steeply in the first two years of the 1980s and then recovered only partially. By the end of the decade they were still over a fifth below their level of ten years earlier. Exports from Latin America fluctuated markedly without showing any clear trend. In both continents imports were depressed as a result of financing constraints. In Latin America, where imports for much of the decade were around a quarter below those at its beginning, these constraints were caused particularly by difficulties in meeting debt-servicing liabilities. In Africa, where the compression in imports was equally severe and in terms of impact even more devastating, infrastructural weaknesses and the low level of development of human resources also played an important role. The volume of exports from the OPEC members also declined significantly, whereas that from south and east Asia was generally buoyant.

7.5 There were significant differences, too, in the nature and composition of trade. Although the only broad category for which the volume of trade actually fell during the 1980s was petroleum, that in primary products as a whole was often depressed. Trade in manufactures was very much more dynamic, expanding on average by 8 per cent annually in the 1980s. Within that category, exports of high-technology goods rose especially quickly (office and telecommunications equipment by 14 per cent annually, for example), but those of some traditional items too rose fast (clothing by 11 per cent, for instance). And trade in services was also

buoyant, especially international travel, insurance, banking and other financial and professional services. As a result, comparing 1980 with 1989, the proportion of world trade accounted for by primary products shrank from 36 to 21 per cent whereas that of manufactures rose from 46 to 58 per cent and that of services from 18 to 21 per cent.

7.6 The extent of the changes is apparent from the fact that nearly one out of six product groups in which there was major trade among developed countries in 1989 had not been of significance to the exporting countries concerned ten years earlier. In many cases this was a result of the microelectronics revolution; but not in all, as Finland's exports of manmade fibres or Portugal's of automotive parts showed. And even more striking is the fact that at the end of the decade new products were of greater importance in the trade structures of developing countries than they were in those of the developed countries. Examples include clothing from Bangladesh, cars from Brazil, television sets from Mexico, and office machines from Thailand.

7.7 Allied to these changes were those in the relative importance of countries, both as suppliers and as markets. In a ranking of exporters, close to one in four of the leading 25 countries in 1989 had moved up ten places or more since 1979, and nearly half of them had raised their position by at least three places. Notable examples included China, Mexico, Hong Kong, Singapore, and Taiwan. On the obverse side prominent cases of countries becoming less important as exporters were to be found from among the petroleum producers. Among changes in the ranking of importers between 1979 and 1989, one in five markets had disappeared from the list of principal destinations and one in ten had been added.

7.8 The depressed demand for imports of most primary products during much of the 1980s, together with the increased supplies available for export as indebted countries sought to increase their foreign exchange earnings, caused marked weaknesses in international prices of commodities. In the first half of the decade especially, these were severely depressed (the average of those in the UNCTAD index was in 1985 some 32 per cent below that of 1980). Thereafter most commodity prices recovered somewhat, but by the end of the decade they were still some 10 per cent below their level at the start. Petroleum prices fell particularly heavily, from over $37 per barrel in 1980 to under $10 in 1986 before making a slight and unsustained recovery later in the decade. Meanwhile the average price (unit value) of manufactured exports from developed countries continued to rise, being 26 per cent higher in 1989 than in 1980. The consequence was a marked deterioration in the terms of trade of developing countries, which fell by 19 per cent during the course of the decade.

7.9 The least developed countries were among those most affected by the deterioration in the terms of trade. It has been estimated that their export earnings between 1980 and 1988 were over $700 million less than they would have been in the absence of any terms of trade effect. Most developing countries suffered. Overall the value of exports from Africa fell by half between 1980 and 1986 and made only a slight recovery in later years. Those from Latin America were also lower in value in most years during the second half of the decade than during the first. And those from the Middle East, consisting almost entirely of petroleum, fell particularly heavily. The value of exports from the remainder of developing Asia was generally buoyant.

7.10 In these changing circumstances many developing countries made sustained efforts to diversify their export products and markets. There were individual successes in developing new products and finding new markets, especially among the newly industrialising economies. But sometimes these markets were realised only by cutting prices. More generally, infrastructural and administrative weaknesses, low levels of education and training, capacity limitations and the inability to finance imports of production inputs held back many countries, especially in Africa but also in much of Latin America.

New Elements Affecting International Trade

7.11 At least half a dozen major factors affected the level, content and pattern of international trade during the 1980s. Although most were not in themselves new, they often contained new elements or nuances which in some cases reversed previous trends but in others accentuated them.

7.12 Among the most important of these factors was the impact of economic growth. In theory, international trade allows specialisation based on comparative advantage; it enables countries to raise the efficiency with which they use their factors of production and the rewards these factors are paid. The relationship between trade and economic growth is therefore a symbiotic one. But since 1983 the rise in international trade has been half as much again as that in GDP, for a variety of reasons, which we discuss below.

7.13 A second factor, of much importance in the 1980s, was the structural change to economies caused primarily by technology development. The last decade saw an intensification in the shift from heavy to light industries, and from industry towards services. It also saw a relative decline in demand for many of the developing countries' traditional exports, sometimes as a result of smaller inventories made possible by computer control (see para. 8.6). Meanwhile, new technologies created new industries and rendered some production processes obsolete. They

offered some opportunities to developing countries; but more generally they demonstrated and often exacerbated their difficulties in competing successfully in a fast moving economic environment. We develop these points further in the next chapter.

7.14 It is however pertinent here to stress a couple of related points particularly relevant to trade. One is the role of technology in reducing the economic distance between potential trading partners. Technology has reduced transport costs, as roll-on roll-off and containerisation have shown. But its main effect has been in reducing the cost and increasing the capacity of the cross-border communications which are a necessary prerequisite for international trade. Allied to this has been the revolution in data processing. The other point is the role of technology—and particularly of informatics—in blurring the distinction between goods and services and increasing the opportunities for trade in services.

7.15 Another cause of structural change was the policies and programmes many developing countries undertook in the 1980s under the aegis of the international financial institutions. We discussed these in general terms earlier in this Report. Here we should draw attention to the fact that they stressed a more outward orientation, particularly the need for export competitiveness and the elimination of obstacles to trade, and a greater openness to foreign private investment. The results were favourable in some countries, such as Mexico, but less so in others, particularly in most of Africa, which lacked the physical and other infrastructures and dynamic sectors necessary to provide an effective export capacity. But as we have mentioned elsewhere, the compression in imports which accompanied the adjustment had severe social as well as economic effects. Vital inputs to the productive process came into short supply.

7.16 A third and related phenomenon affecting international trade in the 1980s was the increasing globalisation of production. This was the result of many factors. The costs of much of the research and development needed to stay in the forefront of technology, and the scale of much of the capital investment required to produce sophisticated products, both required corporate concentration. Helped by the information explosion and foreign exchange liberalisation, transnational corporations sought increased competitiveness by manufacturing wherever it was most advantageous. At the same time, global sourcing meant that trade within transnational corporations increased. And the growing current account surpluses of Japan in particular, led to greatly increased direct investment, especially between industrial countries. Between 1983 and 1989, the annual average increase in the value of foreign direct investment was around a quarter, compared with about a tenth in that of trade in manufactures. Such investment flows would have had a favourable effect

on trade by encouraging production and discouraging protectionism. The deregulation of financial markets provided an additional stimulus in some countries, while the erection of quantitative trade barriers which—unlike tariffs—cannot be absorbed, often had the same effect. The net result is that traditional, arms-length, exports now play a smaller role than they did in the activities of many of the major companies which account for so much of the world's trade in manufactures and certain services.

7.17 A fourth factor which began to affect trade—although only marginally during the 1980s—was concern for the physical environment. This operated at several levels. In some cases it involved governments, as for example with the Convention on International Trade in Endangered Species, which bans trade in certain animals with the aim of conserving biodiversity. In others it involved consumer or 'green' groups, as with boycotts organised in some developed countries, particularly in North America, on the import of certain foodstuffs from particular countries. We revert to this issue later (see paras. 9.29-30). Here we simply point out that the issue is likely to become increasingly topical—at the February 1991 meeting of the GATT Council, for example, there was a debate on the link between trade policies and environmental protection, with a request by EFTA countries that the GATT reconvene its Working Party on Environmental Measures and International Trade. And the environmental cause has the potential to be used, for example by industry associations, for raising new non-tariff barriers to trade. These could become increasingly important in the 1990s and beyond. Clear rules are therefore needed to ensure that the GATT dispute settlement system is properly equipped to deal on request with trade disputes arising from environmental issues of all kinds. Appropriate provisions are also needed to ensure that GATT (and other multilateral agencies concerned with trade, such as UNCTAD) will be able to participate in the follow-up to the 1992 UN Conference on Environment and Development (see para.9.33).

7.18 A fifth factor concerns political developments. Changes pursued as much for political as for economic reasons significantly affected the pattern of international trade in the 1980s. From them flowed much of the increase in regionalism, as we discuss below (para.7.29).

7.19 Political considerations have also affected trade more dramatically and abruptly. Trade embargoes are an obvious example, as between Britain and Argentina early in the 1980s, and between the United States and Nicaragua later in that decade. More recently there has been the UN embargo on trade in almost all items with Iraq. Such developments are usually associated with disagreements which can lead to military conflicts; these in themselves have very considerable effects on trade, almost always for the belligerents and often for third parties, as the affects of the Gulf war on the export of services from South Asian countries highlighted.

7.20 A sixth and vital factor, though one which is implicit in all the foregoing, is government policy. This has both helped to determine the course of the various developments we have just discussed and has been influenced by them. Four main types of policy responses can be identified.

7.21 The first, apparent since the mid-1970s, has been increasing recourse to managed or administered trade. A variety of non-tariff measures has been adopted, outside of GATT principles, rules and disciplines, to meet individual protectionist concerns. 'Orderly' marketing arrangements and 'voluntary' export restraints have increasingly affected trading patterns.

7.22 While only about a third of the 250 or so discriminatory export restraint arrangements in place at the end of the 1980s were explicitly targeted against developing countries, they do fall disproportionately hard on these countries. The products involved include consumer goods such as shoes, cutlery, cars, televisions and radios; intermediate goods such as certain types of steel, chemicals and transistors; and some producer goods such as ships. The principal exporters affected have been Korea, Taiwan and China, though the list is much longer and also includes Mexico and Brazil and several ASEAN countries. Japan, too, has long been the target of these type of measures, particularly in respect of exports of cars and consumer electronics. All the major West European and North American importing countries have invoked them, finding this politically easier, if economically much less appropriate, than adjusting to changes in competitive advantage. The result has been to pose a growing threat to GATT's authority. The irony is that the exemplar for such measures had been negotiated some thirty years earlier under GATT's own auspices: the biggest 'orderly' marketing arrangement of them all, the Multifibre Arrangement which regulates (and restricts) exports of developing countries' textiles and clothing.

7.23 An increasing pressure towards bilateral trade balancing has been apparent in some countries, especially in respect of trade with Japan. The agreement between that country and the United States on trade in semi-conductors is one of the best known examples but there are others, including trade in certain items between Japan and several member countries of the European Community. At a multi-sectoral level, the motivation lying behind the recent Structural Impediments Initiative between Japan and the United States is similar. Although justified (or rationalised) by the United States as an attempt to open the Japanese market further, its essentially bilateral nature again tends to undermine the GATT's authority, and inhibit multilateralism.

7.24 A second but related type of policy response, and a particularly troubling development of managed trade, has been recourse to other

forms of unilateralism. There has been an increasing tendency for industrial countries, particularly the United States, to seek unrequited changes in other countries' trade policies and practices, to refuse to submit to common procedures; and to define 'unfair' trade practices unilaterally. Such measures, epitomised in the super and special provisions of Section 301 of the 1988 US Omnibus Trade and Competitiveness Act, have been directed against a variety of developing countries. They include Brazil, cited for its import licensing restrictions, and India, for its regulations on foreign investment and controls over insurance. They have been associated with a marked increase in the number of trade disputes, including those referred to the GATT. Whilst the references to the GATT might be interpreted as a manifestation of faith in multilateral arrangements and GATT's dispute settlement process, the increase in disputes themselves is a measure of the extent of retreat in some countries' commitment to multilateralism and to the principles and rules of the GATT.

7.25 The third type of response has been multilateralism. Although, as we have shown, this has been under attack, it is far from dead and remains in our judgment the most credible response to changes in the world economy. In some ways the GATT has served the world well. The seven rounds of multilateral trade negotiations completed under its auspices were instrumental in greatly lowering tariff barriers on imports of manufactures. By the end of the implementation of the Tokyo Round in 1987, these had been reduced in developed countries to an overall average of 6 per cent and to 8 per cent on manufactures of particular export interest to developing countries.

7.26 But as is well known, the GATT has many limitations and has had its failures. Among its limitations have been the omission (so far) of trade in services—now a fifth of all trade; and the basing of its negotiations on most favoured nation terms, which have long accounted for a diminishing proportion of the world's trade—now little more than a half. But even more important have been GATT's two major failures. The first has been its inability so far to integrate agriculture into the system; the second its impotence in stopping the erection of non-tariff barriers outside GATT rules. Other deficiencies include allowing textiles and clothing to be traded outside GATT rules under a derogation.

7.27 These deficiencies have long been recognised and an attempt to address some of them was made in the Tokyo Round. This did not prove successful but the Work Programme adopted by the 1982 GATT Ministerial Session attempted to take matters further. It also paved the way for the present negotiations under the Uruguay Round.

7.28 The Uruguay Round is by far the most ambitious set of trade negotiations ever attempted (see Box 7.1 below). It is hardly surprising that the negotiations have proved difficult, that the Ministerial session of the Trade Negotiations Committee held in Brussels in December 1990 to conclude the Round ended in deadlock (mainly because of irreconcilable differences on liberalisation of trade in agriculture) and that the Round has therefore had to be extended.

7.29 The fourth main category of government policy response to developments in international trade during the 1980s was an increasing resort to regional and other preferential trading groups (see Boxes 7.2-7.4 on pp.104-109). The widening and deepening of the European Community was shadowed by the creation of other regional trade groupings among developed countries, including the Canada-United States Free Trade Agreement and the Closer Economic Relations Agreement between Australia and New Zealand. Similar groups were established among developing countries in Asia (for example ASEAN

Box 7.1

Uruguay Round of Multilateral Trade Negotiations

The Uruguay Round, launched at Punta del Este in September 1986, is the eighth to be held under GATT auspices. Its objectives are to:

(i) 'bring about further liberalisation and expansion of world trade to the benefit of all countries, especially less-developed contracting parties, including the improvement of access to markets by the reduction and elimination of tariffs, quantitative restrictions and other non-tariff measures;

(ii) strengthen the role of GATT, improve the multilateral trading system on the principles and rules of the GATT and bring about a wider coverage of world trade under agreed, effective and enforceable multilateral disciplines;

(iii) increase the responsiveness of the GATT system to the evolving international economic environment, through facilitating necessary structural adjustment, enhancing the relationship of the GATT with the relevant international organisations and taking account of changes in trade patterns and prospects, including the growing importance of trade in high technology products, serious difficulties

and SAARC), Africa (for example ECOWAS and PTA), South America (for example ALADI) and Central America (for example CACM and CARICOM). Some groups brought together developed and developing countries, either on a regional basis (for example the Caribbean Basin Initiative and CARIBCAN between certain states in the Caribbbean and the United States and Canada, respectively, and SPARTECA between Australia and certain states in the Pacific) or on an interregional basis (for example the Lome Convention between the European Community and certain states in Africa, the Caribbean and the Pacific). This tendency towards regional and other preferential trading agreements (which in some cases included related development aid provisions and investment promotion arrangements) was accelerated by the evolution of the multiple centres of dynamic economic growth we mentioned earlier. It was in part a defensive action by countries very aware of the narrowing scope for trade on most favoured nation terms and keen to reap the benefits of economies of scale by stimulating regional development. And it was reinforced by the size of the trading

in commodity markets and the importance of an improved trading environment providing, inter alia, for the ability of indebted countries to meet their financial obligations;

(iv) foster concurrent co-operative action at the national and international levels to strengthen the inter-relationship between trade policies and other economic policies affecting growth and development, and to contribute towards continued, effective and determined efforts to improve the functioning of the international monetary system and the flow of financial and real investment resources to developing countries.'

The Round is being negotiated in 15 groups. These deal with the market access issues of tariff and non-tariff measures; sectoral issues such as agriculture, textiles and clothing, and tropical and natural resource-based products; systemic issues such as safeguards, dispute settlement, and the functioning of the GATT system; and new issues covering the trade-related aspects of intellectual property rights and investment measures, and trade in services.

The Round was scheduled for completion in 1990. However, the Ministerial meeting to conclude it was suspended mainly because of irreconcilable differences on liberalisation of trade in agriculture. Negotiations were resumed in February 1991 but it is not clear when they will be concluded.

Box 7.2

Regional Trade Groupings Among Developing Countries

Regional trade groupings include: (a) free trade areas where partners abolish duties on mutual trade, but retain tariff schedules on extra-regional trade; (b) customs unions which free trade between members but also have a common external tariff; and (c) common markets which are essentially customs unions, but with additional provisions for labour mobility and the harmonisation of trading standards and practices. Examples among developing countries include:

Economic Community of West African States (ECOWAS)

ECOWAS was formed in 1975 and comprises Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo. It provides for free trade in unprocessed goods and the gradual elimination of tariff and non-tariff measures.

Preferential Trade Area for Eastern and Southern Africa (PTA)

The PTA was established in 1982 and comprises Angola, Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe. It intends eventually to eliminate all trade restrictions and establish a common market.

Latin American Integration Association (ALADI)

ALADI was formed in 1981 and replaces the Latin American Free Trade Association of 1960. It comprises Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, and Venezuela. It has implemented regional tariff preferences and aims to establish a common market.

Southern Cone Common Market (MERCOSUR)

MERCOSUR was established in March 1991 and comprises Argentina, Brazil, Paraguay and Uruguay. Its main aim is to achieve a common market with a single external tariff and free trade among members by the end of 1994. Other objectives include the coordination of policies on agriculture, industry and transport.

Latin American Group of Three

It was announced in April 1991 that Colombia, Mexico and Venezuela plan to establish a free trade zone by July 1994, subject to the exclusion of certain goods. (Mexico is also negotiating free trade agreements with Chile, Costa Rica and certain other Central American countries, as well as with the United States.)

Central American Common Market (CACM)

CACM was established in 1961 and comprises Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. It applies a common external tariff to all but a few goods from third countries.

Caribbean Community (CARICOM)

CARICOM was formed in 1973 and replaced the Caribbean Free Trade Association of 1967. It consists of Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis, St Lucia, St Vincent and The Grenadines, and Trinidad and Tobago. All except The Bahamas participate in the Common Market, although Belize and Montserrat have been granted longer to phase in the common external tariff.

Association of South-East Nations (ASEAN)

ASEAN, established in 1967, comprises Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand. Since 1984 members have applied a 20-25% tariff preference to other members, subject to national exception lists, and have agreed to enlarge these preferences to up to 50%.

The Gulf Cooperation Council (GCC)

The GCC was established in 1981 and consists of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. Intra trade has been liberalised since 1983 and a common external tariff has been adopted by most members.

Box 7.3

Regional Trade Groupings Among Developed Countries

The European Community (EC)

The EC which was formed in 1968 now comprises Belgium, Britain, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain. All intra-EEC trade is free of duties, and there is a common external tariff. In 1992 the Community is scheduled to become a single market and all barriers to the movement of goods, services, people and capital will be dismantled. Border controls will be removed, financial markets liberalised, and industrial regulations standardised.

The European Free Trade Association

The European Free Trade Association was established in 1960. Its membership has varied but now consists of Austria, Finland, Iceland, Norway, Sweden and Switzerland. Duties on industrial goods traded within the Association were abolished during the latter half of the 1960s. During the 1970s member countries concluded bilateral agreements with the EC abolishing import duties on almost all industrial products, thus establishing virtually

imbalances between major industrial countries and by the consequent growth of informal protectionism. But it has nevertheless made a real contribution to trade liberalisation, although sometimes causing trade diversion and problems for developing country exporters in respect of the application of rules of origin for trade in processed products. And it has brought greater prosperity to its members, albeit sometimes unequally, as well as increasing the strength of economic and political cooperation between them.

