# Impediments to economic, social and sustainable development

A paper presented to the CES Canberra Chapter
on 13 June 2007 by John Langmore

My wife Wendy and I are studying Luke's Gospel at present and last week came to the story Jesus told about the rich man and Lazarus. I will read it to you (Luke 16: 19-31).

This hit me forcibly. By global standards most of us are rich. We probably don't dress in purple and fine linen and feast sumptuously every day. In fact we are all probably relatively modest: eating carefully, living responsibly and giving generously as the parable of the Good Samaritan leads us to do, but we do live in a privileged and wealthy society. Australia is amongst the small group of countries with high incomes and plenty of space, security and opportunity.

Many people blame developing countries for the slowness of their development, and talk of corruption, poor governance and squandering of resources as their principal problems. Those factors can certainly be significant constraints of development but many others are commonly involved, some of which can be far more powerful than these. In this address I will concentrate on the factors which are commonly outside the control of developing countries or which can only be addressed slowly and which are powerful impediments to their development.

Developing countries have to cope with a hostile international environment. It is essential to recognise the extent of the inequities and the strength of the hostile political, institutional and economic structures underlying them. There are many examples of ways in which the structure of power and resources is systematically set against developing countries, making it far more difficult for them to develop. I'm not going to address ways in which developing countries are sometimes not their own best friend, ways in which their domestic policy, actions or behaviour can make their own development more difficult. These also are important, but tonight I will concentrate on issues about which Australians and our government have some responsibility and about which our government has some influence. I will address eight impediments.

The first is the inadequacy of funds for the investment which is essential to stimulating growth. It is scarcely necessary to make the case to you that poor developing countries need concessional external finance. Poor countries have extremely limited sources of funds for education, health services and infrastructure. They are rarely attractive to foreign investors. Their populations are often small and average incomes low so markets are tiny. They cannot offer positive links with other investors. They have poor transport infrastructure and weak human capital.

It is therefore utopian and misleading for Howard and Downer to repeatedly argue that 'For the developing world, it is trade and investment, not aid, that will drive development …' The constraint on developing country exports from rich countries' tariffs and subsidies is obvious, and growth of exports is vital to economic expansion, but it is not a panacea.

The assertion of the White Paper on Australian Aid that trade is more important than aid is a delusion, a convenient rationalisation for the low level of Australia's overseas development aid (ODA). For example, Ethiopia's only substantial export is coffee, for which prices have collapsed, there are no substantive alternative exports, and FDI is tiny and limited to production for the domestic market and tourism.

Most developing countries have small markets and many have a degree political instability so they have little attraction for foreign investors. What foreign capital they do receive is often short term and volatile. Potential foreign investors normally have several location options, putting them in a powerful position to negotiate major tax concessions and infrastructure assistance. FDI is principally attracted to large markets and stable economies with well developed legal and financial systems, all of which are conditions which don't apply to the majority of developing countries.

Jeff Sachs and colleagues write about Africa that 'The structural conditions and history that have led to the [poverty] trap include very high transport costs, small market size, low productivity agriculture, very high disease burden, adverse geopolitics and slow diffusion of technology from abroad. Africa's extreme poverty leads to low national saving rates, which in turn lead to low or negative economic growth rates.' The same constraints apply to many countries in the Asia-Pacific region.

Yet for the last twenty years Australian governments have neglected ODA. Australia's shameful level of ODA is the result of two periods of decline: under Hawke, Keating and Hayden between 1984-5 and 1987-8 when the ratio of ODA to Gross National Income (GNI) fell from 0.46 to 0.34 per cent; and under Howard, Costello and Downer when it fell even further from 0.32 to 0.25 per cent.

This compares shockingly unfavourably with most other donor countries: Australia claimed to contribute 0.30 per cent of GNI in 2006 compared with the average of all donors (members of the OECD Development Assistance Committee, the DAC) of 0.46 per cent. Yet Australia was one of the countries that originated the 0.7 per cent ODA target, through the monograph published by Anthony Clunies Ross in the late fifties entitled One Per Cent and the impact that had on the World Council of Churches, which was one of the first non-governmental organisations (NGOs) to argue for that target.

The quality of our so-called aid is also disgraceful. Last year, under pressure from the US, Aust cancelled $670 m of unpaid debts for wheat, and defined this as aid to Iraq. The cost of prisons for asylum seekers, $130 m last year, is defined as aid. Forty-six per cent of Australian aid is spent on so-called technical assistance, payments to Australians working for Australian companies many of whom make short term visits to developing countries. This is more than twice the average of OECD countries of 22 per cent.

