ALTERNATIVE DEVELOPMENT STRATEGIES FOR THE POST-2015 ERA

EDITED BY JOSÉ ANTONIO ALONSO, GIOVANNI ANDREA CORNIA AND ROB VOS

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Edited by

José Antonio Alonso
Giovanni Andrea Cornia
Rob Vos

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About the Committee for Development Policy

The Committee for Development Policy (CDP) was established in 1965 and its first chair was Nobel Laureate Professor Jan Tinbergen. The CDP is a subsidiary body of the United Nations Economic and Social Council (ECOSOC). It provides ideas, inputs and independent advice to the ECOSOC on emerging cross-sectoral development issues and on international cooperation for development. The CDP is also responsible for reviewing the status of least developed countries (LDCs) and for monitoring their progress.

The 24 members of the Committee are nominated by the United Nations Secretary-General and appointed by ECOSOC in their personal capacity, reflecting a wide range of development experience as well as geographical and gender balance.

Each year, ECOSOC advises the Committee about the theme(s) that the Committee should consider at its annual session. The General Assembly, the Secretary-General and the subsidiary bodies of ECOSOC can also propose, through the Council, issues for consideration by the Committee. In addition, based on its expertise, the Committee itself often provides suggestions to ECOSOC on emerging critical issues for the international development agenda.

For further information, see:
http://www.un.org/en/development/desa/policy/cdp/index.shtml

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Preface

Since the beginning of the twenty-first century the world economy has been affected by a severe "quadruple crisis". Persistent financial instability, food insecurity, climate change and other environmental threats and widening economic inequality have emerged as major interdependent crises with global ramifications. This book suggests new global development pathways aimed at addressing these four crises simultaneously. The new development strategies proposed in the volume require a major departure from existing policy approaches and would require transformative changes in global consumption and production patterns and national and international regulatory frameworks.

The international development agenda of the past decade and a half was guided by the Millennium Development Goals (MDGs), which set out targets towards the eradication of poverty and hunger, ensure universal access to education, foster gender equality, reduce child and maternal mortality and secure a people-centred agenda, prioritizing the needs of the world's poor and vulnerable. The international community set itself a deadline to achieve these targets by 2015. While a lot of progress has been made towards accomplishing these goals, the quadruple crisis has retarded progress and put into question whether the improvements can be sustained over time. Clearly, achieving the MDGs is a global responsibility, requiring changes in developed and developing countries alike. More coherent policy responses are needed, integrating more equitable economic and social policies with pervasive efforts to ensure environmental sustainability. More representative global governance structures will need to be created to guide such policy efforts.

The search for more stable, equitable, food-secure and sustainable development strategies discussed in this volume is based on a critical evaluation of past development experiences, and on the identification of new measures required to respond to the new challenges brought about by the recent four interrelated crises. It also considers the measures required to address the asymmetries and shortcomings of the ongoing process of globalization and evolution of global governance which, in fact, have contributed to the emergence of the four crises.

In this way, this book aims to contribute to the formulation of a new global development agenda for the post-2015 era to be adopted by the United Nations General Assembly. It provides one of the first rigorous

analytical responses to the calls for a new global development strategy that will address the challenges of the twenty-first century and chart out new pathways for human progress, averting the current collision course of widening social inequalities and unsustainable pressures on planetary environmental limits.

The contributions in this book result from an independent research programme organized by the United Nations Committee for Development Policy (CDP). CDP is a subsidiary body of the Economic and Social Council of the United Nations and its members are several independent development experts from around the world. While the views expressed in this book do not necessarily reflect those of the CDP in its entirety, nor of the United Nations and its Member States, the elaboration of the underlying ideas and analysis did benefit from discussions conducted at various workshops and plenary meetings of the CDP as well as from interactive discussions with the Economic and Social Council.