7.30 Many other factors affected trade in the 1980s. We deal with some of them elsewhere in this report—human resource development in Chapter 5 and finance in Chapter 6, for example. But here we wish to draw attention to one of particular concern and more direct relevance—the appropriateness of present institutions for international trade—which we have considered in Chapter 4.

Impact on Development

7.31 The trends and developments in international trade we have sketched out earlier in this chapter have impacted upon the economic

a single market in Western Europe in these products. In 1991 they were negotiating with the EC on the establishment of an 18 country European Economic Area.

Canada-United States Free Trade Area

In January 1989, Canada and the USA entered into an agreement to establish a free trade area (FTA), eliminating all tariffs by the end of a ten-year transitional period. Tariffs have already been removed on one group of products; they will be removed in five equal steps over five years on a second group; and over 10 years on a third, "import-sensitive", group. The FTA is expected to receive a boost if negotiations currently underway for the inclusion of Mexico are successful.

Australia-New Zealand Closer Economic Relations Agreement

In 1982, the Australian and New Zealand Governments signed a Closer Economic Relations Agreement intended, inter alia, to eliminate trade barriers between their two countries gradually and progressively by 1995; and have reportedly achieved the objective already. The Agreement, which built on a 1965 pact to promote trade between the two countries, also provides an opportunity for strengthening broader economic relationships between them.

development of all countries, but because of their greater vulnerability they have been particularly important for many in the developing world. Taken overall, the impact of trade in the 1980s has been to intensify the polarisation of development. Most of the newly industrialising countries and certain other middle income countries, especially in Asia, have been able to benefit considerably, whereas most of the low income developing countries, particularly in Africa, have not, despite their preferential access to developed country markets. There are a variety of reasons.

7.32 One of the most important results from the increasing impact of technology on trade. On the one hand, most developing countries have had growing difficulty in paying for the types of technology needed to produce those goods and services for which demand is rising fastest, whose technical standards which change frequently and are applied rigorously, and where the provision of associated servicing facilities is vital. In some cases they have had problems of access as well. On the other hand, as we explain later (para.8.15), some types of technological advance are reducing the comparative advantage these countries possess, especially in the early stages of manufacturing, as a result of a plentiful supply of low wage labour. In many cases developing

Box 7.4

Preferential Trading Arrangements Between Developed and Developing Countries

The Lomé Conventions

The Lomé Conventions between the 12 member states of the European Community (EC) and 69 African, Caribbean and Pacific (ACP) countries represent the most extensive economic cooperation arrangements between developed and developing countries. The first three agreements were for five year periods, starting in 1975, but the latest one (Lomé IV) is for ten years (1990-2000). Lomé IV provides duty-free and quota-free access to nearly all ACP exports to EC markets, although some agricultural products covered by the Community's Common Agricultural Policy are still restricted. It also contains two stabilisation funds (Stabex and Sysmin) to compensate for losses suffered by ACP countries in exports of selected commodities; a development aid package; mechanisms for industrial and technological cooperation; and joint institutions to supervise observance of the provisions of the Convention and to promote discussion between the groups of countries.

CARIBCAN

CARIBCAN was initiated by Canada in 1985 and became operational in June 1986. It abolished duties on imports into Canada from selected Caribbean countries of all items except textiles and clothing, luggage and handbags, leather clothing, lubricating oils and methanol. The beneficiary members are Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Guyana, Jamaica, St. Kitts-Nevis, St. Lucia, St. Vincent and The Grenadines, Trinidad and Tobago.

countries have found that foreign demand for their staple exports can be made more or less redundant by developments in technology. When this happens to commodities such as copper or jute which are basic to a country's foreign exchange earnings, its effect on development can be substantial.

7.33 A second reason for the polarisation of development concerns the inadequate external support for the reforms undertaken by many developing countries under structural adjustment programmes. Although

US-Caribbean Basin Initiative (CBI)

Conceived by the Reagan Administration in 1981, the CBI was designed to assist Costa Rica, El Salvador, Guatemala, Nicaragua, Panama, Antigua and Barbuda, Barbados, Belize, British Virgin Islands, Dominica, the Dominican Republic, Grenada, Haiti, Jamaica, Montserrat, Netherlands Antilles, St.Kitts-Nevis, St. Lucia, St. Vincent and The Grenadines, Trinidad and Tobago. The Initiative came into effect in 1984 and provides duty-free access to the US market for 12 years for all products from the beneficiary countries except textiles and clothing, work gloves, leather apparel, footwear, handbags, luggage, flat goods, canned tuna, petroleum and petroleum products, watches and watch parts. To qualify for preferential access, goods must be exported directly to the US with a minimum of 35 per cent of their value added locally. The Initiative is supported by a $350m aid programme approved in 1982.

South Pacific Regional Trade and Economic Cooperation Agreement (SPARTECA)

SPARTECA, which came into force in 1981, provides non-reciprocal duty-free access to the Australian and New Zealand markets for a wide range of products, including textiles and footwear, from the island developing countries of the South Pacific Forum (which includes Cook Islands, Fiji, Kiribati, Nauru, Niue, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, Vanuatu and Western Samoa). The agreement is intended to foster economic growth and the expansion of investment in these countries and to promote greater cooperation in the region, particularly in commerce, industry and agriculture.

the reforms made these countries' economies more open and outward-oriented, the programmes did not bring sufficient external resources or allow the countries adequate time to enable them to build enough new production capacity to take full advantage of the marketing opportunities available abroad.

7.34 This resource constraint was not experienced to anything like the same extent by the more successful economies. But on occasions even they suffered, like others, from the very mobility of international funds.

As far as direct investment is concerned, this mobility was specially apparent in transnational corporation activities in the free trade zones which many developing country governments established in the 1980s or earlier.

7.35 Although it has not yet had any significant impact on their development, developing countries may have increasing difficulty in meeting environmental requirements for goods they wish to export. Quite apart from the activities of consumer groups in developed countries, the spectre of global warming means that they may find it difficult to establish smoke-stack industries to produce for export. This will follow from the demands on developing countries to raise environmental standards, as this will inflate their costs unless they can get access to more energy efficient and environmentally efficient technologies (whose operation needs higher skills), and either more funds to buy the technology or foreign investment to transfer it.

7.36 The increasing degree to which bilateral assistance for the export (and other) sectors of many developing countries depends on political and other non-economic factors has also influenced recipient countries' development. Projects are sometimes refused assistance because of potential competition with developed countries' production or because they are too small to accord with the aid donors' administrative procedures. Development can therefore be distorted by non-economic factors. And despite agreement on principles to guide member countries of the Development Assistance Committee in the use of tied or partially tied official development assistance and associated financing so as to increase transparency and reduce distortions to trade and aid, the trade-aid provisions of some countries still leave much room for improvement if they are to accord with the development priorities of recipient countries.

7.37 But politics affects trade and therefore development much more directly through the influence of producers' associations and other pressure groups. It is these which have led to the aggressive and questionable use of anti-dumping provisions, and to the 'grey area', extra-GATT, protective measures masquerading as 'voluntary' export restraints and 'orderly' marketing arrangements. The intensification of these techniques and measures in the 1980s harmed development considerably. They have been given freer rein by the changing nature of the trading environment. During the 1980s this became increasingly dominated by unilateral ad hoc pressures dictated by political power based on economic strength, rather than by multilaterally agreed principles and rules.

7.38 The net result of these factors is that many developing countries have had increasing difficulty in earning sufficient foreign exchange to

be able to acquire enough of the foreign goods and services to transform their economies and spearhead development. Nor have they been able to acquire them through other means (such as by credits, direct investment or official development assistance).

A New Environment for International Trade

7.39 The strength of international trade at a global level during most years since the early 1980s belies the weakness and fragility of the system on which it depends. It also masks the unevenness of different countries' trading performances and the extent to which those wishing to improve their performance are dependent on a better trading environment.

7.40 We see that better environment as being composed principally of two elements. The first is more open markets (especially in the developed countries) through a reduction in all types of trade barrier—official and unofficial, tariff and non-tariff. The second element is strict adherence to multilaterally agreed rules on the conduct of international trade, based on universally accepted principles providing more transparent, predictable and non-discriminatory access to markets.

7.41 If these criteria are to be fulfilled, it is essential that the Uruguay Round is brought to a successful conclusion. At present it is still in danger. Although intensive consultations by the GATT Director-General in the early part of 1991 did establish a basis for restarting the Round, when and whether it can be completed depends on events outside Geneva. The first hurdle has been successfully overcome with Congressional approval in late May of the US Administration's request for a two year extension of the 'fast track' authority from 1 June 1991. A second and in some ways related factor is the timing and outcome of the European Community's internal processes for reforming its Common Agricultural Policy, now underway.

7.42 Agriculture still provides one of the keys to the Round's outcome. Here we believe it essential for the European Community to improve its offer by further reducing internal support measures (and moving progressively towards a system which assists farmers directly and without distorting international trade), by increasing market access (and moving progressively towards tariffication), and by very considerably cutting export subsidies. This should provide a sufficient basis for the United States and the developed and developing country 'fair' traders of the Cairns Group to enter into negotiations. But if a settlement in agriculture is to be acceptable to all, it will be essential to build into the agreement a set of special provisions in respect of the adjustment needs of developing countries, especially those which are net importers of food.

7.43 Substantive and balanced agreements are also needed on a number of other core issues. They include textiles and clothing, for which more liberal offers by developed countries on market access are required (especially by the United States), together with agreement that the sector be brought within the ambit of GATT principles and rules within ten years at most.

7.44 Allied to this we consider that there should be more flexibility in resolving outstanding issues concerned with the safeguards provision and the subsidy code. The EC should be prepared to withdraw its demand for selectivity in safeguards—even on a limited basis—provided that at the same time other parties accept the necessity for stricter disciplines regarding the terms on which subsidies can be permitted without invoking countervailing measures. But again we must emphasise the need for developing countries to be given adequate time to implement such obligations and for least developed countries to be allowed to waive their commitments if desired.

7.45 As regards the 'new' issues, we consider that an agreement on trade in counterfeit goods is highly desirable within the GATT. We are much less sure that this forum, as presently constituted, has the capacity—or is indeed appropriate—to administer an agreement on trade-related aspects of intellectual property rights, as these are often inextricably linked to other aspects of intellectual property. We do, however, believe it is important that any agreement on this item provides adequate safeguards for the development aspirations of less developed countries. This may require a patent system which takes account of developmental needs and ensures that licences do not overly impede technology transfer. On trade-related investment measures, we recognise that more work still needs to be done on the coverage of any agreement and on the level of disciplines it should enforce on such measures. But we would emphasise that prohibiting some investment measures could inhibit development. Developing countries should therefore be given adequate time to accede to any agreement which is reached.

7.46 With regard to trade in services, we accept the desirability of an umbrella agreement which would provide a framework of general obligations and disciplines to be applied by acceding parties to trade in all types of services. But we doubt whether in this Round it is realistic to pursue the detailed sectoral annexes which will eventually be required. If and when they are formulated, however, it will be vital for developing countries that their needs and aspirations are taken fully into account. This will be especially important in respect of trade in labour services.

7.47 Reverting to the issues of regionalism, we see no realistic possibility of the trend to establishing and strengthening regional groups being

reversed. This will be no bad thing provided such groups do not damage multilateralism in general and GATT rules and disciplines in particular; and that they create more trade than they divert. In other words, regionalism should enhance (albeit indirectly) the welfare of third parties as well as of members.

7.48 We note that the completion of the Single European Market scheduled for 1992 should increase trade for general benefit, worldwide, although the possible erection of external barriers, formal or informal, could further divert trade away from third parties. Whatever the outcome, the event will be of some importance for developing countries. It has been calculated that as a result they should be able to increase their exports to the Community by 1.5 per cent. Exports of primary products should rise by 4.6 per cent, or 2.9 per cent excluding petroleum. For manufactured goods, on the other hand, trade diversion may be greater than trade creation.

7.49 The impact on individual countries' exports will differ greatly. Certain small countries such as those in the Windward Islands in the Caribbean, whose main export—bananas—at present receives preferential treatment in the United Kingdom market, are likely to be fundamentally affected. Cane sugar is another commodity where the special arrangements for ACP countries will be difficult to maintain as a result of the free circulation of goods after 1992. In both cases compensatory measures will be needed, either by an increase in Community aid so as to enable the countries concerned to diversify their near-monoculture economies, or by direct income support for the individual exporters, or by balance of payments support for the countries.

7.50 As regards trade in manufactures, the replacement of national quotas by Community ones will be of some significance to exporters of textiles and clothing and, other things being equal, might lead to some liberalisation. (What happens to the Multifibre Arrangement will, however, be of very much greater importance.) But for most other products, ranging from motor vehicles and consumer electronics to footwear, it is likely to mean an extension of protection. The newly industrialising countries may be especially affected.

7.51 Overall, there is a need for continuing close attention, through European Community/ACP contacts and otherwise (including GATT's new Trade Policy Review Mechanism), to the impact of the Single European Market, with a view in particular to avoiding unintended adverse impacts.

7.52 In the longer run, the recent economic and political changes in

Eastern Europe may promote the spread of regionalism in Europe—an extension of the idea of a European Economic Space, for example—with significant effects on world trading patterns. Until recently these countries traded mainly with the Soviet Union and each other. Their payments and industrial arrangements reinforced their political and geographical propinquity. But the breakdown of the CMEA system has altered prospects fundamentally. During the 1990s Eastern Europe (and even the Soviet Union) seems likely to develop a greater export and import capacity. This will, in effect, bring 80 million middle income producers and consumers directly into the world trading system for the first time since 1939.

7.53 Some developing countries are likely to benefit from Eastern Europe's hitherto suppressed demand for consumer goods, others may suffer from greater competition in export markets. The first group includes the newly industrialising countries and those, such as India, which also have a sufficiently diversified production base and established trade links to be able to benefit from additional demand. Experience in establishing joint ventures or ability to provide long-term low-interest loans would also be useful.

7.54 Equally important—at least in long-term prospect—the 1990s may see a greater trend towards regional groupings among developing countries. At present, South-South trade is much smaller than might be expected. But this may not always be the case. In Africa plans are afoot, albeit only embryonically as yet, for a free trade arrangement among most of the continent's countries. Similar developments are in prospect in Latin America and Asia, in some cases—as with the plan for an East Asian Economic Grouping—in collaboration with developed countries. We support such developments as a way to stimulate economic growth and development. They may be particularly helpful in stimulating inflows of private and official capital and in maximising the benefits which these can bring. They may also serve as the basis for intra-regional integrating instruments. But as with other groupings, we must emphasise that they should be seen as a complement to multilateralism, and not as a rival to or substitute for it, or as a means of slowing progress in it. If regionalism is not to constrain the development of the world in general, a strong, vibrant multilateral trading system remains essential.

Chapter 8

Technology Development and Transfer

8.1 Technology, the practical application of scientific and other technical skills and knowledge to the production, processing, distribution and utilisation of goods and services, is vital to economic growth and development. Technology development makes it possible to create entirely new processes, products and services, and to improve existing ones. It raises economic and social productivities, which increase standards of living, and it improves the factoral terms of trade, which enables countries to protect or enhance their international competitiveness in particular products or services. No one country can expect to be completely autonomous technologically, and because technologies can be transferred internationally, a country would not be using its resources optimally if it tried to do so. But all countries should aim to enhance their skills in acquiring technologies, and disseminating, absorbing and adapting them efficiently.

8.2 The gap in scientific and technological capacity between developing and developed countries is not only great but widening, as a result of the accelerating pace of technological change. It is vital that developing countries recognise the crucial need to enhance their ability to absorb, adapt and utilise technology, by reorienting their human resource development policies so that their workforces can contribute effectively to development and ensure that their countries' international competitive positions are maintained or improved.

8.3 In this chapter we consider the changing nature and scope of technological change, its impact on economic and social development, the need to develop technology policy to take account of this impact, and the desirability of improving the terms and conditions of technology

transfer to ensure that developing countries can benefit from the progress that has been made. The centrality of technology to development, its accelerating pace, complexity and pervasiveness, and the need for developing countries to develop and acquire it in the face of growing constraints, provide the rationale for including the issue in this Report.

Changing Nature and Scope

8.4 Technological innovation has progressed incrementally almost since time immemorial. But over the past two hundred years the process has gained momentum, often exhibiting wave-like patterns whose peaks have been associated with major innovations, derived from science and realised through entrepreneurship. Examples include the development of the steam-engine and the spinning jenny in the second half of the eighteenth century, and electricity and the internal combustion engine in the second half of the nineteenth. A more recent example is that of microelectronics. Since its commercialisation over twenty years ago, this technology has given rise to many innovations. The pace and scope of change have been such that discontinuities of historic dimensions are becoming visible in economic, social and political life to an extent that the future cannot confidently be extrapolated from the past.

8.5 We have noted the attention given by the Commonwealth in recent years to technological change and its management, and we acknowledge the major contribution made to thinking on this subject in 1985 when a working group under the Chairmanship of Prof M G K Menon compiled the Report "Technological Change: Enhancing the Benefits". As its title indicates, the Report took a positive approach to the subject. It recognised the great benefits which are being brought about by technological change and in its recommendations concentrated on ways which could enhance those benefits. We understand that as a result a Commonwealth Consultative Group on Technology Management has been set up to provide a better focus on an issue which will be of continuing importance.

8.6 While technological innovation has advanced on a broad front, that in microelectronics has been particularly pervasive. Its effects have been both distinct and synergetic. Microelectronics has transformed many products (often 'miniaturising' and making them capable of multiple functions); improved the control, efficiency, performance and flexibility both of products (such as word-processors and computer-numerically-controlled (CNC) machine tools), and of processes (such as computer-aided manufacture (CAM) and 'just-in-time' manufacturing based on computerised minimal inventory holding); and, most importantly, through computerisation, it has made possible the rapid handling of information of every kind. At the same time, the application of

microelectronics to other advanced technologies, such as biotechnology, lasers, new materials and renewable energy, has enhanced their effectiveness and extended their scope, while creating whole new clusters of technology, such as those in the fields of telecommunications, automated services (especially banking and other financial transactions), and advanced diagnostic, surgery, and healthcare procedures. Its application has similarly enhanced the qualities of more mature technologies.

8.7 Looking to the future, however, other new technologies are expected to have at least as great an impact. Biotechnology, although progressing at a slower pace than many envisaged in the early 1980s, has already been applied in a wide variety of areas. They include agriculture, where genetic engineering and cell manipulation can create desired animal and plant characteristics; healthcare, where recombinant DNA techniques can provide improved diagnostics, vaccines, antigens and other pharmaceuticals; energy, where alternative fuels can be made from biochemical feedstocks; and the environment, where pollution can be reduced and waste treated using microbial techniques. New materials, such as fibre-optics, special plastics, hardened ceramics and composite materials, have an equally wide range of applications, from construction, aeronautical and automotive engineering to medicine and dentistry. Comprised of man-made materials or of commonly available elements, they can be substituted for conventional materials. Where they replace scarcer finite resources such as metals or petroleum, this substitution can be generally beneficial, especially in the long term, but it can also destroy demand for a range of products on which many developing countries depend for their foreign exchange earnings.

8.8 The need to develop renewable energy technologies is even more manifest, to provide both for wider spatial distribution of energy sources in developing countries and for more environmentally benevolent forms of energy. The latter is especially important in view of current concerns over fossil fuel use and the greenhouse effect of global warming. Technologies to produce energy from such renewable sources as sunlight, wind, water and biomass have been developed, and are being improved. But while they have the potential to assist development in the rural areas of developing countries, they are expected to contribute only marginally to global energy consumption during the next couple of decades (and only up to some 15 per cent by the year 2025). On the other hand, energy conservation technologies, such as integrated heat and power systems and fluidised-bed combustion, are expected to contribute significantly to higher energy efficiency, and hence to reduced consumption of fossil fuel per unit of output. There is particular scope for increasing efficiency in energy use in those countries, such as in Eastern Europe and certain

of the newly industrialising countries, where a large proportion is used in heavy industry.