Yet demonstrably Australia has the capacity to both increase the quantity and the quality of ODA. Gross domestic product has been growing by two and a half to four per cent a year for the last fifteen years. Per capita income is higher than ever before. The Commonwealth Government has no debt. There is a budget surplus. So there is clearly capacity to increase ODA. There has been some improvement in the quantity of ODA during the three years. Yet under the Howard Government the ratio of ODA to national income has been and continues to be lower in every year than it ever was in any other year under any previous Australian government. This year it is forecast to be 0.3 per cent of GNI and present plans are claimed to lift it to 0.33 per cent by 2010.

One of my honours year student's wrote her final essay on a comparison between the aid programs of Australia and Norway. Not only does Norway give one per cent of GNI as ODA but also:

- Over half to less developed countries rather the Australia's less than a quarter;
- Norway allocates 22 per cent through development NGOs rather the Australia's 6 per cent;
- 16 per cent of Norway's aid is environmentally focussed compared with Australia's 4 per cent;
- Norway allocates 34 per cent through multilateral agencies rather than Australia's 18 per cent.

The excuse of the sceptics is that aid is often wasted and that is true. If so-called aid is misused for the brutal imprisonment of asylum seekers, or for opportunistic quasi-military and commercial purposes such as cancellation of debt to Iraq and payments to Australians, this will do little for poverty reduction.

The World Bank estimate that additional external financial assistance totalling in the order of $35-76 billion would be required each year until 2015 to even just enable countries to reach the Millennium Development Goals (MDGs). The Bank reports that such increases in aid would still on average bring recipient countries to only a third of their absorptive capacity. Assistance for these purposes would directly improve productivity and employment and so speed up the rate of economic growth.

In estimates published during 2004, Sachs *et al* made national needs assessments based on country-level investment plans for three well-governed African countries – Ghana, Tanzania, and Uganda – and concluded that in order to reach the MDGs these countries would require average annual ODA of at least 20-30 per cent of GDP each year until 2015. This translates into a doubling or more of ODA to the sub-Saharan African region in order to adequately finance achievement of the MDGs.

Such estimates have apparently not yet been made for countries in the Asia-Pacific region. Whether or not increases of that order are required in order to reach the MDGs in each of the Asia-Pacific countries, it would be difficult to argue convincingly that substantial increases in Australian aid are not required. They would enable this wealthy country to make a more adequate contribution to economic and social development in Australia's neighbouring countries on the western side of the Indian Ocean as well as for those on the western side of the Pacific. A minimum goal is that set by the World Bank, of doubling ODA.

When aid is targeted at encouraging development and poverty reduction, the comprehensive surveys have generally reached positive conclusions about the value of ODA. For example, Mark McGillivray has surveyed the literature on aid and growth and concludes that 'the overwhelming majority of recent empirical studies find that aid increases growth, despite many valid criticisms of aid delivery.' Aid increases public expenditure, including expenditures that aim to improve services for the poor. Donors are tending to focus more actively on policies that assist development than in the past, when the objectives of aid were more diffuse.

In an influential paper published towards the end of 2004 Clemens, Radelet and Bhavnani divide aid into three categories: emergency and humanitarian aid; aid that could affect growth only over a long period of time, such as to support democracy, the environment, health or education; and aid that could plausibly stimulate growth within four years, including budget and balance of payments support, and also investments in infrastructure and for productive sectors such as agriculture and industry.

There is a strong, positive relationship between aid of the third kind, which accounts for 53 per cent of all aid flows, and economic growth over a four-year period, two to three times as large as between aggregate aid and growth. 'Even at a conservatively high discount rate, at the mean a $1 increase in short-impact aid raises output (and income) by $1.64 in present value in the typical country.' This clearly suggests that aid targeted at stimulating growth is likely to be effective.

For the last two years Australian military spending has been increased each year by $2 b without a murmur of dissent. Yet there is no serious justification for that squandering of public funds that is in Australia's real national interests. Military spending does little to combat terrorism. The increases are justified by apologists who prioritise interoperability with the US. But the US is currently the world's most aggressive country, having invaded Iraq and now threatening Iran and provoking Russia and China. We would be far safer by arguing for the international rule of law, cooperation with the rest of the world through the multilateral system of the UN, and seeking to reduce the causes of despair, anger and poverty by strengthening development. If we had used $3 billion of the $4 billion increase in military spending during the last two years for ODA, Australia would rapidly become both a safer and a more respected country.

Kevin Rudd recently announced that if elected in November, Labor would aim to increase ODA to 0.5 per cent of national income by 2015. That would still be well short of the UN target of 0.7 per cent but it is far larger commitment than the Howard Government is proposing and would put Australia back into the mainstream of aid donors and allow is to make a serious contribution to achievement of the Millennium Development Goals.