This volume would not have seen the light of the day without the support of many other collaborators. First, we would like to thank the CDP Secretariat and Ana Luiza Cortez and Namsuk Kim, in particular, for organizing several workshops that helped shape this undertaking and for guiding the editorial process. Preliminary versions of the chapters were presented and discussed in the CDP plenary, in March 2011, which helped develop the basic hypotheses for the research. A research workshop was held in Florence, Italy on 7 and 8 December 2011 at which the drafts of the chapters included in this volume were discussed and peer reviewed. A second workshop was held at United Nations headquarters on 16 and 17 March 2012 in order to discuss the complete versions of the chapters.

We are indebted to the UNICEF Innocenti Research Centre and to Gordon Alexander, Bruno Martorano and Cinzia Iusco Bruschi, in particular, for hosting the second research workshop of this project. Our most sincere thanks go also to the contributors to this volume for the time they dedicated to this undertaking, for their path-breaking analyses, and for the patience shown in revising their chapters over and over again. Last, but not least, we are also grateful to Elizabeth Coleman who took care of the copy-editing of this volume, Nancy Settecasi for the typesetting, Leah C. Kennedy for following through on the production process, and Valentina Kalk for her support in getting this to the publisher. Without them this volume would not be in its present shape.

As the global community is taking stock of the progress made in achieving the MDGs and is moving towards the definition of a new agenda that is to shape global development after 2015, we hope that this book's analysis will contribute to those considerations and lay the foundations for fairer and sustainable progress in human wellbeing worldwide.

March 2013
Madrid, Florence, and Rome

José Antonio Alonso, Giovanni Andrea Cornia, and Rob Vos

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Overview
Alternative development strategies beyond 2015

José Antonio Alonso, Giovanni Andrea Cornia and Rob Vos

Introduction

We live in an era of many changes and challenges, a time that calls for well-researched and inspiring responses. The world that will emerge from the ongoing economic and financial crisis is likely to be very different from the one we have known so far. In fact, the sheer magnitude of the challenges we face make that observation imperative. Those challenges relate to continued widespread poverty, inequality and hunger, growing levels of international risk and insecurity, doubts about future supplies of basic goods like water and energy, the threat of climate change, the demographic pressures emanating from a growing and ageing world population, and a rapidly shifting balance of power in the world economy. Moreover, these challenges are strongly interconnected at the global level through deeply integrated but flawed markets. In this context, continued reliance on the independent decision-making of individual governments and market actors will lead to disorderly and unsustainable outcomes. In short, "business as usual" is no viable response. Only internationally concerted answers can open the way for building "a better future for all".

New development approaches are needed to address the challenges posed by and emanating from the multiple and interrelated financial, food, energy and environmental crises which have hit the international community, as well as the asymmetries and shortcomings of the current process of unfettered globalisation which – as it stands – has maintained untenable inequalities and led to a notable increase in instability and risk in the international system. Tackling these challenges involves, first of all, identifying a development strategy that can promote a broad-based economic recovery with job creation and, at the same time, guarantee social equity and environmental sustainability both within and between countries. The new development approach should also promote the reforms needed to improve global governance so as to promote a more equitable distribution of opportunities among countries and people, a more efficient provision of global public goods and a reduction of human, environmental and financial risks currently afflicting the international system. Again, the magnitude of the challenges requires everyone – independent analysts and policymakers, governments, business groups and civil society organizations, rich and poor – to rethink the future, ambitiously and with an open mind. The present book aims to make a modest contribution to that task.

An additional motivation of this study relates to ongoing discussions on the revision of the current development agenda that was agreed upon by the international community in 2000 and which aims to have achieved the so-called Millennium Development Goals (MDGs) by the year 2015. As that deadline approaches, there is a need to review the MDG agenda, examine its strengths and weaknesses and think about the next steps. The existing evidence so far shows that, although much progress has been made, many targets will not be met. At the same time, there is increasing recognition that important dimensions, such as reducing inequalities and protecting the environment, were either given insufficient priority or excluded from the MDG agenda. This is the appropriate moment to evaluate what has been achieved and to define new development goals for the future. However, this volume does not aim to come up with a concrete set of new targets to replace the existing ones. The aim of this study is more modest and more ambitious at the same time. While not trying to define a coherent set of new goals and targets, it focuses on identifying options for feasible new development pathways through national strategies and more enabling rules for global economic governance in pursuit of more broadly defined objectives of sustainability, stability and equity.