Economic and Social Impact

8.9 As with previous major innovations, the overall impact of microelectronics and other advanced technologies on economic growth and development has been very positive. These technologies will continue to produce new goods and services—in some cases whole new industries—as well as foster international competitiveness in the countries adopting them. And as with previous experiences, we expect that over the longer term, increased demand for labour derived from higher economic growth and enhanced development will more than compensate for job losses arising from the use of labour-saving new technologies. But, in the short term, we acknowledge that the effects are likely to be negative for particular enterprises which have become uncompetitive, and for particular groups of workers whose skills have become redundant. In extreme cases, the effects can even be negative even for countries if they lack the capacity, or otherwise fail, to adopt new technologies vital to their economies. Restructuring and retraining are therefore crucial elements in the management of technological change, as is the building of indigenous technological capacity.

8.10 To the extent that industrial countries have adopted advanced technologies, their overall output and employment have increased and their international competitive positions have generally improved commensurately. In most of them the output of high value-added, high-skill industries employing advanced technologies has tended to rise faster than that of sectors based on more mature technologies; and within industry the movement has generally been in the same direction—away from heavy engineering and shipbuilding towards light engineering and electronic components, for example.

8.11 For countries which are economically less developed, technological change has usually been more difficult to accommodate and manage. Its impact has tended to be more disruptive, because of the lower capacities of these countries to absorb and adjust effectively to new technologies, and because their economies often lack diversity. Technologies which have led to a deterioration in the international competitiveness of a country's major export, for example, can have severe effects on employment and balance of payments, and pose major problems of economic management, which in some cases can be overwhelming. The danger has been intensified with the linked use of computers and telecommunications. This has largely globalised markets and made it very difficult for any country, developing as well as

developed, to be economically successful but remain outside the global economic system.

8.12 On the other hand, the growing internationalisation of production made possible by the use of new technologies can present new opportunities for developing countries, not only in traditional areas such as industrial sub-contracting and assembly, but in new ones such as data processing and software development. Moreover, the cost reduction in data generation, processing and transmission, as well as in telecommunications, is of benefit to all countries. Microelectronics has also given new life to small-scale industries with modest capital requirements and production processes often well attuned to the resource circumstances of the countries concerned. Biotechnology has the potential not only to reduce the cost of food and drugs in developing countries but also to stimulate indigenous development, for example tissue culture, which is not very demanding in terms of research resources, and to create new products (for example drugs tailor-made to tackle specific tropical diseases). In addition, the use of new technologies can increase the dissemination of information on, and the acquisition of knowledge of, a wide variety of functions or activities. And, crucially, the adoption of advanced industrial technologies can enable newly industrialising countries to leapfrog certain stages of the industrial development process. On the whole, therefore, the problem is not one of too much technological change, as of the need to have and share in it, the difficulty of managing it, and the widening gap in capabilities that is apparent between developed and developing countries, particularly the poorest which are in danger of technological marginalisation. The utilisation of the growing technological opportunities depends on the availability of a skilled labour force, capital and infrastructure, which are usually missing in the poorer countries, as well as on appropriate macro-economic and technology policies.

8.13 The impact of advanced technologies, particularly microelectronics, on employment skills is two-fold: on the one hand, they create greater demand for technical and managerial skills, but on the other, they can deskill jobs. The consequence is likely to be a deepening polarisation in the labour force: those workers conversant with new technologies secure higher paid, protected employment, while those without such skills are increasingly vulnerable and marginalised. (The same is true of countries.) Overall, technological change requires more and higher skills, not less. Those who wish to keep pace with it must commit themselves to much scientific and technical training, and in view of the foreshortening in innovation and production cycles, to continuous retraining as well (see paras.5.25-5.27 above).

8.14 New technologies have already begun to affect the organisation

of work, both within the workplace and in its spatial relationships. Within enterprises, former hierarchical structures are being replaced by more flexible group-based systems of operation. Spatially, information technology theoretically permits almost unlimited decentralisation of activities, ranging from administrative staff working from their own homes or from cheaper locations, to data processors working in one country and transmitting the results to another. (How far such movements will be constrained by social, security and other factors remains to be seen.) Information technology also has the potential to reduce urban congestion by means as different as home-working and computerised traffic control. And by reducing the need for business travel, through the use of fax machines, computer-video links and teleconferencing, it can in the longer term contribute to reducing energy consumption and thereby lessening pressures on the environment.

8.15 Most importantly, new technologies are already changing the international division of labour and influencing the pattern of world trade. As we mentioned in the previous chapter, global production strategies made possible by the use of modern technologies are enabling transnational corporations to reap the benefits from changes in international competitiveness through locating their production facilities in the lowest cost areas and sub-contracting particular processes to the lowest-cost suppliers. Many of the newly-industrialising and some other middle-income countries are benefiting economically and technologically from such arrangements, but many other developing countries are being disadvantaged through the resultant trade and investment diversion. Some developed countries have also suffered, as the ongoing process of developing new technologies is continuing to alter the balance of competitive advantage between countries. All aspects of industrial production, from raw-material sourcing to marketing and transport, as well as labour relations, are being affected. Increased automation in manufacturing, using computer-controlled processes including robotics, means that relative wage rates are becoming less important even in traditionally labour-intensive industries like garment making, and have enabled developed countries to become competitive again in some sectors. And the pace of this process is accelerating. Some developing countries have however been able to maintain their competitive advantage by adopting new technologies; but since these are usually costly as well as labour-saving, they have been mainly restricted to export industries, even in the newly industrialising countries.

8.16 As noted earlier, new technologies are also increasing the tradeability of services and blurring the distinction between them and goods. Traditionally the nature of most services meant that with the exception of shipping and airlines, only a small proportion entered world trade. But new information technologies have facilitated

the increasing export of financial, banking, insurance, data processing and related professional services. They have also facilitated travel and have therefore helped to promote tourism. Developed countries see tremendous potential for exporting knowledge-based services, and in the GATT Uruguay Round and other fora have been trying to persuade developing countries to reduce their controls on the import of such services. Technology developments are likely to have mixed results as far as developing countries' services are concerned. These countries' economies may benefit from increased tourist receipts and from greater investment; but in some cases this may only be at the cost of environmental deterioration, increased external dependence, and a lack of control over services.

8.17 As food and raw material producers, developing countries' interests can also be profoundly affected by new technologies. For example, biotechnology can, on the one hand, multiply agricultural yields and varieties and enable crops to be produced on marginal lands, thereby assisting these countries to feed their people better, increase agricultural exports and reduce food imports. But on the other hand, it can increase the yields of temperate products and enhance their competitiveness; it can enable tropical crops to be grown in temperate climates; and it can destroy demand for conventional commodities by providing synthetic or other substitutes. This last characteristic is true of other new technologies, for example the substitution of fibre optics for copper. New technologies can also reduce raw material requirements through increasing efficiency in utilisation, miniaturisation and reduced need for inventories. This process of substitution has been at work for a long time but the new trends in technology may well have caused it to accelerate.

Technology Policy

8.18 The widening gap in living standards between developed countries and most developing countries is attributable in part to the widening gap between them in the efficient application of research and development (R&D) to production processes. This, in turn, depends to a considerable extent on linkages between applied R&D and production. It is also evident in the different proportions of the labour forces of developed and developing countries who possess scientific and technical skills, and in the comparative expenditures on R&D in the two categories of country. In the 1980s the OECD countries devoted about two and a half per cent of their GNP to R&D, while the corresponding expenditure by developing countries was less than one per cent of their much smaller GNP. Total R&D expenditure in 1988 was estimated at around $350 billion in the developed countries, whereas in the developing countries it was only around $20 billion, spread over a much larger population.

8.19 The pace and complexity of technological change confront developing countries with daunting problems. If they do not keep abreast, they risk becoming increasingly uncompetitive. In many cases they have the capacity to exploit new technologies. But if they are to do so, clear and positive policies are needed on scientific and technical training, as well as on technology monitoring and evaluation, adaptation and development, and utilisation and diffusion. In view of their circumstances, developing countries should pay particular attention to policies for technology transfer, something we consider in the next section. The need for clear and positive policies applies also, of course, to industrial countries, as does the need for policies on technology transfer in view of the complexity and widespread application of modern technology development.

8.20 A policy to enhance human resource development is crucial to all elements of technology. Scientific and technical knowledge and awareness of technology developments internationally are needed to guide the formulation of technology policy (including technology transfer), and to make effective use of technology by being able to identify, evaluate and assimilate those which are suited to domestic circumstances and to adapt those which are not. There is also need to undertake overall technology assessment related to economic and social need. All this must rest on an infrastructure of human resource development, especially education in the application of physical sciences.

8.21 We have considered human resource development in Chapter 5 but here we should emphasise the importance of developing countries increasing the proportion of budgetary expenditure devoted to education and, within it, raising the amount spent on scientific and technical training. This need extends from primary to tertiary level, as is evident from the glaring differences between developed and developing countries. In the developed countries the ratio between technology-related and white collar types of tertiary-level course enrolments is of the order of 50:50; in the developing countries it is of the order of 10:90. And because of the much lower enrolment rates at tertiary level in developing countries (see Annex Table 5.5 on p.171), the real differential between the number of technology students in developed and developing countries is far more than the 5:1 implied by these figures; it is probably in excess of 20:1. One of the main reasons is the much higher cost of technology-related courses. In some developing countries, the lack of demand for technologically and scientifically trained graduates also contributes both to the 'brain drain' (see para.5.41) and to low enrolment, creating a vicious circle which obstructs a transition to higher technology development. One of the main tasks for developing countries is to reorient their educational and training programmes more towards science and technology. Similarly, it is necessary for all countries to

encourage computer use and computer literacy because of the pervasive importance of computer technology, especially in manufacturing and services. Where import restraints on hardware and software constrain wider computer use, we believe they should be reviewed and if possible removed.

8.22 In shaping their technology policies, developing countries need to build a capacity to monitor and evaluate technological developments and to forecast, if only in general terms, the likely course of events. The aim here will be to distinguish those technological advances useful to a country in its particular circumstances from among the bewildering mass of technological developments.

8.23 There is no doubt that indigenous development of technology is important for developing countries, especially in fields such as agriculture where specific production circumstances require effective local and regional R&D. For many developing countries, however, it is not crucial in the initial stages of most other sectors, where greater reliance can be placed on technology transfer and adaptation.

8.24 Developing countries need policies to encourage technology development, adaptation and absorption. In addition to measures providing for or promoting appropriate scientific and technical education and training, this requires support for indigenous research and development, programmes to diffuse technological knowledge and its application, and the encouragement of innovation and competition.

8.25 We recognise that it is often very difficult for developing countries to cope on their own with technological change. Small developing countries will find particular problems in attaining the minimum thresholds required for R&D, training of high-level personnel and creation of technological capacity generally, from within their own resources. This is an area clearly calling for regional cooperation. But bilateral and multilateral cooperation can also be of help. The continuing weakness of local R&D institutions and other indigenous efforts in most developing countries emphasises the importance of joint ventures with relevant R&D institutions in developed countries. These possess many scientists and technologists who, with some facilitating assistance, could be harnessed to help develop and adapt technology in developing countries.

Technology Transfer

8.26 No country, even the most economically advanced, can expect to develop itself all the technology that it wishes to use; developing countries, in particular, need to import technology to upgrade their

domestic activities and compete internationally. To do this effectively requires the capacity to identify and evaluate appropriate foreign technologies. These can be acquired in different ways (see Box 8.1 below). Most of them are owned by private interests, particularly the transnational corporations. Many developing countries will be at a disadvantage in negotiating to acquire these corporations' technologies. They need to exercise great care and on occasion seek assistance to ensure

Box 8.1

Technology Transfer

The main means of technology transfer are through direct foreign investment (equity participation, joint ventures, subsidiaries of transnational corporations); direct transfers of technology (patenting, licensing agreements, technical consultancies, management service contracts, on- and off-the job training); imports of capital goods (often in association with other transfer elements such as information on technical specifications, training, consultancy); turnkey projects (sometimes involving an entire enterprise); reverse engineering (i.e. unpackaging technologies); and non-negotiated transfer, such as screening of foreign journals, direct observation by scientists and technicians at universities and R & D institutions abroad, etc.

These methods of transfer involve different costs and benefits to the receiving country in terms of price, control, and ability to absorb or adapt the technology concerned, or develop totally new processes or products. Any one method may be appropriate in particular circumstances, but the aim of developing countries is to acquire technology at a fair price, on reasonable terms and conditions, and with maximum effectiveness in developing their indigenous assimilative and innovative capacities.

In order to evolve a coordinated technology development strategy, developing countries need to strengthen their human resource capabilities (through technical education, vocational training, etc); institutional systems (R & D institutes, technology development centres, consultancies, diffusion and extension services); organisation arrangements (data-banks, patenting, rule- and standard-setting); and administrative capabilities (technology forecasting and assessment, technology and related industrial and trade policy-making, negotiating capacity etc.).

that the technologies are transferred to them on equitable terms. They need also to secure appropriate training for local staff, a right to sell the resultant products or services freely abroad as well as at home, and rights to adapt and diffuse the technology in question. As the experience of South Korea has proved, an ability to unbundle packages, acquiring what is needed and rejecting what is not, is of particular relevance in this respect.

8.27 From a policy standpoint, technology transfer is a complex issue. There is sometimes a need to reconcile the protection of specific areas of economic activity (perhaps for reasons of security or other public policy) by restricting imports, with the maintenance of a non-discriminatory and liberal trade regime (for reasons of general development). Such matters can probably be resolved only on a country-specific basis. Whereas selective protection was a component in the industrial successes of some countries such as Japan and Korea, in others policies restricting the use of imported technology have had mixed results: considerable success sometimes in terms of fostering technological development domestically, but failure in terms of promoting overall economic growth due to the uncompetitiveness of the technologies fostered in this way. In general, liberal import policies appear to have been more effective in promoting technological progress and economic growth when assessed together.

8.28 The control of technology transfers remains a crucial policy issue in many developing countries, as the evolution of biotechnology illustrates. The products and processes of the 'gene revolution' are now largely in the hands of transnational corporations and specialist companies in the developed countries. Their control has made access more costly and in other ways more difficult for developing countries in two respects. One is the extension of intellectual property rights to plant and animal products and biotechnology processes. The other is the increasing proportion of academic research which is commissioned by, and contracted to, industry; previously widely disseminated, this is now either shrouded in secrecy to protect commercial interests or available only at a high price.

8.29 This underlines the need for greater collaboration and networking between universities or public sector research institutes in pure and applied science. Biotechnology is a particular case in point. Greater support is also needed for publicly-funded collaborative efforts in advanced technology. In this connection we welcome UNIDO initiatives in establishing international centres of excellence—on Biotechnology and Genetic Engineering, and on Science and High Technology—and urge that they be strongly supported.

8.30 Access to technologies could be made more difficult by other developments in the international sphere. In the fora concerned with

structuring the international commercial, legal and scientific environment affecting the transfer and use of technology, the developed countries have been pressing for extended and tighter control of industrial and intellectual property rights. As we noted in Chapter 7, Governments such as the United States have (under Section 'Super 301' of its 1988 Omnibus Trade and Competitiveness Act) threatened bilateral retaliation against countries not adhering strictly to international agreements on such rights. The treatment of these rights remains at issue in the GATT Uruguay Round of multilateral trade negotiations (as pointed out in Chapter 7). They are also under revision in WIPO (Paris Conventions on Patents and Copyrights, etc) and UNESCO (copyright conventions etc.).

8.31 Also of concern to developing countries is the possibility of collusive action by transnational corporations to restrict access to technologies, and by industry associations to control trade in 'technology products' (such as arrangements between US and Japanese companies on trade in integrated circuits). We acknowledge that this is a problem, and that governments do have a role in ensuring fair competition practices, but we believe the crucial need for them is actively to encourage and facilitate transfers of technology, for example by joint ventures. In other words, to promote an approach that is more business-like than legalistic.

8.32 On the other hand, while recognising that technology development frequently requires massive initial investments, that those who make these investments will want to sell or license the resultant technology profitably, and that intellectual property rights must therefore be adequately protected through internationally agreed rules,we feel that the techonologies themselves should be widely available on equitable terms. If the outcome of the GATT negotiations is less than satisfactory to the developing countries in this respect, we consider that there will be need to devise new mechanisms to foster the transfer of technology to them, including subsidising the payment of fees for industrial and intellectual property rights. Official development assistance may have a role to play here. For example, there will be instances, perhaps particularly in the environmental field, where a coincidence of interests between developed and developing countries will justify special arrangements to provide technologies on a non-commercial basis through such assistance. We explore this point further in the next Chapter.

Chapter 9

The Environment

9.1 Much has been written on environmental issues. We address them here because of their increasing impact on and implications for the development process and relations between developed and developing countries. This has followed from the dramatic upsurge in international concern about environmental degradation during the past decade and the significant changes which have occurred in perceptions of the problem. Advances in scientific knowledge have exposed grave threats to our common future—such as would follow global warming and ozone depletion—which were barely understood or thought to exist a decade ago. A better understanding of ecology has also led to greater awareness of how irreversible damage has been done to some of the Earth's life-support systems. Conventional notions about economic growth and development are increasingly being questioned as environmental awareness grows. Nowhere is this more apparent than in the energy sector, which perhaps more than any other highlights the linkage between environmental and developmental concerns. On the one hand, energy is vital to economic growth and development. On the other, it is the cause of many environmental problems.

9.2 Although all countries have a common interest in safeguarding the future of the planet, there are serious differences of view between them on environmental problems. Developed countries consider that developing countries should participate in global environmental conservation efforts. Developing countries accept this, but point out that it is the developed countries which have caused the greater damage to the environment in achieving their high living standards and that it is these countries which still consume a disproportionate amount of non-renewable resources (particularly fossil fuels). Developing countries are also

concerned about the imposition of new forms of conditionality—based on environmental criteria—with no assurances that significant additional resources will be forthcoming to meet the high costs of environmental conservation. There are strongly held fears that resources will be diverted from traditional development assistance to the environmental sector. Developed countries, for their part, are concerned about the domestic budgetary implications of allocating additional resources to support environmental conservation in developing countries.

9.3 These divergencies are the cause of serious problems. But they also give developing countries leverage in negotiations and provide them with other opportunities. Some progress in resolving the difficulties has already been made. Agreements on burden-sharing have been reached in certain areas (for example in reducing ozone depletion), and international institutions including the World Bank are devoting more resources to global and domestic environmental protection. But a more comprehensive understanding between countries is clearly needed on this issue in the interest of securing a global partnership to tackle environmental problems.

The Nature and Scale of the Problem

9.4 The impact of human activities on the biosphere, which was marginal for almost the entire history of human evolution, has increased exponentially in the last two centuries through industrialisation and other forms of economic development and, more recently, through the population explosion. The consequent damage to the environment manifests itself at different levels.

9.5 Some phenomena such as the threat of global warming, the depletion of the ozone layer, and the loss of biodiversity, constitute global changes harmful to all humanity. Others, ranging from sulphur dioxide emissions to illegal dumping of noxious waste, have trans-border implications. Finally, problems such as soil erosion and riverine flooding have serious implications which are usually confined to a single nation. We restrict ourselves here to noting those problems which are causing the greatest concern.

9.6 Human activities are substantially increasing atmospheric concentrations of gases, posing the danger of global warming through the 'greenhouse effect'. The most important cause is the burning of fossil fuels (see next paragraph). A clear scientific consensus has emerged on the range of global warming (and consequent sea-level rise) which can be expected during the twenty-first century. The findings of the 1989 Commonwealth Report on Climate Change have largely been confirmed by the United Nations Intergovernmental Panel on Climate Change. In

the absence of action to limit growth of greenhouse gas emissions, by the year 2100 the world is likely to be 3 degrees centigrade warmer than today and global sea-level 65 cm higher. Although significant uncertainties remain, the ensuing climatic changes might place stresses on natural and social systems unprecedented in the past 10,000 years. A rise in sea-level of one metre, for example, would engulf low-lying islands and coastal zones and displace tens of millions of people.

9.7 Largely because of the burning of fossil fuels, the energy sector accounts for roughly half of the anthropogenic emissions of gases which are accelerating global warming. Coal-burning thermal electricity generating plants pollute the air and cause acid rain. In many developing countries part of the reason for the increasing rate of deforestation is the need to meet the growing demand for fuelwood in poor rural and urban households.