Partly because of the inadequate level of ODA from most donor countries, during the last ten years there have been net financial transfers from developing to developed countries. Net transfers are the net flow of financial resources less net interest and investment income payments. These net transfers from developing to developed countries have risen from US$8 b in 1997 to $483 b in 2005. This is largely due to the growing net export surpluses of an increasing number of developing countries, caused by rapidly rising export volumes and higher prices for both oil and non-oil commodities. Most of these funds have flowed to the US. In 2005 the major flows were from Eastern and Southern Asia $189 b. We are familiar with that because we know of the enormity of America's current account deficit with China. A net $155 b left Western Asia, $96 b flowed from Latin America and $56 b Africa, though there was a tiny net flow into Sub-Saharan Africa in 2005 of $2 b.

Another aspect of that problem which is a significant impediment for many developing countries is capital flight. For example, there is estimated to be tens of billions of dollars of capital flight from Africa each year and that the external stock of capital held by Africans totals US$700-800 billion. The problem is partly the uncertainty of the financial and economic situation in those countries.

The most obvious way of enabling developing countries to help themselves is to ensure they have access to the markets of the developed countries. Yet, despite the recent 'everything but arms' reduction in protection announced by the EU, they still face severe discrimination from agricultural and manufacturing protection in developed countries. This is the most publicised external impediment with which developing countries have to cope.

The World Bank estimates that total subsidies to farmers in developed countries amount to over $350 billion, around seven times the level of their aid. Oxfam reported during 2005 on the extent to which the rich countries conceal their agricultural subsidies through 'creative accounting'. The so-called Doha development round is stalled, principally because of European, Japanese and American intransigence about agricultural protection and subsidies, and also because the developing countries combined into a group of 20 which is negotiating with more determination.

As well, trade liberalisation has been imposed on developing countries as a condition of their borrowing from the World Bank and International Monetary Fund (IMF). They are often required to cut tariffs, reduce non-tariff barriers, and quantitative restrictions. Parts of the international trade regime are concrete impediments to improving well being in developing countries, including not only the Agreement on Trade-Related Aspects of Intellectual Property Rights or TRIPs but also the regime covering trade in services or GATS. Bilateral trade deals by the US now require trading partners to rewrite their domestic laws in relation to intellectual property, national health care policy. The US government does this because of pressure from pharmaceutical, computer software and media companies including film production companies. This is completely inconsistent with the history of now developed countries before they got the upper hand.

Australia's protection record is relatively constructive, since tariffs have been substantially reduced during the last 30 years or so. This is one reason why Australian political leaders can emphasise the importance of increasing market access. It is one dimension of this discussion about which we do not need to be embarrassed.

Developing countries are usually more severely damaged by financial instability than developed countries. The 1997-8 Asian financial crisis had repercussions for Russia and other countries and those have recently been followed by the economic and financial disaster in Argentina which has recently also affected neighbouring countries. These are only the most recent examples of the growth of multi-country financial volatility. There have been 100 episodes of financial crises over the last two decades, with fiscal burdens often exceeding 20 to 30 percent of GDP.

It is clear that financial liberalisation has increased vulnerability to instability in some countries and that lessons include at least much slower and more incremental change so as to allow time for the establishment of highly professional supervisory central banks with adequate regulatory tools for addressing destabilising forces, and the need for greatly improved international collaboration and international instruments for addressing instability. One response to this by East Asian countries has been to hold excessively large financial reserves. This is wasteful because the funds earn little interest and contribute nothing to national development while sitting in American – or European banks and financing investment in those countries.

Developing countries account for 85 per cent of the world's population and that proportion is rising, but they are *politically* seriously under-represented in most international institutions. Whereas at the United Nations, where each member state has a single vote and *developed* countries have 17 per cent of the voting power; the G8 is exclusively limited to the largest developed countries and Russia; and membership of the OECD is principally limited to developed countries. Governance of both the IMF and the World Bank is asymmetrical and unequal.

At the IMF the US has 17.4 per cent of the total vote, Japan 6.2, Germany 6.1, France and the UK 5 per cent. The G7 have combined votes of 47.7 and if Switzerland – which usually votes with the US – is included this gives the G7 over 50 per cent. The developed countries have about 61 per cent of the votes in both the Fund and the Bank. The concentration of voting power in the hands of the major industrial countries ensures that they have a controlling influence in IMF and World Bank policies.

The lenders are the principal shareholders and the borrowers provide the income. A large proportion of the voting rights are vested in a small number of developed countries. The US has *de facto* veto power at the IMF. Neither Bretton Woods institution provides fair representation to all members or meet the standards of transparency and accountability which they habitually urge countries to adopt. Without fairer structures of representation neither institution has sufficient legitimacy to ensure ownership by all members of its policies.

There may well be net costs for developing countries in hopelessly attempting to fit into the ‘golden strait-jacket’ of market fundamentalist policies required by the Fund and Bank as conditions for lending. The credit rating agencies also base their assessments partly on acceptance of these policies. So developing countries struggling for policy acceptability are under enormous pressure to adopt tight macroeconomic policy, low corporate tax rates, tough labour laws and light environmental regulation, so as to appeal to these institutions, agencies and corporations.

Some of those policies, such as the rule of law, transparency, bureaucratic effectiveness, and regulatory simplicity are useful whether or not they attract approval from the Bretton Woods institutions and foreign investors, but others such as liberal economic policies that undermine public services, limit public investment and reduce the quality of government are self-destructive.

A necessary condition for preparation of realistic development strategy in many poor countries is recognition that one policy does not fit all, and that each developing country should be allowed and encouraged to prepare the policies which its leaders judge to be in their country’s best interests.

The economic liberalism of the Fund and Bank has sometimes become a form of ideological imperialism. Yet alternatives are available, such as the more pragmatic UN development agenda which has been negotiated at the global summits and conferences since 1990. These are summarised in the paper entitled the UN Development Agenda released in July 2007 by the UN Department of Economic and Social Development and available by Googling that title.

Reform of the structures of governance of the international financial institutions is being widely proposed, and may be a necessary condition for adoption of more pragmatic policies by the Fund and Bank. The consensus communiqué from the International Conference on Finance for Development held at Monterrey, Mexico in March 2002 made a commitment to increase the voice and participation of developing and transition countries in the Bretton Woods institutions and this has been repeated several times at later conferences.

Income from intellectual property accrues disproportionately to the developed countries. It is estimated that industrialised countries hold 97 per cent of all patents and that global corporations, overwhelmingly based in developed countries, hold 90 per cent of all technology and product patents.

The brain drain of professional and technical personnel from developing to developed countries is a major impediment. Developing countries suffer great damage when their doctors and nurses, teachers and researchers, engineers and knowledge workers leave to work elsewhere, even though they send back remittances.

One in three highly qualified Africans now lives in the developed countries. Almost half of Ghana's graduates have left and there is only one doctor for each 16,000 people, compared with a doctor for each 417 people in Australia. The World Bank estimates that by 2000 between 80 and 90 per cent of all graduates from some Caribbean countries had emigrated, mostly to the US.

In the Pacific the estimate is that 75 per cent of graduates from Samoa and Tonga and even over 60 per cent of Fijian graduates had emigrated by 2000 – and what is the situation like now, after the coup? Australia alone attracts about 50,000 immigrants from developing countries each year. If their training cost $100.000 that is an annual benefit to Australia of $5 billion, 60 per cent more than the aid budget.

Why does Australia welcome this: because it is cheaper than training our own professionals. Countries such as Australia celebrate because this enhances our skills base, increases our output, and increases our ethnic diversity. But it severely undermines the capacity of developing countries to provide education and health services to their own people.

Of course immigrants from developing countries send back remittances which are estimated to total well over $100 b a year, more than total aid from developed countries. As Tim Colebatch writes 'The long term damage is that the best and brightest are no longer at home to be agents of change, drivers of growth, innovators, founders and reformers.'

What should Australia be doing? Training our own people, of course. Funding universities and technical training properly, and recognise that aid is merely a partial compensation for the contribution which developing countries make to our well-being.

International taxation arrangements strongly favour the already developed countries. For example, the OECD model bilateral tax agreement provides for taxation of transnational countries in their country of origin rather than in the country where productive activity takes place.

To conclude: there is growing concern that over the last quarter century the 'policy space' available to developing countries has shrunk to such an extent that their ability to achieve economic development is threatened. Structural adjustment lending the most blatant form; conditionality; mission creep – even to the extent of ordering privatisations or the independence of the Korean Central Bank and telling private companies how much debt they should have.

The Millennium Project began its recent report Investing in Development:

> We have the opportunity in the coming decade to cut world poverty by half. Billions more people could enjoy the fruits of the global economy. Tens of millions of lives can be saved. The practical solutions exist. And for the first time, the cost is utterly affordable. Whatever one's motivation for attacking the crisis of extreme poverty – human rights, religious values, security, fiscal prudence, ideology – the solutions are the same. All that is needed is action.

What Australia should do?

- Elect a new government.
- Hold an inquiry into this broad issue; aim for Australia to become a leader amongst developed countries in advocating and implementing strategies and policies which support and encourage development.
- Re-engage with the multilateral community through the UN, with commitment.

Uploaded 28 August 2007