9.8 The atmosphere is also being affected in other ways. Increased emissions of chlorofluorocarbons (CFCs) as a result of the expanding use of aerosols, refrigerators and plastics are causing complex chemical reactions which are breaking down the ozone layer. It has been scientifically established that the present rate of depletion of the ozone layer has significantly increased the risk of skin cancer and other ailments because of ultraviolet radiation. Nuclear accidents like that at Chernobyl have also caused much environmental pollution and increased the incidence of cancer.

9.9 Deforestation contributes to global warming but also carries with it the loss of biological diversity. The current rate of deforestation is such that perhaps a quarter of the earth's species may be extinguished in the next 20 to 30 years. At the national level, deforestation is also a major cause of soil erosion which has already led to the advance of the desert in many developing countries. Today, two-fifths of Africa's non-desert land risks being turned into desert, as does one-third of Asia's and one-fifth of Latin America's. The potential loss of agricultural and pastoral production threatens the livelihood of many millions and the food supply of many more. Inequitable land distribution and population pressures compel millions of the rural poor to clear hillside forests for agricultural purposes as well as for fuelwood. In an increasing number of developing countries, this has caused serious erosion of upland watersheds, with grave consequences for agricultural production downstream in valleys and deltas. But environmental problems are not restricted to the land. Indiscriminate fishing and pollution of fishing grounds have done great damage to marine resources in many areas. Oil spills have also caused much ecological damage as recent events in the Gulf have shown.

9.10 Almost all these events are symptoms of the fundamental problem

of unsustainable development highlighted by the 1987 Report of the World Commission for Environment and Development (the Brundtland Commission). The growth and development strategies which have created today's $20 trillion world economy —characterised by vast international disparities in consumption and wealth—cannot be sustained indefinitely in ecological terms. There are finite limits to the capacity of the biosphere to accommodate and support human activities. The world invites ecological catastrophe if it breaches those limits. The Commission, therefore, called for a profound change in economic development policies based on the principle of environmental sustainability: development should meet the needs of the present generation without compromising the ability of future generations to meet their own needs. It was optimistic to think that a 'new era' of ecologically sound growth could ensure higher living standards for all without doing further damage to the environment. This would require the integration of environmental considerations in every aspect of economic, social and political life. The Commission also stressed the need to address a related developmental challenge: the alleviation of poverty. It warned that a world in which poverty is endemic will always be prone to ecological and other catastrophes. The satisfaction of basic needs in developing countries is therefore essential to achieving sustainable development.

9.11 The principle of sustainability, among other things, requires that the environment be seen as a form of capital which is producing a flow of services (providing raw materials, absorbing waste products, and supporting life) to humanity. A major reason for the continued degradation or depletion of the environment is that humanity is trying to enjoy too many of those services as if they were free, and continuing largely to ignore full cost accounting for environmental destruction (for example air and water pollution).

Causes of Environmental Degradation

9.12 All countries have contributed to the world's environmental problems, but the degree to which they have done so varies substantially. With only a fifth of the world's population the developed countries account for over three-quarters of its consumption of non-renewable resources. They consume 85 per cent of the world's fossil fuels, whose burning is the main cause of the greenhouse effect. Their energy use releases perhaps three-quarters of the sulphur and nitrogen oxides that cause acid rain, and their industries generate most of the world's hazardous chemical wastes and CFCs which are damaging the ozone layer. The dissemination of scientific facts about environmental degradation has caused profound changes in public perceptions and preferences in many developed countries. Environment has moved to the top of the political agenda in several of them. But despite growing

awareness and concern about environmental matters, the developed countries have not so far succeeded in checking, let alone reversing, the increase in the damage they do to the environment.

9.13 The developing world, on the other hand, has so far contributed relatively little to the degradation of the global environment. What damage it has caused is largely local and has flowed in particular from its poverty. Peasant farmers destroy their own future livelihood by indiscriminate tree felling, but do so only because they have no immediate alternative. The excessive depletion of tropical rainforests, partly to provide timber for developed country markets and partly for agricultural settlement, attracts justified concern for the future. An estimated 470 million (or 60 per cent) of the developing world's poorest people live in areas which are already ecologically fragile. The sheer pressure of population on scarce resources (land, water and firewood) or improper land utilisation is exacerbating problems such as deforestation, desertification, soil erosion and water pollution which, in turn, are causing further immiserisation. Breaking this vicious cycle of poverty and environmental degradation in these marginal areas will require major investments which developing countries will be unable to finance without substantial external assistance.

9.14 Environmental degradation results partly from the unmet basic needs of the poor but more so from the over-consumption and waste by the rich. With continuing population growth and the manifest need for development to raise living standards, developing countries will increasingly add to the burden on the global environment. Meeting their needs will require that consumption of water, energy and forest products continues to increase. But if further pressure on the world's fragile eco-systems is to be avoided, we believe it inevitable that developed countries will have to reduce their consumption of energy and raw materials and use them far more efficiently. The crucial question is how, and how rapidly, a 'culture of sustainability' can replace deeply entrenched values which equate happiness with continuous increases in material consumption.

Solutions on a National Scale

9.15 No country can alone assure its own environmental well-being. But each should take primary responsibility for its own problems. We consider the key to success lies in implementing the concept of sustainable development along the lines espoused by the Brundtland Commission (see para.9.10). In essence, economic growth and development must respect, not destroy, environmental capital. This represents a daunting challenge because economic and political systems are still biased towards meeting immediate needs. Until very recently the welfare of future generations rarely figured in this short-term calculus.

9.16 To put the concept of sustainable development into practice even within one country requires action on many issues. Due weight needs to be given to environmental assets and costs in the process of arriving at every economic decision. In particular, these environmental assets need to be treated as capital, not free goods.

9.17 Many familiar instruments of economic policy can be used to promote environmentally sound activities and behaviour. For industrial countries we propose that taxes and subsidies be used more actively to alter market prices and thereby encourage a switch in production and consumption from environmentally harmful products to benign or less harmful ones. We recognise that in some cases, these mechanisms would need to be supplemented by regulatory instruments.

9.18 For developing countries the overall solution is more fundamental and depends in large measure on alleviation of the sort of poverty which compels people to think only of the daily imperatives for survival. Only when their position has been altered substantially will it be possible for peasant farmers, for example, to avoid over-grazing grasslands to rear cattle, over-exploiting soils to produce more food, and over-cutting their woods to meet requirements for firewood. Degradation in terms of soil loss, urban congestion, water pollution and deforestation are taking place at an alarming scale in many parts of the Third World.

9.19 Economic development will greatly help developing countries to reduce their population growth and improve their capacity to protect the environment. Their domestic environmental problems cannot be treated as if they were separate from their general development problems. Additional external assistance can attenuate the dilemma many developing countries confront of having to allocate scarce domestic resources away from pressing needs to ensure sustainable development. Such assistance—and efficiency in resource allocation—is urgently needed for environmental protection purposes. But we emphasise that it must be additional to that for other purposes: diverting aid is not the solution since the maintenance of economic growth is vital for providing the resources and technical capacity to deal with environmental problems. And aid generally should not be made conditional on environmental protection measures which can often be undertaken only if growth can proceed.

9.20 In both the industrial and developing countries, the case for energy conservation and greater efficiency in the production and use of existing energy resources, and the development of new and renewable ones, has been strengthened greatly by the type of environmental concerns we have sketched out above. Currently, renewables (almost entirely hydropower and biomass) account for 18 per cent of the world's energy consumption

and nuclear power for another 4 per cent. The remainder is met by fossil fuels. There is growing recognition that energy prices should reflect more closely the external social costs of production and use, including the dangers from air pollution and nuclear contamination, and the economic, ecological and health costs of global climate change. Measures like carbon taxes, which have been introduced in some Scandinavian countries and are being considered in several others in the industrial world, will be crucial in encouraging a shift away from more polluting fossil fuels (such as petroleum and coal) to less polluting ones (for example natural gas). They can also help to make non-polluting sources like solar energy more competitive, although it is likely that more radical steps such as subsidies on research and development will also be required. As for nuclear energy, while there is renewed interest in it as a medium-term solution, it is unlikely that there will be a major shift in investment as long as concerns about safety and waste disposal remain acute.

International Solutions

9.21 Countries acting individually through domestic measures can achieve much. But the global or trans-border nature of many environmental problems requires international solutions through strengthened international cooperation and institutions. We note that there have been some encouraging signs of progress. The world community has, for example, put in place reasonably effective measures to slow and eventually prevent further depletion of the ozone layer (see Box 9.1 on p.134).

9.22 As the extent of past environmental destruction and new environmental threats becomes clearer, there is growing concern about how the high costs of environmental protection will be met. It has been estimated that those not presently covered would cost developing countries between $20 and $50 billion a year during the 1990s. If developed countries—which currently spend 1-2 per cent of their total output on pollution control—are concerned about diverting resources to environmental protection, such concerns are far more acute in developing countries. It is being increasingly recognised that, unaided, the latter cannot hope to reconcile other pressing development needs with taking measures to protect the environment.

9.23 In respect of global environmental problems such as ozone depletion, global warming, tropical deforestation and the loss of biodiversity, we believe the developed world has a self-interest, as well as an obligation, to provide additional financing to help developing countries. For without the participation of the latter, an effective response to these problems will be very difficult and perhaps impossible. We consider it is also in the developed world's interest to facilitate the transfer, to the developing countries, of the technologies which will be

Box 9.1

The Environment: Some Recent Initiatives

i) March 1989: Basel Convention adopted on the Control of Transboundary Movements of Hazardous Wastes and their Disposal.

ii) May 1989: UNEP Governing Council asks Ad Hoc Working Group of Experts on Biological Diversity to expedite preparation of an international legal instrument to protect bio-diversity.

iii) October 1989: Leaders of 47 Commonwealth nations meeting in Kuala Lumpur adopt the Langkawi Declaration on the Environment: a commitment to foster sustainable development through national and collective efforts.

iv) December 1989: UN General Assembly decides to convene a United Nations Conference on Environment and Development, to be held in Brazil in June 1992.

v) June 1990: Parties to the 1987 Montreal Protocol to protect the ozone layer agree to phase out CFCs and other major ozone-depleting chemicals by the year 2000. They also agree to establish an Interim Multilateral Fund to help developing countries phase out CFCs.

vi) November 1990: Second World Climate Conference endorses the conclusion of the WMO-UNEP Intergovernmental Panel on Climate, that without actions to reduce greenhouse gas emissions the rate of global warming over the next century will be historically unprecedented.

vii) November 1990: $1.2-$1.5 billion Global Environment Facility established under the auspices of the World Bank, UNEP and UNDP to help developing countries participate in global environmental protection efforts.

viii) February 1991: UN Intergovernmental Negotiating Committee begins negotiations on a Framework Convention on Climate Change.

needed to take effective global action. There has been some progress on the financial side. Multilateral arrangements, such as the interim fund to help developing countries phase out CFCs, and the recently established Global Environment Facility (under the auspices of the World Bank, UNEP and UNDP) will provide some assistance, but this is likely to be still far short of requirements. Bilateral official development assistance can also help, particularly if it is used in part to subsidise the transfer of technology, as we have suggested earlier (see para 8.32). But even if this were to happen, adequate resources will probably not be forthcoming from traditional sources. We propose that consideration be given to tapping new sources of funding such as international taxation. For such taxation to be fair and progressive, the burden should be borne mainly by developed countries. One example could be an international tax on carbon dioxide emissions. Although we recognise that its collection and distribution would pose considerable logistical and other problems, we still consider it worthy of examination.

9.24 The Third World's inability to mobilise adequate resources to tackle environmental problems which do not have global implications may also have adverse, if indirect, repercussions for the developed countries. Continued neglect of serious problems like soil erosion and desertification in some countries could lead, in the future, to a large-scale exodus of 'environmental refugees' across borders, causing crises which would necessitate emergency aid. In some regions, notably the Middle East, international assistance to support joint projects for the management of scarce common water resources can, in the long run, avert conflicts which may have international ramifications. We believe such projects are worthy of increased support.

9.25 The North also has an environmental interest in assisting the South to use energy more efficiently and to switch to more benign forms, such as natural gas rather than fuelwood unaccompanied by reafforestation. On the basis of current trends, it is estimated that in about 20 years, developing countries will be consuming as much energy as the industrial countries do now. A key issue is whether these countries can avoid repeating the mistakes of the industrialised world and meet their energy needs in ways that are less damaging to the environment. Capital and technological constraints are the major impediments to increasing energy efficiency and developing renewable sources like solar power.

9.26 Increased assistance to developing countries in respect of their energy transformation, transportation and utilisation is urgently needed. It is particularly important for environmental as well as more narrowly economic reasons that these countries (and those of Eastern Europe) raise the efficiency of their energy utilisation. The World Bank's Energy Sector Management Assistance Programme has found that

some of the more industrialised developing countries use four times as much commercial energy per unit of GDP as do the countries of Western Europe. Part of this divergence reflects the different sectoral proportions of their economies, but most of it is a result of using obsolete technologies. The Bank has estimated that updating those technologies could save about 20 per cent of the energy used. Inefficiencies have been especially marked in some of the heavy users of commercial energy such as thermal electricity generation, metal smelting and cement production. Inefficiencies have also been of considerable environmental significance in the household and rural uses of energy from fuelwood and other biomass, where improvements in technology ranging from better designed domestic ovens to the use of genetic engineering for creating fast-growing species of trees could greatly improve the lives of the poor.

9.27 The developing countries are currently receiving some support for this from the international system. The UN Fund for Science and Technology for Development and UNIDO have assisted in the development of energy technologies, for example, while UNCTAD has helped developing countries in the transfer of these technologies; the UNDP and World Bank have undertaken energy management and assessment programmes. But the help provided is far from adequate to meet the need.

9.28 In the longer run, it is vital that developing countries are able to acquire the technology, capital and other resources needed for the large-scale exploitation of new and renewable sources of energy from commonly available elements such as hydrogen, or from the sun, wind or sea. Support for these activities is available from several UN agencies. The UNDP's Energy Account, for example, has since 1980 made funds available for exploratory surveys, inter alia for natural gas and renewable sources of energy (especially hydropower sites), focusing on the poorest countries and those most severely affected by rising costs of fuel imports. The UN Revolving Fund for Natural Resources Exploration has since 1983 played an important role in the search for geothermal energy resources. But in both cases their resources are small.

9.29 An increasingly important issue which is emerging on the international agenda is the imposition by some developed countries of unilateral restrictions against certain imports from some developing countries on environmental grounds. This is often the result of pressures from NGOs; examples include recent US restrictions on imports of tuna and citrus fruit from Mexico and of grapes from Chile. The 'greening' of politics and the 'greening' of trade are closely intertwined as the recent debate on the proposed US-Mexico free trade agreement has illustrated. Since the GATT already permits import restrictions for health, phytosanitary and national security reasons it has been argued that

restrictions necessary to satisfy environmental conservation requirements might similarly be recognised and acted upon.

9.30 But this raises several controversial issues. One is the degree to which each GATT contracting party should have discretion to impose such restrictions. More serious, as we have said earlier (see para.7.17), is the danger that environmental factors will simply be used as pretext to impose new non-tariff barriers to imports. Developing countries would be particularly vulnerable to such measures. There have already been controversial cases where restrictions have been imposed on imports of products not because these did not conform to domestic environmental standards but because they were judged to have been produced or processed in the exporting country in an ecologically unsustainable way. While recognising that there can be difficult cases, we emphasise the need for legitimate environmental considerations to be reconciled with trade requirements in ways which do not hurt the equally legitimate export interests of developing countries. The GATT Contracting Parties are beginning to address this problem but they should do so more actively. It would be particularly important to ensure the transparency of any trade restrictions imposed on environmental grounds and to establish effective mechanisms for dispute settlement and compensation. Finally, we urge the lifting of trade restrictions (for example on processed timber products) which perversely serve to encourage ecologically unsustainable practices.

Conclusion

9.31 Environmental problems have several dimensions and need to be tackled in a multifaceted way. Both developed and developing countries need to intensify efforts to deal with their local environmental problems by integrating ecological considerations into economic policies and using economic instruments to promote sustainable development. But these are not the only types of environmental problem.

9.32 Those which pose a global threat to humanity underscore the interdependence of nations. They also risk becoming a major arena for North-South confrontation. They can only be confronted effectively through truly global responses. Other environmental problems may also have serious international repercussions. Their solution also requires international co-operation. Agreement on how to deal with global environmental problems and on the financing and other mechanisms to help developing countries participate in the solutions must be expedited (see Box 9.1 on p.134, items v and vii). A consensus on fair burden-sharing in paying for the high costs of environmental protection will be essential in order to create the global partnership that is needed to avoid conflict and secure humanity's common future. The North has

incurred a large ecological debt to the world due to its environmentally destructive patterns of production and consumption. It is in the interests of the developed countries to mobilise adequate additional financial resources to help developing countries achieve environmental and other developmental objectives, without imposing new forms of conditionality in development assistance. But donor countries' fears about having to meet all the costs of global environmental protection must also be recognised.

9.33 We hope the revival of multilateralism in some aspects of international behaviour has improved the prospects for negotiating a global compact to meet the world's environmental challenges in a way that is consistent with development. The 1992 UN Conference on Environment and Development will provide the international community with a unique opportunity to forge it.

Chapter 10

Conclusions and Recommendations

10.1 We were commissioned almost two years ago to look at the impact of global change on development. In Chapter 1, we have tried to summarise the most important changes affecting the development process with which we were confronted when we started work; and those which have occurred since. In Chapters 2-9 we have looked at these changes from a number of different points of view. We want now to pick out what seem to us to be the salient points in this earlier consideration; draw conclusions; and bring together specific proposals for action to tackle the problems and exploit the opportunities which we have identified.

Change

10.2 Earlier chapters demonstrate that the pace of change has greatly accelerated in recent decades. The extent to which we have had to accommodate new changes in our analysis in the course of our work has brought this home to us very vividly. What is more, changes in one field often have a bearing on changes in others and can accelerate them further. We have tried to identify the major changes of recent decades affecting developing countries and the development process, some directly, some indirectly. In our efforts to keep our work within an easily usable compass, we have confined our discussion to change whose impact on development is serious and manifest.

10.3 Many of the changes we have analysed affect the external economic environment in which developing countries are trying to earn a living. Anything which affects the world trading system affects them. So do changes in the availability of official development assistance and private

capital. They are self-evidently affected by changes in demand for the commodities on whose export many developing countries rely. And, perhaps most important of all, technological advance is altering the balance of comparative advantage between the industrialised and the developing world, and among developing countries.

10.4 Other changes affect the political and security position of the countries of the developing world. The end of the Cold War has simultaneously brought a reduction in global tension and a new unpredictability. It has reduced super power sponsorship of one side or the other in regional conflicts and simultaneously removed the old constraints which kept such conflicts within bounds. At the same time we can observe a strengthening of commitment to national and group causes and a flourishing of ethnic loyalties, producing tensions just as fundamental as those generated in the past by super power rivalry.

10.5 Even more pervasive than such economic and political change is the impact of technological development. It is changing the nature and organisation of economic activity everywhere, stimulating, for example, the new phenomenon of globalised industrial production. It can alter the balance of effective power between governments and major companies. It is bringing about a steady acceleration in the pace of change. And technological change increases the premium on human adaptability. Those economies which through effective investment in human resources can keep pace with it will flourish. Those which cannot, whether industrialised or developing, will be pushed to the margin of world affairs.

10.6 Yet another category of change concerns the patterns of global management. The international institutions established shortly after the Second World War are ageing. Their evolution has been checked by national rivalries and suspicions, and by institutional inertia. They have not kept pace with the speed of economic, political and technological change. Members of the world community have increasingly committed their fortunes to more limited interest groups. They have sought security in regional groupings and prosperity and influence in economic groupings representative of their own level of development. Once again, those many developing countries unable to adapt or find a place for themselves in these interest groups have been pushed to the margin of concern.

10.7 All these changes in long established areas of consideration have been matched by the emergence of new issues and new approaches. A notable example is the growth of environmental problems and of concern for their solution. Another is the greater attention, stimulated by fear of scourges such as AIDS and drug dependence, to issues of health and substance abuse. Terrorism too is now a preoccupation of almost all governments and peoples. And in the course of our work over the last

two years we have observed a steadily increasing concern about political, economic and environmental refugees and about the brain-drain from developing to industrial countries which, together, may make migration the issue of the 'Nineties. Governments and peoples have, lastly, revisited a variety of old issues such as good governance and the benefits of market forces in a way which has introduced them into the global economic and political debate as major issues of intellectual and philosophical concern.

Interdependence

10.8 In our work, we have learned that the problems and opportunities thrown up by these changes cannot be analysed in isolation. One change in the economic field has an impact on all others in the same field. So does political or technological change, or the evolution of intellectual and philosophical attitudes. Nor is it possible to separate economic from political change, or technological change from the patterns of global management. We can find solutions only if we see these changes as part of a rich, complex, confusing but potentially promising whole.

10.9 All this leads us to a central conviction. It is the belief that humankind has a common and universal interest in solving the problems and exploiting the opportunities which change brings. The changes are inseparable from one another; their impact affects societies at every level of development; and little can be done to address them within the conventional limits of individual societies. Problems and opportunities, issues and priorities can no longer be seen as exclusively, or even predominantly, of concern to North or South.

10.10 Any of the changes and new issues which we have identified can serve to illustrate this proposition. Security, for example, is no longer just a question of political and military capacity to confront national rivals. It can be threatened by terrorists, ethnic challenges within national borders and the demands of particular interest groups. Its enhancement requires economic as much as political and military action. Similarly, environmental change and degradation present a diverse range of issues for attention. Many are soluble only by international action. Effectiveness and equity both demand that this international action should extend to technology and financial transfers from the industrialised to the developing world in the cause of a better environment for us all. Failing that, future Third World development will do as much damage as the activity of the industrialised world has already done to the global environment. Issues such as health, drug production, addiction and trafficking, and migration provide a third illustration of our point. The new health scourges, like the old, do not respect national frontiers. The drug culture links the poor producer to the addict through a global network which exploits human need and human dependency.

And migration, a response to a variety of causes, presents a multitude of problems, soluble only by international action.

10.11 All the issues which we have taken as illustrations and most which we have not stem from a multitude of causes. Solutions to them are equally numerous and complex. But poverty and under-development in the Third World are among the causes of most of them. None is capable of solution without measures which address the need for the Third World to develop out of poverty. In a world which is outgrowing the old limits of geography, some degree of dignity for all humankind is an essential element in any world order which seeks peace, security, stability and prosperity.

Recommendations

10.12 We make no apology for the fact, therefore, that all our recommendations are designed to promote sustainable development and thus enable the poorer countries of the world to take their place in a just, stable and prosperous global system. We address them in turn to the developing countries; to the countries of the industrialised world; and to the international system.

10.13 Developing countries should:

- Promote macro-economic stability and efficiency by reducing budget deficits; pursuing a non-expansionary monetary policy and an open trade policy; reforming the tax system; and reassessing the role of the private sector.
- Improve the climate for domestic and foreign investment and reverse capital flight by promoting market economies and efficient capital markets; by reforming investment approval procedures, exchange control and tax regimes; and by developing physical infrastructure and human resources.
- Promote good governance, in the interests of economic development and as a good in itself; and improve the quality of public administration.
- Cut military spending, making use of the opportunities presented by the ending of the Cold War to redouble their efforts to divert resources to more constructive purposes.
- Develop human resources through education and training programmes and policies which recognise the need to exploit the opportunities offered by technological change; and develop indigenous technological capacities, especially in areas such as agriculture, agri-processing and biotechnology.

- Pursue effective population policies.
- Recognise the importance of environmental policies for sustainable development, and ensure that environmental considerations are taken into account in the formulation of development and energy policies; implement poverty eradication programmes which will help contain and reverse environmental degradation.
- Adopt energy-saving policies and develop diversified and renewable energy sources.
- Recognise the benefits which regional economic integration can bring, particularly where individual countries' size limits their economic efficiency or bargaining strength, and consider new regional approaches to development strategies, while respecting the overriding need for an open global economic system.

10.14 Industrial countries should:

- Adhere strictly to multilateralism in trade policy; and ensure that the growth of regionalism does not undermine the multilateral trading system.
- Recognise the complementarity between aid and trade; dismantle barriers to imports from developing countries; and reconsider their agricultural, industrial, commercial and other policies in terms of their impact on developing countries.
- Ensure that the emergence of new claimants on world savings, such as Eastern Europe and the Soviet Union, does not result in a diversion of official development assistance flows from developing countries; and, recognising that aid performance has been deteriorating at a time when the aid agenda has expanded, double official development assistance and reach the agreed UN target of 0.7 per cent of GNP by the end of the century.
- Exploit the opportunity offered by the reduction in East-West tensions to cut military spending; ensure that part of the resultant peace dividend is devoted to increasing official development assistance; and help others achieve reductions in military expenditure by unilateral and multilateral measures to cut arms sales.
- Implement more effective measures for developing countries' debt relief; establish fora to pursue comprehensive and equitable burden-sharing arrangements between all creditors and to restructure debt in relation to debtors' capacity to service it; adopt the Trinidad and Tobago terms for debt-distressed low-income countries; and ensure that debt relief is not extended at the expense of flows of official development assistance.

- Remove impediments to the transfer of technology for development, on affordable and in some instances concessionary terms.
- Take immediate and more effective action in conserving the environment, recognising that their own economic structures and lifestyles are major causes of global environmental degradation.
- Provide concessionary assistance to help developing countries adopt energy-efficient and other sustainable development technologies, bearing in mind the global nature of environmental threats and the commonality of interests in overcoming them.

10.15 The international system:

- The world community should continue to seek systems of global security which in time might render national systems and alliances redundant; strengthen the capacity of the United Nations to resolve conflict and respond effectively to threats to national security; and promote a more comprehensive concept of security that takes into account economic and social development, human rights and environmental concerns.
- The Uruguay Round of multilateral trade negotiations should be carried to a successful conclusion. The GATT system should be strengthened and mechanisms established for resolving conflicts in new areas such as the trade-related aspects of intellectual property rights (including technology transfer), services, and the environment.
- The major industrial countries, in their collective consideration of economic policy in fora such as the G7, should give due attention to the effects of their policies on developing countries; and they should widen their consultative processes to include the views of developing countries. The role of the IMF in the surveillance of industrial countries' policies should be enhanced.
- Member states of the IMF should strengthen the Fund's compensatory financing capacity to provide greater protection for the developing countries from the adverse effects of industrial countries' economic policies; from fluctuations in commodity export earnings; and from unforeseen economic and natural shocks such as drought and natural disasters.
- The present IMF arrangements for compensatory finance to ameliorate the impact of oil price fluctuations should be similarly strengthened. The inclusion of the oil import element in the IMF's Compensatory and Contingency Financing Facility should be made permanent.
- International support for efforts to increase developing country export earnings from commodities, by such means as diversification,

increased processing, quality improvement and research, should be enhanced.

- The international financial institutions should pay special attention to the needs of small states, which face particular economic vulnerabilities due to their size, by adopting more flexible and contingency- oriented criteria in the provision of assistance.
- Member states of the IMF and the World Bank should find ways of addressing the particular problems presented by multilateral debt.
- The case for meeting the liquidity needs of developing countries through expanding IMF quotas and strengthening the role of Special Drawing Rights, both as a reserve asset and as a source of liquidity, should be pursued in view of the commercial banking system's reluctance to lend to many of these countries.
- The design of structural adjustment programmes should pay greater attention to the need for economic growth and poverty alleviation, and should also aim to safeguard budgetary allocations for human resource development and the social sector.
- The world community should recognise its common interest in halting and reversing the degradation of the global environment, and agree to take co-ordinated action to achieve environmental conservation and sustainable development; it cannot afford to let the United Nations Conference on Environment and Development fail; nor should it miss the opportunity which the environment issue provides for taking advantage of the convergence of long-term interests between the North and the South, and embarking upon global discussions on a new agenda based on these changed perceptions and aimed at achieving sustainable development for all.

10.16 We believe that each of the measures we recommend has intrinsic value. But throughout our work we have repeatedly been reminded of the indissoluble links between the issues, changes, problems and opportunities which we have identified. Each measure we have listed can be made that much more effective by action on other recommendations at the same time. To take one chain of relationships almost at random to illustrate our point, we note that any reduction in obstacles to imports from developing countries serves to decrease the dependence of these countries on external finance and to increase their ability to achieve economic growth and reduce poverty while avoiding environmental degradation.

The Way Ahead

10.17 We recognise that the proposals we make above comprise a

formidable list and that including all the lesser recommendations we have made in earlier chapters would lengthen it even further. We recognise also that to carry these proposals into effect will require the sustained exercise of political will as well as concerted action in many fora. Our last recommendation is therefore that the Commonwealth should take an early and sustained lead in bringing all these issues to the attention of governments and institutions. The aim would be to stimulate a wide-ranging debate at many levels, in public and in private, within national administrations, in specialised international organisations, and in bodies which, like the Commonwealth, bring specialised sectors together. We believe that such discussions would confirm our conviction that the world is faced with a new agenda which offers opportunities as well as problems; that development is central to effective action; and that the world community has a common interest in that development. We hope that the debate will prepare the way for a meeting of Heads of Government representative of the global community to focus the world's attention on the impact of current changes on the process of development. They will encounter problems, as we have done. But they will encounter too the opportunities which all change brings. And those opportunities, if seized with courage and conviction, offer dignity to the developing world and peace, justice, security and prosperity to us all.

Annex 1

Terms of Reference

EXTRACT FROM THE COMMUNIQUÉ OF COMMONWEALTH FINANCE MINISTERS MEETING, KINGSTON, JAMAICA (SEPTEMBER 1989)

World Economic Situation

2. Ministers noted that the economic growth in industrial countries, which had been sustained for seven years, is threatened by a resurgence of inflationary pressures. They noted the continuing adjustment difficulties among major industrial countries. They emphasised the need to maintain control over inflation, noting that, while high interest are currently necessary to curb inflation in industrial countries, they have serious adverse effects on indebted developing countries.

3. Growth is now slowing down and Ministers emphasised the importance for the world economy as a whole of maintaining non-inflationary growth in industrial countries. They asked industrial countries to review their mix of monetary and fiscal policy in order to minimise pressure on interest rates and facilitate orderly adjustment. They recognised the value for adjustment and growth of policies to enhance competitiveness and flexibility, and the use of market mechanisms. They stressed the importance of closer policy co-ordination among major countries, keeping in view the impact of industrial country policies and growth on developing countries and they supported an enhanced IMF surveillance role in that process.

4. Ministers noted that, while in much of Asia economic performance was strong, a deep and protracted development crisis continues to affect large parts of the developing world, particularly in sub-Saharan Africa

and Latin America and in the Least Developed and small island developing countries. They were encouraged by the large number of countries which sought to establish sound policy frameworks for growth through the adoption of adjustment programmes. There have been a few successes. However, in some cases sustainable growth has not been attained in spite of economic reform and adjustment programmes. In many countries, implementation and effectiveness have been hindered by unfavourable factors such as negative resource transfers, high international rates of interest, increasing protectionism and continuing low commodity prices. Ministers expressed concern at the very poor prospect for improvement in the living standards in many countries in the foreseeable future.

5. In the light of recent changes and emerging trends in the world economy, Ministers invited the Secretary-General to set up an Expert Group to review how these changes affect the interrelationship between the developed and developing economies and their specific implications for management of the debt problem and the adjustment policies and growth strategies of developing countries; and report to Finance Ministers.

EXTRACT FROM THE COMMUNIQUÉ OF COMMONWEALTH HEADS OF GOVERNMENT MEETING, KUALA LUMPUR, MALAYSIA (OCTOBER 1989)

Paragraphs on the Establishment of an Expert Group

63. Heads of Government emphasised that an important opportunity was offered by reduced East-West tensions to reinvigorate efforts to tackle other major world problems, particularly poverty. They expressed hope that assistance to support economic reform in East European countries should not result in decreased financial flows to developing countries. They called for greater global solidarity in response to the major economic and environmental challenges and for a special effort to improve development cooperation.

64. Heads of Governments noted the rapid changes in the world economy. These needed continuing review, especially as regards their impact on economically weak countries. They were pleased to note that Commonwealth Finance Ministers in Kingston had asked for a Commonwealth Expert Group to examine how recent changes and emerging trends in the world economy affected the inter-relationship between developed and developing countries. They asked that major international institutions, including official and private financial institutions, should be associated with the examination. They also asked that the Expert Group should report as soon as possible, if necessary confining

itself in the first instance to an interim report summarising the main issues of concern to the world community.

65. Recognising that existing economic consultations among industrial countries (G7) largely reflect the perspective of those countries, Heads of Government believed that this dialogue should be supplemented by appropriate consultations with developing countries. They noted the proposed Special Session of the United Nations General Assembly on International Economic Cooperation and Reactivation of Economic Growth and Development, and also the Four-Nation Paris Initiative for North-South consultations at summit level.

66. They felt that the Commonwealth might have a particular role to play. They believed that the global political and economic climate was much more propitious for dialogue than for many years. There was broad agreement on the principles necessary to bring about sound development. But developing countries were faced with grave resource constraints in applying those principles. They believed it might be right for the Commonwealth, within which dialogue had not been interrupted, to take matters forward. The agenda provided by the Expert Group should be a good basis for doing so.

67. Heads of Government invited Commonwealth Finance Ministers to consider the agenda identified by the Expert Group as soon as possible. They should then make recommendations as to the appropriateness at that time of the proposal by the Prime Minister of Jamaica for a Commonwealth initiative to bring about a meeting of a representative group of Heads of Commonwealth and non-Commonwealth countries.

Annex 2

Impact of the Gulf Crisis on Developing Countries

Introduction

The Gulf crisis has had both direct and indirect effects on developing countries. It increased the cost of oil imports of developing countries. It also affected their export earnings through the loss of markets in the affected Middle East countries, as well as through reduced demand from its impact on world economic growth. And, for some countries in particular, it also resulted in loss of earnings due to its impact on workers' remittances, revenues from tourism and receipts from pipelines, canals, shipping, and insurance. Taking into account both direct and indirect effects, the World Bank has estimated that the size of the external shock on all affected countries for 1991 is about $20 billion.

The impact of the Gulf crisis is particularly severe on some countries. A study sponsored by the Overseas Development Institute (ODI)[1] is particularly illuminating. Its estimates of the effects on 35 low and lower middle-income countries, based on the implicit assumption that the final effects of the crisis will end by the middle of 1991, are given in Annex Table 2.1 on p.151. For all these countries the costs exceed 1 per cent of GNP—the UN definition of a natural disaster—and for 16 of them, they exceed 2 per cent. The total direct costs for low-income countries are at

[1] The following paras on the impact of the Gulf crisis rely heavily on 'The Impact of the Gulf Crisis on Developing Countries', ODI Briefing Paper, March 1991; and 'The Economic Impact of the Gulf Crisis on Third World Countries', a memorandum prepared by CAFOD, Christian Aid, CIIR, OXFAM, Save the Children Fund and World Development Movement: London, March 1991.

Annex Table 2.1 Impact of Gulf Crisis (where impact > 1% of GNP)

	Country	Oil Cost/ (Benefit) US$m	Non-oil Cost US$m	Total Cost US$m	% of GNP
Low income	**Middle East**				
	Yemen	(570)	1400	830	10.4
	South Asia				
	Bangladesh	130	115	245	1.4
	Pakistan	560	295	855	2.4
	Sri Lanka	140	125	265	4.0
	Sub-Saharan Africa				
	Benin	40	–	40	2.2
	Chad	25	–	25	2.5
	Ethiopia	115	–	115	2.0
	Ghana	50	–	50	1.0
	Kenya	125	–	125	1.5
	Lesotho	15	–	15	2.0
	Liberia	20	–	20	2.0
	Madagascar	50	–	50	2.1
	Mali	35	–	35	1.9
	Mauritania	10	–	10	1.2
	Mozambique	20	–	20	2.0
	Rwanda	35	–	35	1.6
	Sudan	75	305	380	3.8
	Tanzania	80	–	80	2.8
Lower middle income	**'Front line' states**				
	Jordan	200	1,570	1,770	31.5
	Turkey	1,210	2,150	3,360	4.9
	Egypt	(1,215)	2,200	985	2.9
	East Asia				
	Papua New Guinea	60	–	60	1.8
	Philippines	470	160	630	1.6
	Thailand	980	–	980	1.7
	Latin America & Caribbean				
	Costa Rica	75	–	75	1.7
	Dominican Rep.	150	–	150	3.4
	Honduras	60	–	60	1.4
	Jamaica	70	–	70	2.6
	Nicaragua	45	–	45	1.4
	Panama	60	–	60	1.4
	Paraguay	105	–	105	2.8
	North Africa				
	Morocco	260	150	410	2.0
	Sub-Saharan Africa				
	Botswana	35	–	35	2.8
	Cote d'Ivoire	110	–	110	1.1
	Mauritius	50	–	50	2.6
Total severely affected low income countries				**3,200**	
Total severely affected low and lower middle income countries				**12,100**	

Note: Estimated increases in oil import costs based on six-month period of higher prices. Other estimated costs arise from: decreases in migrant worker remittances up to mid-1991; resettlement costs of returning workers; estimated loss of 50% of one year's export earnings to Iraq and Kuwait; losses of tourism receipts; and identified decreases in aid flows.

Source: Overseas Development Institute, Briefing Paper, March 1991.

least $3.2 billion; when lower-middle-income countries are included the figure rises to $12 billion. The coverage does not include India, the third most affected country with an estimated loss of $1.6 billion (or 0.6 per cent of GNP). The overall impact of the Gulf crisis is estimated to have lowered real GNP in the net debtor oil importing developing countries by slightly more than 0.5 per cent in 1990. Real output in these countries in 1991 is expected to be slightly less than 0.5 per cent lower than it would have been otherwise.

The following paragraphs summarise the findings of the ODI paper in specific areas of impact.

Higher Oil Prices

Some 60 oil importing developing countries were seriously affected by the higher price of oil, which averaged about $30 per barrel during August 1990 to January 1991, compared to $18 in the first half of 1990. For these countries, each dollar increase in the oil price raised the import bill by some $2 billion. Of these 60 countries, 24 are in sub-Saharan Africa, and 19 in Latin America and the Caribbean. While the impact of the current crisis has been less severe than that of the oil price shocks of 1973-74 and 1979-80, the higher oil import bills came at a time when many countries faced a precarious financial situation.

Workers' Remittances

By 1990 some developing countries had become significantly dependent on workers' remittances from the Gulf region for their balance of payments. Eight countries—Egypt, Jordan, India, Pakistan, Sri Lanka, Bangladesh, Sudan and Turkey—were severely affected. In addition, the repatriation of workers is likely to have both long-term and widespread effects, affecting not only their families but also others dependent on them for finance and employment, as well as the stability of the already fragile social and political systems.

Impact on Trade in Goods and Services

Trade with Iraq and Kuwait was severely disrupted. The countries especially dependent on exports to these markets included Turkey, Jordan, Syria, Yugoslavia, Sri Lanka and Romania. In addition, the ban on the import of crude oil and petroleum products from Iraq and Kuwait disrupted supplies to many countries, including Sudan, Turkey, Brazil, Yugoslavia, India, Philippines and Hungary. Many developing countries were also hit from the loss of income from tourism. Middle East tourist traffic was severely reduced, with the economies of Morocco and Tunisia, as well as of Cyprus, being severely affected. Airlines faced increasing costs and a loss of business from the higher price of jet fuel,

increased insurance premia, the diversion of traffic from the war zone and a reduction in overall traffic. Shipping was adversely affected as well. In addition, some developing countries suffered a loss of service contracts.

Impact on Banking and Insurance

Overall net banking exposure to the Gulf was small; the most exposed centre was Bahrain. Several of the foreign banks reduced or closed their branches in the region.

Insurance premia on cargo rates for both shipping and aircraft rose sharply particularly in relation to Jordan, Saudi Arabia, Turkey and Iran.

Indebted Countries

The crisis was a severe shock for the heavily-indebted oil importing countries. Most of them faced a worsening in their terms of trade, leading to lower income and output. In addition, the economic slowdown in the industrial countries and higher interest rates adversely affected their exports and debt-service obligations. The countries most affected were Benin, Madagascar, Mali, Sudan and Tanzania. The impact on moderately indebted low-income countries was even greater. Included in this group are Bangladesh, Ethiopia, Pakistan and Sri Lanka. Among the highly indebted middle-income countries, substantial losses were incurred by Philippines and Brazil.

Oil Exporting Countries

Except for Kuwait and Iraq, the oil exporting developing countries experienced windfall gains from higher oil prices. The non-Gulf countries benefiting included—Venezuela, Mexico, Ecuador, Trinidad and Tobago, Algeria, Nigeria, Cameroon, Congo, Gabon, Indonesia and Malaysia. For the debtor countries that export oil, the improvement in the terms of trade offset the damaging influence of higher world interest rates and lower demand abroad. Overall the current account of the balance of payments of these countries improved and real output should, on balance, increase.

Aid Flows

Aid flows to some developing countries outside the Middle East region could be affected by the diversion of potential aid funds to some of the most severely affected countries in the region. In addition, Arab aid flows to developing countries, which amounted to $1.5 billion in 1989, are likely to be reduced. The large contributions to the war, the

maintenance of refugees and reconstruction of Kuwait and Iraq are new obligations which will take precedence.

Emergency Food Relief

The crisis also hampered efforts to provide emergency food relief to some countries in Africa. The immediate impact was an unavailability or increased cost of transportation, by air and sea.

International Assistance to Affected Countries

The international community has mobilised considerable resources to assist affected countries. Some $14 billion has been pledged in aid for the most severely affected countries, by members of the Gulf Crisis Financial Co-ordination Group (consisting of the 24 OECD countries and Saudi Arabia, United Arab Emirates, Qatar and Kuwait). Most of the funds—$10 billion - have been pledged by the Gulf States, with Japan and the EC promising a further $2 billion each.

The Group's assistance has, however, been extremely narrowly focused, with $10.5 billion earmarked for Egypt, Turkey and Jordan. The remainder is intended for those other states affected by the crisis and which joined the US-led coalition. Five countries have been specifically mentioned: Bangladesh, Pakistan, Syria, Lebanon and Morocco. The details of the criteria used or the process involved in allocating these resources have not been publicised.

The response of the World Bank and IMF has been more limited in extent but broader in geographical terms. The two institutions have essentially concentrated on adapting existing mechanisms. The World Bank launched a programme of assistance to the affected countries involving increases in both IBRD and IDA commitments for Financial Year 1991 (ending 30 June 1991). Disbursements from both IBRD and IDA were accelerated through the temporary raising of cost-sharing limits for affected countries on new as well as on existing loans and credits. Additional disbursements from these changes are estimated to be $500 million in FY 1991, when the total increase in lending from IBRD is expected to be about US$ 1.1 billion. This will include additional lending for structural and sectoral adjustment programmes in affected countries and special emergency operations. The increase in IDA assistance to the affected countries is expected to total SDR 630 million in FY 1991. This expanded IDA programme for these countries is to be financed partly through a special allocation of SDR 200 million of IBRD net income to IDA and a supplementary contribution of SDR 27 million from the Government of Kuwait. This assistance includes

emergency operations aimed at setting up infrastructure, social services and employment-creation programmes for repatriated workers.

The core of the Fund's response has been through its existing mechanisms, through rephasing and augmentation of Stand-by Arrangements, Extended Arrangements,Enhanced Structural Adjustment Facility (ESAF) Arrangements and the Compensatory and Contingency Financing Facility (CCFF). Where margins remained under existing access limits, additional resources were made available. For the ESAF eligible low-income countries, access under it can be increased at the time of the mid-term review to meet the impact of the shock, and where justified, ESAF support could also be extended to a fourth year.

The CCFF has been revised to extend the coverage of its compensatory component to include receipts from pipelines, canals, shipping, transportation, construction and insurance. An oil import element has also been introduced on a temporary basis to cover the excess cost of imports.

The Fund has also decided to allow an external contingency mechanism to be attached to an arrangement at the time of a review.

By the end of April 1991, the amount the Fund had expected to disburse since the crisis began was about SDR 6 billion, of which SDR 2 billion would have been provided to nine countries under the oil element of the CCFF, with additional requests expected. There had also been a considerable increase in the use of external contingency mechanisms, both attached to arrangements through the CCFF and within arrangements as contingent adjustments to programme targets.

Impact on the Environment

The war did grave ecological damage in the Gulf region, the full extent of which has yet to be assessed. The 11 million barrel oil spill - the largest ever recorded—has had severe consequences for marine and bird life, and appears to have caused significant coastal damage in Saudi Arabia, Kuwait and Iraq. Because the Gulf region's eco-systems are very fragile, it may take many years for marine life to recover. Clouds of soot rising from fires in several hundred of Kuwait's oil wells are already affecting the region's climate. According to experts, it will take at least nine months, possibly three years or more, to put out these fires. The reduction in sunlight and consequent drop in surface temperatures, together with acid rain (which is falling from Turkey to Iran) are likely to harm agricultural production. These climatic effects are expected to be confined to the Gulf region as long as the smoke is not carried high into the atmosphere.

Post-Crisis Impact

The cessation of hostilities should contribute to a resurgence of global economic growth because of the revival of business and consumer confidence and the substantial reconstruction spending in the Gulf. A recovery is also expected in the tourism and airline sectors.

The impact on world oil prices, however, is more uncertain. The overhang in supplies will tend to push prices downwards. But prices will also depend on the capacity of producers, notably OPEC, to manage supplies, particularly when Iraq and Kuwait resume production.

The erstwhile capital surplus oil producing countries, such as Saudi Arabia and Kuwait, could begin to make demands on world capital markets. Instead of being net savers, these and other Gulf states could, in the short term, become large net drawers of funds, and contribute further to the world shortage of savings.

Annex 3

The Impact of Drug Trafficking

Background

Illicit drug trafficking which involves the cultivation, manufacture and export of a wide variety of drugs is sophisticated and complex in nature. Marijuana, produced from the cannabis plant, is the most widely-used drug. But some of the most potent and therefore most profitable drugs are heroin, obtained from the opium poppy plant, and cocaine, produced from coca leaves. It is estimated that world production of opium and cocaine reached approximately 4,400 tonnes and 206,100 tonnes, respectively, in 1990, 98 per cent and 21 per cent, respectively more than their 1986 levels. Apart from increasing, the trade is also evolving, the newest aspect being an expansion in the illegal demand for synthetic drugs such as amphetamines, barbiturates and tranquilizers.

Countless states are involved in the illicit drugs trade, either as producers, processors, transit points or as final markets. The major producing/processing countries for heroin are in Southern Asia—Afghanistan, Iran, Pakistan, Thailand, Myanmar and Laos—while those for cocaine are in Latin America—Bolivia, Colombia, Peru and Ecuador. Important transit countries are located in the Balkan-corridor (Turkey, Bulgaria, Yugoslavia, Italy, Austria); West Africa (Benin, Nigeria, Togo); Latin America (Venezuela, Mexico) and the Caribbean (The Bahamas, Jamaica). The final markets are located in North America and Europe.

Impact

In examining the impact of the illicit drugs trade, several points should be noted. First of all, the 'underground' nature of the drugs trade and

its intricate links with the formal economy and legitimate enterprises render any assessment of its impact difficult. Secondly, since the drugs trade generates a host of human problems such as crime and drug-addiction, social as well as economic effects have to be considered. Thirdly, illicit drug trafficking has had varying impacts on countries, depending mainly upon the importance of such trade to the economies concerned. Notwithstanding all these problems however, an attempt is made below to outline the major effects, with reference to countries which have been among the most heavily involved on the supply side, and therefore most severely affected.

The illegal drugs trade has provided certain countries with badly-needed foreign exchange, created some employment and generated some economic activity. The United Nations estimated that in 1987 cocaine exports from Bolivia, Peru and Colombia were equivalent to 75 per cent, 14 per cent and 13 per cent, respectively, of these countries legal exports. The cocaine industry in Latin America is estimated to provide direct employment for some 1.5 million people who work in cultivating, processing, refining, transporting and smuggling the drug. A large number of legally employed persons in the services sector (for example lawyers, accountants, bankers) also benefit from the multiplier effect of the cocaine industry.

The illicit drugs trade has also helped to revive ailing sectors in certain countries. For example, during the 1980s, the proceeds of cocaine exports stimulated a mini-boom in Colombian textiles, construction and other industries. Economically depressed areas, such as in eastern Bolivia, have also benefited from the low-cost housing, sporting and other public facilities provided by the drug barons.

The negative effects of illicit drug trafficking, however, far outweigh these positive factors. The emergence of the drugs trade has led to a gross misallocation of resources and to the decline of the legal exports sector; it has also represented a costly drain on government revenues and facilitated large capital outflows. Furthermore, the exaggerated profitability of the drugs activities and the resultant money laundering activities of the traffickers have severely distorted the financial sector. Overall, the drugs trade has been far from a catalyst for the economic takeoff of countries. Instead, it has produced highly undesirable economic as well as social consequences.

The channelling of resources into drug cultivation has led to labour shortages in other parts of the agricultural sector. For example, in Colombia large-scale plantations growing bananas, coffee and sugar have had difficulty in finding pickers and growers. As a result, traditional

exports have declined, and food production has dropped, raising the amount of foreign exchange needed for food imports.

Almost all the profits from the drugs trade usually pass through official banking channels, and the massive financial inflows have had severe inflationary effects, as most countries have not had adequate financial policies or instruments to deal with the consequences. The drug traffickers' money-laundering techniques, which include manipulation of stock exchanges, formation of shell companies, and the creation of fictitious banking accounts and commercial operations, have caused severe distortions in the financial sector. Furthermore, the erratic spending patterns of the drugs dealers have led to the collapse of a number of banking and credit institutions in certain countries including Colombia. Distortions have also been created in the real estate market as large numbers of properties have been bought with cash. Land prices have been driven upwards, making low-cost housing difficult to provide.

The unofficial exchange market has grown substantially in many drug-trafficking countries, acting in effect as a vast money-laundering operation. In some instances the blackmarket exchange rate has actually fallen below the official rate. Attempts to institute stricter exchange controls in countries such as Colombia have created further problems. More drugs money has been retained outside the country, leading to undercapitalisation, where once there was overcapitalisation, and to a flourishing contraband trade with other Latin American countries to such an extent that its volume has been estimated to far exceed the official trade.

Profits from the drugs trade have not been used to promote economic development in the drug-exporting countries. Some have been invested in legal enterprises, but mainly in real estate and securities, rather than in directly productive ventures. Repatriated drug profits are frequently spent on 'protection' (ranging from bribes to the acquisition of private security systems) or on imported luxury items.

The drugs trade has also encouraged the growth of large populations of addicts and high crime rates; it has in addition been the cause of falling productivity. Governments have had to try to combat these effects by utilising revenues which should have been employed in other important social programmes. When account is taken of the lost productivity, the expanded law-enforcement agencies, the overloaded judicial and penal systems, and the expense of providing treatment and rehabilitation facilities for addicts, the final cost of drug trafficking becomes phenomenal.

Policies

National governments and international agencies such as the United Nations Fund for Drug Abuse Control have devised strategies to halt the production, trafficking and use of drugs. Most of these strategies have relied on supply-side approaches involving the enactment of anti-drug legislation and increased law-enforcement. Thus, drug plantations and drug laboratories in South America have been destroyed, trafficking networks disrupted, assets seized and extradition facilitated.

While these measures have resulted in record seizures and soaring arrests, drug supplies in general appear to be largely uninterrupted, and the risk of detection insufficient to deter either dealers or consumers. Crop substitution programmes have been tried but not with great success, given the huge disparity in returns between cultivating drugs and other crops such as wheat and barley. In Pakistan, for example, gross returns from growing opium were 3,500 rupees per acre in 1981, compared to 500 rupees per acre for maize.

Other policies aimed at drug eradication are placing greater emphasis on demand-side strategies. They include information and public-awareness programmes and treatment and rehabilitation programmes for drug dependent persons. Recent approaches include those set out in two major reports which, it is understood, will be considered by the 1991 G7 summit. The first contains proposals for controlling the supply of chemicals used in the processing or production of drugs, and the second urges continued coordinated action against the laundering of 'drug money'. Action to tackle money laundering was first raised at the 1989 Paris summit. A task force was created which last year drafted 40 proposals recommending better international cooperation and new national legislation. The task force now has the support of the G7 members, the EC, the Gulf States, Hong Kong and other financial centres. Experts have warned that controls need to be extended beyond banks to entities such as casinos and money exchange bureaux, and to property dealers. It is proposed that the task force continues its work, with its costs funded from assets seized by individual governments.

Annex 4

Decision-making in the Bretton Woods Institutions, IFAD and UNCTAD's Common Fund

The World Bank

The World Bank comprises the International Bank for Reconstruction and Development (IBRD) and its two affiliates, the International Development Association (IDA) and the International Finance Corporation (IFC). The IBRD and IDA, though legally and financially distinct entities, constitute a closely integrated unit and are administered by the same staff.

IBRD

Under its Articles of Agreement, all the IBRD's powers are vested in a Board of Governors consisting of one governor for each member country. Barring certain powers specifically reserved to them by the Articles of Agreement (for example decisions on membership, allocation of net income and changes in the capital stock), Governors have delegated their powers to a Board of Executive Directors. This functions on a full-time basis at the Bank's headquarters, and is the organisation's key decision-making body. There are 22 Executive Directors; five are appointed by the five members having the largest number of shares of capital stock (ie. the United States, Japan, Germany, the United Kingdom and France). China and Saudi Arabia are single member constituencies and the rest are elected to represent a constituency comprising a group of countries.

A country's voting power is linked to the size of its subscription to the

IBRD's capital which is based on its economic and financial strength and linked to its quota in the IMF. Each country has 250 basic votes plus one additional vote for each share of stock held. Voting is therefore weighted and in the Executive Board, each Director's vote is the sum of the voting power of the country or countries he or she represents. All votes cast by an elected Director must be cast as a unit. By virtue of the larger size of their subscription, industrial countries collectively exercise control over a majority of the votes.

Because of the manner in which voting power is determined, a general increase in the IBRD's capital (such as that which came into effect in April 1988) involving equiproportional increases in members' capital subscriptions, reduces the weight of the basic votes of each member, consequently diluting the relative power of smaller members. This has led to a reduction of the total voting power of developing countries. This problem has been receiving the attention of the Executive Board of the Bank. An Ad Hoc Committee, established in February 1988 and comprising eight Executive Directors, examined the issue. In its report, all but one of the members of the Committee recommended the use of membership votes, increased automatically at the time of each capital increase, to protect the voting power of smaller members. The issue has now been included in the terms of reference of another Ad Hoc Committee, set up in August 1989 and comprising 17 Executive Directors, which is examining the criteria for the allocation of Bank shares.

IDA

Decision-making in the IDA is similar to that in the IBRD, with the IBRD's Board of Governors and Executive Directors exercising the same responsibilities in respect of IDA. However, the system for allocating voting rights is different. For their initial subscriptions, original IDA members received 500 membership votes plus one additional subscription vote for each $5,000 (1960 dollars) they subscribed. This formula meant that the distribution of voting rights in IDA was approximately the same as in the IBRD. But the voting power of smaller members, which had been diluted in the IBRD because of successive capital subscription increases, was strengthened in the IDA by giving members relatively more membership votes, in comparison to total votes available, than was the case in the IBRD at that time. Under IDA's Articles of Agreement, developing country members had to be given an opportunity to increase their subscriptions so as to maintain their relative voting power. During negotiations for the IDA 3 replenishment (1972-74), when it was agreed that voting rights of industrial countries should be adjusted to reflect the relative size of their cumulative contributions, a new voting rights system was established to preserve the relative voting

power of developing countries. This system, involving allocation of extra membership votes in addition to additional subscription votes (developing countries were also allowed to make their extra subscriptions entirely in their own currencies) has basically been followed ever since.

IFC

The composition of the Board of Governors and of Executive Directors is the same in the IFC as in the IBRD/IDA. Voting is weighted, each member's voting power being linked to its subscription to the IFC's total capital.

The International Monetary Fund

The Fund is run by a Board of Governors, on which all member countries are represented, a much smaller Executive Board and an international staff. The Board of Governors is the highest decision-making body in the Fund. Each member country chooses a Governor who is usually its Minister of Finance or the Governor of its Central Bank. The Board of Governors, which in practice meets only once a year in a joint Annual Meeting of the Fund and the World Bank, has several reserve subjects under its purview, covering such matters as the admission of new members, determination of quotas, allocation of SDRs and amendment of the Articles of Agreement. All other powers have been delegated by the Board of Governors to the Executive Board.

The Executive Board consists of six appointed directors representing France, Germany, Japan, United Kingdom, United States, and Saudi Arabia (since 1978) and sixteen elected directors each representing a constituency comprising a group of countries (except China which has been allowed to elect an Executive Director with only that country in its constituency). The Managing Director, who is appointed by the Executive Directors, is Chairman of the Executive Board and Chief of the Fund's staff.

The Fund uses a system of weighted voting which gives the industrial countries a controlling share. The voting strength wielded by each Governor or Executive Director is based primarily on the quotas of the country or countries which he/she represents. The quotas of the member countries correspond roughly to their relative economic size. Each member has a basic allotment of 250 votes; in addition it has one vote for each SDR 100,000 of its quota. The basic allotment is intended to strengthen the voting position of the economically smaller members. It is contended that the variable allotment is designed to recognise differences

in subscriptions and to protect the interest and ensure the co-operation of those members that account for the greater part of international trade and financial transactions. Elected Executive Directors cast all the votes of their countries as a unit; however, this does not prevent them from indicating the positions of individual members of their groups during Board meetings.

Most decisions taken by the Board of Governors or Executive Directors are adopted by a simple majority of the votes cast. However, a 70 per cent majority of the total voting power is needed to solve such operational issues as rates of charges on the use of the Fund's resources and the rate of interest on holdings of SDRs. An 85 per cent majority ('high majority') is required for amendment of the Articles of Agreement, changes in quotas, SDR allocations and the disposition of the Fund's gold. The system of weighted voting results in practice in the major industrial countries exercising considerable influence over decision-making in the Fund. The United States, alone, or the members of the EC can veto proposals subject to a 'high majority'. In most instances, however, decisions in the Board are arrived at by consensus.

GATT

Unlike the World Bank and the IMF, the GATT is not in a strict sense an organisation and has no corporate structure. It is a multilateral contract among participating countries with only the very limited degree of authority that precedent and practice have provided, particularly in respect of its more powerful members. In the GATT, each contracting party has one vote and except in a few specific cases, decisions require in theory only a simple majority of the votes cast. A two-thirds majority of those voting is required for waivers (Article XXVI) while a two-thirds majority of the Contracting Parties is required for decisions relating to waiving of members' obligations necessitated by membership of customs unions or free trade areas. But in practice voting has been very rare and GATT decisions are usually reached by consensus.

However, at the GATT bargaining power has been substituted for voting power, and developing countries and even some developed countries play only a limited role, particularly in the multilateral trade negotiations (MTNs). Although there is far wider participation in the Uruguay Round of negotiations currently in progress, than in the seven earlier rounds, bargaining still takes place mainly among major trading countries, often on a bilateral basis or among small groups, and the agreed results given general application.

Consultation, decision-making by consensus and expert examination by independent panels have been built into the GATT's trade dispute settlement process. However, its procedures and arrangements are inadequate to enforce rules, particularly against major trading parties. It has often proved difficult even to adopt panel reports with which one of the disputants disagrees. Furthermore, there are no effective mechanisms to follow-up panel decisions.

In the Uruguay Round, negotiations are taking place on a number of measures to improve the functioning of the GATT system, including the dispute settlement process. A wide range of measures to expedite the formation and working of panels have been agreed upon and implemented on an interim basis. It has also been agreed that the Contracting Parties should meet at Ministerial level at least once every two years, among others to provide direction to GATT's work and to reinforce the commitment of governments to the GATT system.

The International Fund for Agricultural Development (IFAD)

IFAD has 145 member countries. The membership is divided into three categories, each having equal voting rights in the Fund's governing bodies: Category I, consisting of 21 developed (OECD) countries; Category II, 12 oil-exporting developing countries; and Category III, the 112 other developing countries. The Executive Board consists of 18 members, six from each category. Representation on the Executive Board from category III countries comprises two members each from Asia, Africa and Latin America.

The initial financial resources of IFAD pledged by member countries and effective on 30 November 1977 was US$1 billion, of which the developed countries contributed 56 per cent, the oil exporting developing countries 43 per cent and the other developing countries 1 per cent. The Fund has had three replenishments. The latest, effective on 24 December 1990, amounted to $556.3 million, of which the developed countries contributed 67 per cent, the oil-exporting developing countries 22 per cent and the other developing countries 11 per cent.

At present the non-oil exporting developing countries contribute 11 per cent of the capital and possess one-third of the voting rights. If the oil exporters are included, the developing countries have two-thirds of the voting rights, while contributing only one-third of the resources.

The Common Fund (UNCTAD)

One of the distinctive features of the Common Fund is its voting

structure. Unlike the Bretton Woods institutions, which tie voting closely to financial contributions, the Common Fund has given practical expression to the principle of greater equality in decision-making between rich and poor countries.

The 24 member countries of the OECD contribute 51.4 per cent of the Fund's directly contributed capital. The voting share of these countries is 40.2 per cent. While the developing countries (G77) contribute 32.1 per cent of the capital, their share of voting amounts to 45 per cent, reflecting their larger membership. The voting share (14.8 per cent) of the countries which used to be categorised as Group D (USSR, Bulgaria, Czechoslovakia, east Germany, Hungary, Poland and Romania) is somewhat less than their financial contribution (16.5 per cent). While this distribution of votes gives developing countries an unprecedentedly large voice in the decision-making of an international financial institution, the requirement for a two-thirds majority, or three-quarters in certain circumstances, gives the industrial countries, as a group, an effective power of veto over the Fund's most important decisions.

Annex 5

Demographic and Human Resource Development Indicators

Annex Tables

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Annex Table 5.1
Demographic Indicators

	1950-55	1955-60	1960-65	1965-70	1970-75	1975-80	1980-85	1985-90
Population growth rates				(percentage)				
World	1.80	1.86	1.99	2.06	1.97	1.74	1.74	1.73
Developed countries	1.28	1.25	1.19	0.91	0.86	0.73	0.65	0.53
Developing countries	2.05	2.14	2.35	2.53	2.39	2.10	2.10	2.10
Africa	2.18	2.35	2.48	2.63	2.69	2.95	2.95	3.00
Asia	1.90	1.95	2.19	2.44	2.27	1.86	1.86	1.86
Latin America	2.74	2.76	2.80	2.60	2.48	2.28	2.19	2.09
Birth rates				(per 1,000 population)				
World	37.4	35.6	35.2	33.9	31.5	28.4	27.7	27.1
Developed countries	22.6	21.6	20.1	17.9	16.7	15.6	15.2	14.6
Developing countries	44.6	42.1	41.9	40.4	37.1	32.9	31.8	30.9
Africa	48.9	48.6	48.5	47.7	46.7	46.4	45.5	44.7
Asia	42.9	39.6	39.5	38.4	34.8	29.7	28.4	27.6
Latin America	42.5	41.7	41.2	37.9	35.3	32.4	30.9	29.1
Death rates				(per 1,000 population)				
World	19.7	17.2	15.5	13.3	12.2	11.1	10.4	9.9
Developed countries	10.1	9.3	9.0	9.2	9.3	9.4	9.6	9.8
Developing countries	24.3	20.9	18.3	15.1	13.3	11.7	10.7	9.9
Africa	27.0	24.8	19.4	21.1	23.0	17.6	16.4	14.9
Asia	24.1	20.4	17.7	14.1	12.4	10.7	9.8	9.1
Latin America	15.3	13.6	12.2	10.9	9.7	8.7	8.0	7.5
Fertility rates				(per woman)				
World	5.00	4.88	4.97	4.88	4.45	3.84	3.61	3.44
Developed countries	2.84	2.82	2.69	2.44	2.20	2.03	1.93	1.90
Developing countries	6.18	5.95	6.08	5.99	5.41	4.54	4.19	3.92
Africa	6.61	6.69	6.74	6.71	6.60	6.52	6.37	6.23
Asia	5.92	5.57	5.71	5.67	5.05	4.06	3.72	3.45
Latin America	5.86	5.90	5.95	5.50	5.00	4.38	3.98	3.61

Source: World Population Prospects 1988, United Nations 1989

Annex Table 5.2
Life Expectancy at Birth

	1950-55	1955-60	1960-65	1965-70	1970-75	1975-80	1980-85	1985-90
				(in years)				
World	45.9	49.0	51.5	54.9	56.7	58.1	59.6	61.5
Developed countries	65.7	68.2	69.6	70.3	70.9	71.7	72.3	73.4
Developing countries	41.0	44.4	47.6	52.1	54.2	55.8	57.6	59.7
Africa	38.0	40.1	42.1	44.1	46.1	48.1	49.9	51.9
Asia	41.1	44.5	48.0	53.3	55.8	57.5	59.3	61.7
Latin America	51.2	54.1	56.7	58.7	60.9	62.8	64.5	66.0

Source: World Population Prospects, United Nations 1988

Annex Table 5.3
Infant Mortality Rate

	1950-55	1955-60	1960-65	1965-70	1970-75	1975-80	1980-85	1985-90
	(per 1,000 births)							
World	155	139	118	103	94	86	79	71
Developed countries	56	41	32	26	22	19	16	15
Developing countries	180	163	136	117	106	97	89	79
Africa	187	175	164	154	140	126	116	106
Asia	181	164	133	110	99	91	83	73
Latin America	126	112	100	91	80	70	63	56

Source: World Population Prospects, United Nations 1988

Annex Table 5.4
Nutritional Levels

	1961-63	1969-71	1978-80	1979-81	1980-82	1981-83	1983-85	1984-86	1986-88
	(daily calorie supply per capita)								
World	2,296	2,434	2,617	2,587	2,652	2,665	2,666	2,694	2,671
Developed countries	3,063	3,229	3,407	3,333	3,395	3,398	3,374	3,377	3,398
Developing countries	1,939	2,106	2,328	2,319	2,388	2,409	2,424	2,464	2,434
Africa	2,042	2,121	2,311	2,268	2,391	2,316	2,278	2,299	2,261
Asia	1,904	2,087	2,326	2,307	2,379	2,422	2,437	2,485	2,450
Latin America	2,374	2,514	2,591	2,675	2,643	2,633	2,700	2,705	2,732

Source: FAO, Production Yearbook 1989

Annex Table 5.5
Enrolment Rates by Level of Education

		1960	1970	1980	1985	1986	1987	1990
		(number enrolled as percentage of age group)						
		Primary						
World	Total	84.1	88.5	96.1	98.8	99.6	99.6	100.1
	M	94.8	95.8	103.5	105.7	106.3	106.1	106.3
	F	72.9	80.8	88.3	91.6	92.6	92.8	93.7
Developed countries	Total	105.6	103.9	101.4	101.5	101.8	101.8	101.6
	M	106.5	104.2	101.6	101.7	102.3	102.2	102.0
	F	104.7	103.5	101.1	101.3	101.3	101.3	101.0
Developing countries	Total	75.9	83.5	94.9	98.2	99.1	99.1	99.8
	M	90.4	93.1	103.9	106.6	107.1	106.9	107.2
	F	60.8	73.5	85.3	89.4	90.7	90.9	92.1
Africa	Total	42.3	54.6	79.5	75.2	75.2	76.0	79.7
	M	53.8	65.4	89.7	83.5	82.8	83.7	86.8
	F	30.8	43.8	69.2	66.8	67.5	68.2	72.5
Asia	Total	84.9	89.2	96.7	103.0	104.5	104.3	104.3
	M	101.0	99.5	106.4	112.1	113.2	112.9	112.4
	F	67.8	78.3	86.4	93.3	95.1	95.3	95.6
Latin America	Total	72.7	90.7	104.8	106.4	107.2	107.8	109.3
	M	74.7	91.9	106.4	108.7	109.5	110.1	111.4
	F	70.7	89.4	103.3	104.1	104.8	105.5	107.2
		Secondary						
World	Total	27.6	36.2	44.6	46.1	47.3	48.6	52.8
	M	31.3	40.7	49.6	51.4	52.6	54.1	58.4
	F	23.7	31.5	39.4	40.5	41.7	42.9	46.9
Developed countries	Total	61.1	76.8	84.4	88.6	89.7	91.3	93.6
	M	62.3	77.3	83.2	88.4	89.5	91.0	93.5
	F	59.9	76.2	85.8	88.8	89.9	91.6	93.8
Developing countries	Total	15.8	23.9	35.3	37.4	38.7	40.1	44.9
	M	20.4	29.6	41.7	43.8	45.1	46.7	51.6
	F	10.9	17.8	28.6	30.6	31.9	33.2	37.8
Africa	Total	5.1	10.8	23.0	28.4	29.9	31.4	32.4
	M	7.2	14.7	29.1	35.6	37.5	39.4	40.0
	F	2.9	6.9	16.9	21.1	22.1	23.2	24.8
Asia	Total	20.8	27.9	37.9	39.3	40.6	42.0	47.7
	M	25.9	34.2	44.8	46.1	47.4	48.9	55.0
	F	15.3	21.3	30.5	31.9	33.3	34.6	40.0
Latin America	Total	14.6	25.5	44.9	50.7	51.7	53.7	57.6
	M	15.2	26.3	44.4	49.0	49.9	51.7	55.7
	F	14.0	24.6	45.4	52.4	53.5	55.6	59.6

		1960	1970	1980	1985	1986	1987	1990
		(number enrolled as percentage of age group)						
		Tertiary						
World	Total	5.3	8.5	11.5	12.1	12.3	12.6	13.5
	M	7.1	10.4	12.9	13.4	13.6	14.0	15.0
	F	3.5	6.5	9.9	10.7	10.9	11.1	12.0
Developed countries	Total	13.5	23.4	30.3	32.9	33.4	34.1	36.8
	M	17.3	27.3	31.2	32.9	33.1	34.2	37.0
	F	9.6	19.3	29.4	32.9	33.7	33.9	36.5
Developing countries	Total	2.1	3.0	5.7	6.8	7.1	7.4	8.3
	M	3.1	4.2	7.4	8.5	8.8	9.2	10.1
	F	1.1	1.8	4.0	5.0	5.3	5.6	6.5
Africa	Total	0.7	1.5	3.5	4.2	4.3	4.3	4.9
	M	1.2	2.3	5.2	6.2	6.2	6.2	6.8
	F	0.3	0.7	1.9	2.2	2.4	2.5	3.0
Asia	Total	2.6	3.5	5.6	6.5	6.9	7.3	8.2
	M	3.9	5.0	7.6	8.4	8.8	9.3	10.4
	F	1.2	2.0	3.6	4.6	4.9	5.2	6.0
Latin America	Total	3.0	6.3	13.5	15.9	16.2	16.9	18.7
	M	4.2	8.0	15.3	17.3	17.2	18.0	19.3
	F	1.8	4.5	11.7	14.4	15.1	15.7	18.2

Source: UNESCO Statistical Yearbook, various issues

Annex 6

Recent and Projected Savings Behaviour in Industrial Countries

Gross national saving in industrial countries declined from 26 per cent of GNP in 1973 to 19½ per cent in 1983 before recovering slightly to 20 per cent in 1987 where it has stabilised since. Net national saving, i.e. gross saving adjusted for depreciation of plant and equipment, fell much more markedly from 17 per cent of GNP in 1973 to 8 per cent in 1983 and has since remained below 10 per cent.

Aggregate data, however, mask the wide discrepancy in savings behaviour across countries. In terms of gross saving rates, Luxembourg, Japan, Norway and Switzerland have been high savers (averaging above 25 per cent of GNP during 1980-87) whereas Denmark, Belgium, Sweden, as well as the United States have been low savers (averaging between 15 and 17½% of GNP during 1980-87). Among the Group of Seven major industrial countries, of the six[1] for which data are available, all except Japan exhibited some decline in savings between 1965 and 1987, with the largest decreases occurring in the United States and France.

The decline in government saving was primarily responsible for the sharp fall in national saving—4¾ of the 5½ percentage points fall in terms of gross national savings between 1973 and 1983—for five major industrial countries for which data are available. The declines in Japan, Germany and the United Kingdom were concentrated in the 1970s, in the United States in the 1980s, and in Canada during both the 1970s and 1980s. Since 1981, the government sectors in the United States, Canada and France

[1] The United States, Japan, Germany, France, Britain and Canada. Disaggregated data on the seventh, Italy, are not available on the UN system of national accounts.

have become dissavers and this was reflected in the aggregate position of the government sector in six major countries as dissavers during the 1980s.

Household savings also fell in the six major countries, with substantial declines in all of them (except Germany). However, in Japan, Germany and Canada, household saving had risen earlier, so that in 1987 it was as high as or even higher than in the late 1960s and early 1970s. Also, part of the decline in household saving since the early 1980s reflects economic changes that are intrinsically beneficial, including the fall in inflation (and consequently in interest rates) and financial reform. Furthermore, in most countries the drop in household savings has been offset by the increase in savings by the business sector, leaving total private sector savings as a proportion of GNP more or less unchanged throughout the 1980s.

Until recently, domestic investment moved in tandem with national saving in most industrial countries, with high saving countries also being high investment countries. However, since the early 1980s national saving and domestic investment have moved in opposite directions in some countries, the gap being reflected in their external current account balances. Capital mobility, financial market deregulation and globalisation of international capital markets have meant that governments and the private sectors in different countries have been able to tap foreign sources of finance, while private investors in different countries have become free to allocate their savings across countries to seek the highest available risk-adjusted returns.

There is no systematic tendency for private sector savings to offset movements in public sector savings, so that a change in the public sector deficit should be reflected in the change in the external deficit (or depending on the degree of capital mobility, in crowding out of domestic investment). In fact, during 1981-86, in relation to GNP, the US fiscal deficit worsened by 2½ percentage points and the current account deficit by 3½ percentage points. Simultaneously, Japan's fiscal and current account positions improved respectively by 5 and 4 percentage points and those of Germany by 2½ and 5 percentage points. Thus the trends in the early 1980s reflected a strong association between fiscal and current account deficits. However, the fact that changes in the external account positions were larger than in the fiscal position suggests that changes in the difference between private savings and domestic investment also played an important complementary role. For instance, Japanese and German private savings were increasingly used to finance the gap between US private investment and savings. In the late 1980s, whereas the fiscal positions of Japan and Germany continued to improve, the current account surpluses (in relation to GNP) fell or remained unchanged as

the gap between private savings and investment narrowed. Gross private domestic investment in Japan and, to a lesser extent, Germany increased markedly. In the case of the United Kingdom, the current account drifted from sizable surplus to a deficit of more than 4 per cent in 1989, in spite of a steady and substantial improvement in the fiscal positions, as private investment increased sharply and consequently the gap between private investment and savings widened.

The private savings rate of the G7 countries is expected to record only marginal improvement over the medium-term to 1995. At the same time, serious concerns persist regarding the overall fiscal position of these countries. The recent budget agreement in the United States represents a major step toward coping with the longstanding fiscal problem in that country, provided it is implemented in full. It is encouraging that the package includes both revenue measures and provisions to curb spending as well as a tightened enforcement mechanism designed to ensure the achievement of the planned deficit reduction. However, additional fiscal action is likely to be required to address fully the problem of inadequate national savings in the United States.

The net effect on other countries of increased German public and private sector demand for the country's savings has been a reduction in the availability of savings and a rise in real long-term interest rates. The increase in the German fiscal deficit that is currently in prospect exceeds previous expectations and is a matter of serious concern. Despite the budgetary package introduced in January 1991, the tax increases announced at the end of the following month, and the indication, in April 1991, of the intention to reduce subsidies further, starting in 1992, the budgetary outlook remains uncertain. Additional deficit reduction measures may be needed, particularly if it appears that the deficit will not fall rapidly after 1991. Strong fiscal action is necessary to permit domestic interest rates to fall without undermining price stability. This, in turn, would reduce upward pressure on interest rates in other European countries, while avoiding tensions within the Exchange Rate Mechanism of the European Monetary System.

Germany and the United States are not the only G7 countries where fiscal action is necessary to strengthen savings performance. The persistence of large deficits in Italy calls for a more aggressive fiscal plan. Fiscal imbalance is also high in Canada. However, the measures announced in Canada's latest budget strengthen the prospects of improved fiscal performance in the medium term.

Over a much longer term, up to the year 2025, national savings rates are expected to decline substantially in most industrial countries because of the rise in the average age of the population, with the largest declines

occurring in Japan and Germany, currently having the highest savings rates. In Germany after unification, however, with a much younger population in the eastern states, the effect on savings is expected to be less severe than projected for west Germany alone. In Japan (and west Germany) the dependency ratios by 2025 are expected to increase by 15 per cent (and 13 per cent). This would imply very substantial declines in the private savings rate, in the case of Japan from its current 25 per cent to about 10 per cent in 2025 (and for west Germany from 22 per cent to 9 per cent). Smaller declines are expected for other countries. These demographic changes would also imply large increases in government expenditures, especially on pensions. For Japan, the combined expenditures on pensions, health and education are projected to increase by 10 per cent of GNP by 2025 (and in west Germany by 8 per cent).

In the absence of any tax increases, the combined effects of lower private savings rates and higher government deficits would be reflected in the current account positions, and consequently in the net foreign asset and liability positions of these countries. Yet compared with the situation that would have obtained had no demographic changes taken place, the net foreign asset positions in relation to GNP of Japan (and west Germany) are expected to be lower by 100 per cent (and 60 per cent) respectively while those of the United States and Canada, where ageing of the general population is occurring much later than in other industrial countries, are expected to be about 70 per cent higher. The effects of projected demographic changes would, therefore, reverse the recent trends among the three largest industrial countries.

Annex 7

World Military Expenditures in the 1980s and 1990s

Data on defence spending are generally scarce, unreliable and vary from one source to another. Even so, what estimates there are indicate some very disturbing trends: the growing size of permanent military establishments, the intensifying financing burden on central governments, and the diversion of vast resources from productive investment and consumption.

According to the Stockholm International Peace Research Institute (SIPRI), world military expenditures in constant 1986 prices (excluding the USSR), rose from $461 billion in 1980 to $566 billion in 1986 before slipping to $545 billion and $519 billion in 1987 and 1988 respectively (see Chart on p.178 and Annex Table 7.1 on p.179). The World Bank put global military spending, including that by the USSR, at around $1 trillion in 1987; it estimated that NATO and Warsaw Pact countries devoted 16 per cent and 37 per cent respectively of current government expenditure, or 5 per cent and 11 per cent of GNP, to military purposes. The corresponding expenditure in the developing countries totalled $173 billion, representing 19 per cent of central government budgets or 5 per cent of GNP. World military expenditure in 1989 was estimated at $950 billion (see Box 6.1 on pp.74-75).

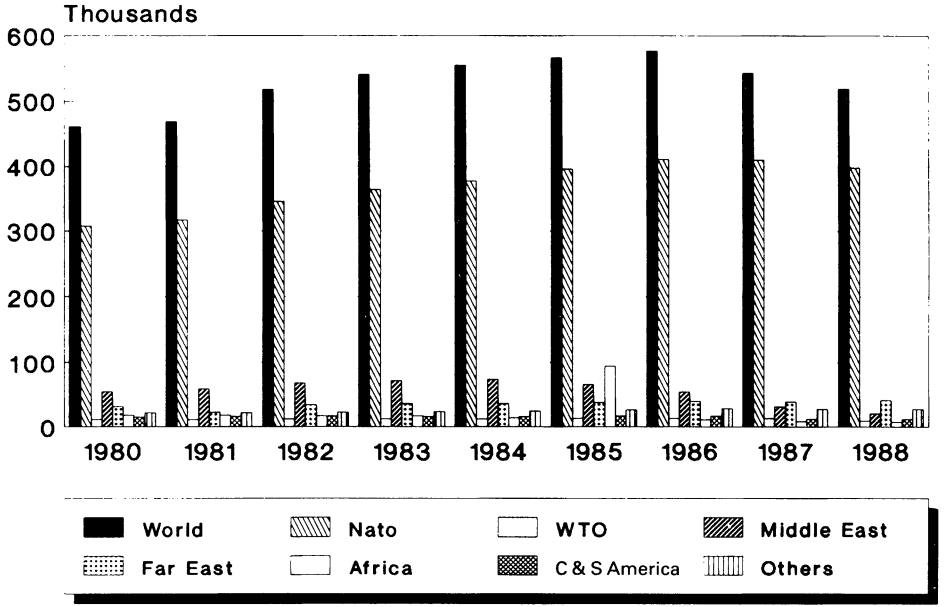
The increase in central government outlays on defence during 1980-87 in the industrial countries was largely accounted for by the United States, where defence expenditure rose from 5.4 per cent to 6.7 per cent of GDP. In the United Kingdom, it remained fairly constant at around 5 per cent of GDP. Sizeable defence expenditures in the 1980s were also maintained

by Middle East countries, whereas SIPRI estimates that those in Africa declined during the period (see Annex Table 7.1 on p.179).

The outlook suggests that the reduction in military expenditures that began towards the end of the 1980s may be continued in the 1990s. Although difficult to predict, some project a decline in defence spending of the order of 50 per cent over current levels by the end of the decade. Much of this hinges on the extent to which the strategic arms negotiations between the Warsaw Pact and NATO member countries bear fruit, as well as the degree to which the unilateral decisions by the United States and the USSR to limit defence expenditures are sustained. The pace of political democratisation in Eastern Europe and developing countries, and the paring of 'replacement expenditure' after the Gulf War, are also important factors.

The prolonged nature of disruption caused by armed conflicts and militarisation makes it difficult to assess the human, social and economic costs of military expenditures. The opportunity costs of the pursuit of military power, in terms of the neglect of social and economic needs, are high. Developing countries spend almost as much on defence as on health and education combined. Reductions in military expenditure in these countries would release much needed resources for the social sector and improve the budgetary and external positions. While the developing countries have a responsibility to their peoples to re-orient their priorities, it is also unacceptable that the industrial countries spend much more on defence than on official development assistance: during 1986-88 their defence expenditure averaged one to six per cent of GDP but that on aid was less than 0.5 per cent of GDP.

World Military Expenditures 1980-1988 *
(US$m at constant 1986 Prices)



Source: Stockholm International Peace Research Indt. (SIPRI) Yr 1989
Nato – North Atlantic Treaty Organisation
WTO – Non Soviet Warsaw Treaty Organisation

* Exclude Soviet military expenditure

Annex Table 7.1
World Military Expenditures 1980-1988*
US$m at constant 1986 Prices

COUNTRY	1980	1981	1982	1983	1984	1985	1986	1987	1988
World	461,226	468,986	517,508	540,785	554,891	565,919	576,012	541,991	518,552
Nato	307,685	317,151	344,915	364,027	376,981	396,016	411,371	409,965	398,607
WTO	11,648	11,820	12,069	12,109	12,812	13,510	13,431	13,397	9,654
Other Europe	11,107	10,861	10,830	10,588	10,698	11,381	11,572	10,510	10,353
Middle East	54,844	60,003	67,820	72,017	73,463	65,931	55,088	31,247	21,355
South Asia	6,699	7,013	7,850	8,321	8,809	9,806	11,327	12,397	11,989
Far East	31,395	22,971	34,582	35,622	36,476	37,802	39,344	39,102	41,935
Oceania	3,980	4,201	4,391	4,525	4,868	5,088	5,187	5,076	4,933
Africa	18,158	18,273	17,483	17,620	14,154	9,450	11,924	8,266	7,498
Central America	4,226	4,392	4,483	4,978	5,599	6,876	5,858	2,515	2,326
South America	11,484	12,212	13,085	10,978	11,031	10,029	10,910	9,516	9,872

Note: Nato – North Atlantic Treaty Organisation
WTO – Non Soviet Warsaw Treaty Organisation
* Excludes Soviet Military Expenditure

Source: Stockholm International Peace Institute (SIPRI) Yearbook 1989

Annex 8

Recent Debt Initiatives and their impact

Aid Debt Forgiveness

As early as 1978, following an UNCTAD resolution, creditor countries had started writing off official development assistance (ODA) or aid loans to the least developed and other low-income countries. Some $3.7 billion was cancelled between 1978 and 1986. In recognition of the particularly adverse situation facing the severely-indebted low-income countries (SILICs), over 1987-89 a further $2.1 billion was cancelled (including $1.7 billion for SILICs). This is likely to reduce annual scheduled debt-service by an estimated $350 million, or about 5 per cent of the 1990 scheduled long-term debt service of the beneficiary countries. It is estimated that a further $4.9 billion of aid debt (including $4 billion for SILICs) was cancelled in 1990. But despite recent actions, $18-20 billion of aid debt is still owed by SILICs to the donor countries.

Toronto Terms and Related Proposals on Bilateral Official Debt of Low-Income Countries

Following a decision by the leaders of G7 industrial countries at their 1988 Toronto summit, the Paris Club agreed to new options (the so-called Toronto terms) for rescheduling concessional and non-concessional official debt of severely-indebted low-income African countries. In 1990, these terms were extended to low-income countries outside Africa. Under the terms, all rescheduled concessional debt is to be repaid with a 25-year maturity, including a 14-year grace period. A substantial amount of the concessional debt is being cancelled, particularly that owed by low-income African countries (see above). For non-concessional debt,

creditor countries can choose from a menu of three options. Option A: cancellation of one-third of eligible debt and the rescheduling of the balance at market interest rates, with a 14-year maturity and an eight-year grace period. Option B: rescheduling all eligible debt at market rates, with a 25-year maturity and a 14-year grace period. Option C: charging of below market interest rates, and requiring payment with a 14-year maturity and an eight-year grace period. To date, consolidation periods for debt-service, eligible for these reschedulings, have been only in the range of 12 to 36 months, so that the extra relief offered has been limited. Between October 1988 and March 1990, 20 countries (including Guyana, Tanzania, Uganda and Zambia in the Commonwealth) rescheduled about US $6 billion of their debt on Toronto terms. This amounted to about 20 per cent of the bilateral official debt of the rescheduling countries. The average consolidation period has been approximately 16 months, and seven countries have been able to reschedule twice on these terms. The estimated cash-flow savings, compared to standard reschedulings, was about US $100 million, or 1.5 per cent of scheduled debt service.

Because of the limited benefit offered by the Toronto terms to eligible countries, John Major, the then UK Chancellor of the Exchequer, proposed at the Commonwealth Finance Ministers meeting in September 1990, an additional initiative. The Trinidad and Tobago terms, so named because of the venue of the Commonwealth meeting, would modify the Toronto terms in four ways: the Paris Club would tackle the total stock of debt in a single long-term operation and not reschedule maturities over one to three years at a time; it would cancel two-thirds of the entire stock of eligible debt instead of one-third; it would reschedule the remaining one-third over 25 years instead of 14 years; and it would capitalise interest payments of the first five years to be repaid with other consolidated debt. The terms also envisage making adjustments to the future course of repayments to reflect a country's ability to pay. If approved by other members of the Paris Club, the proposals could mean cancellation of $18 billion of the $27.5 billion official debt of 19 eligible countries. These countries would be those with an average per capita income of less than $600, which spend more than 25 per cent of their export earnings on debt service and have an IMF programme.

In a separate initiative, Jan Pronk, the Netherlands Development Cooperation Minister, proposed at the second UN conference on the Least Developed Countries in Paris in September 1990, that all official debt—both export credits and ODA—owed by the 41 poorest developing countries be forgiven.

IDA Debt-Reduction Facility to Reduce Commercial Bank Indebtedness of Low-Income Countries

In 1989, the World Bank established a three-year $100 million IDA Debt-Reduction Facility, funded by the Bank's net income, to support

reduction of the commercial debt of low-income countries by providing grants of up to $10 million per country for either a buy-back or an exchange of debt at a market-related discount. To-date, 15 countries have requested the use of this facility involving debts of about $2 billion. Negotiations have been slow, partly because of the difficulty in obtaining commercial bank consent to waive provisions of the original loan agreements which block debt-reduction operations. Some banks are unwilling to set precedents when only small amounts of debt are involved. In February 1991, Niger became the first country to use this facility by buying back its $111 million of commercial debt at 18 per cent of face value. France and Switzerland supported this IDA operation by providing additional bilateral resources. The resources available to this IDA facility suggest that only about 10 per cent of the total commercial bank debt of severely-indebted low-income countries can be retired. Bilateral donors could, however, enhance the value of the programme by joining it, as they did in respect of Niger.

The Brady Initiative on Commercial Bank Debt-Reduction of Middle-Income Countries

The Baker plan (1985) proposed fresh funds for countries indebted to commercial banks, provided such countries were willing to pursue economic reforms. The relief provided to the adjustment-undertaking debtor countries proved, however, to be relatively small, as the banks were unwilling to provide the additional resources that were needed to bring about the necessary improvement in growth. The need for augmenting the debt relief available under the Baker plan soon became apparent.

In March 1989, following several proposals for debt relief, Nicholas Brady, the US Treasury Secretary, proposed that countries with sound adjustment programmes should be supported in their voluntary debt and debt-service reduction with commercial banks by international financial institutions and official creditors. The IMF, World Bank and Japan agreed to provide $30 billion over three years. In October 1990, the Board of the Inter-American Development Bank also approved lending in support of debt and debt-service reduction. Creditor countries have adjusted their tax, regulatory and accounting rules in support of debt-reduction.

To date, five agreements have been completed—for Mexico, Philippines, Costa Rica, Venezuela and Uruguay—and a sixth, for Morocco, is contingent on obtaining an IMF Extended Fund Facility by December 1991. Debt and debt-service reduction encompass a variety of options such as debt buy-backs, swaps of commercial loans for face-value bonds with fixed below-market interest rates, and bonds with discounted value bearing market-related rates. The options also include provision of new money. The five agreements completed so far affect commercial bank

claims of $78 billion through the various options available under the present strategy for the highly indebted middle-income countries. The first four agreements with Mexico, Philippines, Costa Rica and Venezuela affected $76.4 billion of the external debt of these countries and resulted in a reduction in the face value of such claims by $11.5 billion, once allowance is made for the new debt issued. The reduction in net present value terms is significantly higher at $22 billion. However, this reduction has to be set against the $8 billion of less flexible new debt now due to official creditors, although some of this money is being used to purchase zero coupon bonds to collateralise the principal of the new bond issues. The Brady-style agreements, while easing debt problems considerably, are not likely to be sufficient to free the countries from the debt overhang problem. Moreover, the amount of official finance currently available is not likely to be adequate to cover all countries which would potentially qualify for debt reduction.

Restructuring Bilateral Official Debt of Lower Middle-Income Countries

Following the decision by the 1990 Houston G7 summit, Paris Club creditors agreed in September 1990 to provide longer maturity and grace periods on a case-by-case basis to severely-indebted middle-income countries. For ODA debt, these periods will be 20 and 10 years respectively, and for export credit debt, 15 and eight years, instead of the more conventional 10 year maturity and five year grace periods. A major innovation in the new arrangement is the provision of various types of debt concessions such as 'debt-for-nature', 'debt for equity', and 'debt for aid'. While there are no limits on the amount of ODA or inter-governmental loans that can be converted, there is a ceiling of 10 per cent on export credit conversions. By January 1991, five lower middle-income countries, Congo, El Salvador, Honduras, Morocco and Nigeria, had benefited. But at 12-21 months, consolidation periods remained short.

US Enterprise for Americas Initiative

In June 1990, US President George Bush announced the 'Enterprise for the Americas' Initiative. This proposes legislation to allow, inter alia, substantial reduction and restructuring of existing US concessional loans to Latin American and Caribbean countries (which mainly fall into the middle-income category) with serious debt-servicing problems and for interest payments to be accepted in local currency to support environmental projects. It also envisages the sale of some outstanding bilateral non-concessional credits from the US Exim Bank and Commodity Credit Corporation to encourage foreign investment and fund environmental projects.

Special Debt-Relief Measures for Poland and Egypt

Paris Club creditors have reached agreement on Poland's bilateral official debt amounting to $33 billion. Debt and debt-service reduction is, however, subject to Poland reaching an agreement on an Extended Fund Facility (EFF) arrangement with the IMF. Poland's debt to Paris Club creditors is to be reduced by 50 per cent, on a net present value basis, in two stages, 30 per cent at the outset and 20 per cent in the fourth year upon successful completion of the EFF arrangement with the Fund. Creditors would choose from three options, or a combination of them: writing-off part of the debt; accepting lower interest payments but leaving the debt face-value unchanged; and interest capitalisation. The United States has agreed to reduce the Polish debt owed to it by 70 per cent. It is envisaged that Egypt will be offered a similar arrangement. These provisions for Poland (an upper middle-income country) and Egypt (a lower middle-income country) are thus much more generous than those offered to severely-indebted low-income countries under the Toronto terms.

Annex 9

Some Proposals for Relief of the Commercial Debt of Highly Indebted Countries

Many proposals have been made for alleviating the commercial debt of highly indebted countries. Some of them are summarised briefly below (see also Box 6.2 on pp.82-83 for some proposals on debt refinancing):

(i) Ex-President Raul Alfonsin of Argentina (1986) proposed recycling a part of the debt service on existing loans and part of the surplus of the industrial countries for the purpose of accelerating growth in the highly-indebted countries.

(ii) D. Avramovic (1988) suggested that the debt situation of the developing countries could be improved by stabilising and increasing primary product prices. In that regard he expressed the wish that the UNCTAD Integrated Programme for Commodities, involving the establishment of buffer stock arrangements under the aegis of the Common Fund, had been implemented with resources closer to the original proposals than was in fact the case.

(iii) David Obey (1986), US Congressman, and Paul Sarbenes, US Senator, proposed the establishment of a special facility at the IMF or the World Bank to buy and then restructure outstanding bank debt. The facility would purchase loans at a discount from their face value, and then pass the discount to the developing country governments. The financing for the facility would have to come largely from the countries with balance of payments surpluses.

(iv) Felix Rohatyn (1985), of Lazard Freres, New York, who was

among the first to call for the use of official resources for special arrangements to alleviate developing country debt, and Roger Altman, former Assistant Secretary of the US Treasury, proposed a special plan to refinance Mexico's debts at below-market rates and organise and finance a substantial expansion of investment in Mexico's manufacturing industry. A temporary US-Mexico development finance authority would be created for this purpose, with a US Government guarantee providing a basis for market borrowing by the authority.

(v) Bill Bradley (1986), US Senator, suggested that commercial banks cut the interest rate on loans to developing countries by 3 percentage points annually and write off 3 per cent of the principal on current loans over the same period. In addition, he proposed additional lending by the MFIs of $9 billion over the same period. The debtor countries benefiting from the relief would be expected to agree to liberalise their trade regimes and promote domestic economic growth, thereby helping to strengthen the international financial system.

(vi) Jeffrey Sachs (1988), Harvard, suggested debt relief for countries which had suffered marked declines in per capita income, in the form of forgiveness of interest payments for three to five years.

(vii) Victor Urquidi (1986), Collegio de Mexico, proposed that interest payments be split in two parts. Interest corresponding to the LIBOR rate, less current inflation, would continue to be paid in foreign exchange. The difference from the market interest rate would be payable in local currency to be utilised by the foreign creditor banks for domestic lending and investment, for purposes agreed by the domestic government. The profits and dividends would be transferable in a given proportion into the foreign currency of the original loan.

(viii) Franz Lutoff (1986), General Manager of the Swiss Bank Corporation, Basle, suggested a temporary grace period on interest payments and a postponement of amortisation, until export commodity prices of the affected debtor countries had recovered.

(ix) Charles E. Shumer (1986), US Congressman, suggested that banks write off 30 cents on each dollar of their developing country loans. (This was in line with the average discount at which banks were reselling their Third World debt at the time.) The US Government was to facilitate this process by allowing the write-offs to occur over a 10-year period. The remainder of the debt would be restructured, with extended maturities and lower interest, to enable countries to use no more than 25 per cent of export earnings for debt repayment.

(x) Henry Kaufman (1986), Salomon Brothers, New York, suggested that countries undertaking internationally acceptable adjustment efforts should be able to write down a portion of their debts by turning loans into marketable securities, with the resulting bank losses spread over a number of years. This would provide debt relief to developing countries equal to the difference between the original value of the loans and the face-value of the new securities.

(xi) The World Institute for Development Economic Research (WIDER) estimated in June 1989 that an additional $50 billion would be required for an effective debt reduction scheme, i.e one which provided debt reduction of at least $125 billion out of the total outstanding commercial debt of the highly indebted countries of about $370 billion. It argued that IMF Trust Fund arrangements offered the most flexible and quickest means of attracting additional resources for debt reduction; in particular for buybacks and collateralisation. The resources for the Trust Fund could be mobilised from surplus countries such as Japan and Germany. Other countries might also wish to make loans or deposits with the Trust Fund or to make their markets available for borrowings connected with debt reduction schemes.

Sources: 'Developing Country Debt Revisited: Facts, Theory and Policy', Dragoslav Avramovic, in World Economic Problems, Ed. K. A. Elliot and John Williamson, IIE (1988).

'Debt Reduction', World Institute for Development Economic Research (1989).

'Resolving the Global Debt Crisis,' Morris Miller, UNDP Policy Discussion Paper (1989).

Annex 10

Commonwealth Group of Experts on the Impact of Global Economic and Political Change on the Development Process

Members of the Group

Hon. G. Arthur Brown OJ (Chairman)	Governor, Bank of Jamaica.
H.E. Dr J. L. S Abbey	Ambassador for Ghana, Washington.
Mr. Muchkund Dubey[1]	Foreign Secretary, Ministry of External Affairs, Government of India.
Prof. Stuart Harris	Professor, Australian National University, Canberra.
Mr. Philip Khoo	Managing Director, Safetytech Sdn Bhd, Malaysia.
Dr. Ibbo Mandaza	Executive Director, Southern Africa Political Economy Series (SAPES) Trust, Harare.
Dr. Sylvia Ostry	Chairman, Centre for International Studies, University of Toronto.
Prof. Adedotun O. Phillips	Director-General, Nigerian Institute of Social and Economic Research, Ibadan.

[1] Due to unforeseen events in relation to his substantive duties as Foreign Secretary, Government of India, Mr. Dubey was only able to attend the first meeting of the Group.

Prof. Clive Thomas	Professor of Economics, University of Guyana.
Sir Douglas Wass GCB	Co-Chairman, Nomura International Ltd., London.
Dr. Arshad Zaman	Chief Economist, Ministry of Planning and Development, Islamabad, Pakistan.

Other Participants at the Meetings[1]

Mr. Rattan Bhatia	IMF Special Representative to the UN, New York.
Mr. Jean Baneth	Director, World Bank Office, Geneva.
Mr. Roger Lawrence	Director, Co-ordinator, Resources for Development Programme, UNCTAD, Geneva.
Mr. Iqbal Haji	Office of the Director-General for Development and International Economic Cooperation, United Nations, New York.

Commonwealth Secretariat

Mr. P. W. Unwin	Deputy Secretary-General (Economic)
Dr. B. Persaud	Director and Head Economic Affairs Division (Secretary of the Expert Group)
Mr. I. R. Thomas	Assistant Director Economic Affairs Division
Dr. S. K. Rao	Assistant Director Economic Affairs Division
Dr. I. Coomaraswamy	Chief Officer (Economics) Economic Affairs Division

[1] Mr. Stanley Fischer, Vice-President, World Bank, also participated.

CHANGE FOR THE BETTER
Global Change and Economic Development

Global political and economic change and its impact on the development process, together with ways to improve development policies – domestic and international – are the principal themes of our Report.

In our work, we have learned that the problems and opportunities thrown up by these changes cannot be analysed in isolation . . . We can find solutions only if we see these changes as part of a rich, complex, confusing but potentially promising whole.

The Commonwealth should take an early and sustained lead in bringing all these issues to the attention of governments and institutions. The aim would be to stimulate a wide ranging debate at many levels . . . We hope that the debate will prepare the way for a meeting of Heads of Government representative of the global community to focus the world's attention on the impact of current changes on the process of development.

From the Report

The Group's Report points to the danger of further increase in the existing disparities, if action is not taken urgently by the developed and developing countries as well as the world community as a whole. It points to the mutuality of interest which makes action a necessity; and to the opportunities presented by change. But effective action will only be possible if there is ready acceptance that the challenge of development cannot be ignored; and that current piecemeal efforts are not the answer. International understanding and cooperation will be a critical requirement.

From the Foreword by the Commonwealth Secretary-General

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