Global challenges

The quadruple crisis

Since the late 2000s, the world has been gripped in multiple mutually reinforcing crises, which have led to increased uncertainty, insecurity and inequality worldwide, as explained by *Rob Vos* in chapter 1. The recent global financial crisis took an enormous toll on the world economy. The financial problems emerged in the United States in 2007 but quickly spread to the rest of the world evolving into a severe and prolonged recession in large parts of the industrialised world. The crisis manifested itself in falling output growth, severe contractions of production capacity and employment, and a collapse and subsequent feeble recovery of global trade. Beyond these impacts, the crisis revealed the unsustainability of a pattern of economic growth based on a continued and illusory appreciation of financial assets, fed by mounting indebtedness and excessive leveraging of banks and other private agents. At the same time, the crisis also brought to the open the systemic failures in the functioning of national and international financial markets, the inappropriate behaviour of several financial institutions and of their managers, and the hands-off approach of regulators and supervisors in many markets. To tackle this crisis, governments resorted initially to truly exceptional measures to sustain the financial system and stimulate demand to head off a further recession. Individual country solutions were supplemented by international policy coordination (through the G-20) while proposals to reform the financial system emerged as well. However, the international reform drive has been progressively diluted while successive summits were called and the attention of governments in developed countries turned towards their fiscal imbalances and the external debt. Recently, government responses in tackling the crisis, particularly in Europe, have been dominated by an obsessive call to austerity and fiscal adjustment. These responses have accentuated the recessive bent of the crisis, worsened social conditions and the climate of governance of the countries affected, and exacerbated the problems of their external debt.

The impact of the global financial crisis was compounded by the effects of other crises. First, the world was hit in 2007-2008 by a severe *food crisis*, which has recurrently manifested itself since. Rapidly rising and highly volatile world food prices in generally tight markets have been symptoms of global food insecurity, with the poorest countries most prone to recurrent and acute food shortages. This crisis emerged largely due to the long neglect

of agriculture in development strategies, both by the affected countries and international donors. It is also the result, however, of changes to dietary patterns associated with economic progress in major developing economies (such as China), changes in land use linked to the production of biofuels and the speculative action of investors who see in the futures and derivatives markets for agricultural commodities a profitable alternative to other forms of investments, as *Joachim von Braun* further highlights in chapter 6.

Second, the world has witnessed for some time an *energy crisis* that is closely associated not only with the rise in oil prices but also with the search for alternative sources of energy. However, the development of some of these new energy sources, such as biofuels, could negatively affect the achievement of other equally desirable objectives, as mentioned, such as those related to food security. In any case, the severe damages to the environment caused by the technology and energy mix of present growth and development strategies have now reached a stage where it is clear that the survival of livelihoods and human mankind are at stake. The threat of destabilising climate change is perhaps the most imposing manifestation of this challenge, which makes it imperative to review existing economic growth patterns and internalise the costs of climate change mitigation and adaptation, as *Hans Opschoor* points out in chapter 5.

Third, another more opaque and silent but no less severe emerging crisis is a progressive *deterioration in levels of fairness* in the distribution of incomes and wealth in many countries. The tendency began to appear two decades ago in almost all countries in the developed world and in a large part of the developing world (although with some significant exceptions as *Giovanni Andrea Cornia* and *Milica Uvalic* point out in chapter 4). During this period, wage shares in national income have been stagnant or declining in most parts of the world and income differentials among different types of workers (particularly between skilled and unskilled) have been widening as a major source of rising inequality overall. This trend was reinforced by the adoption of inequitable macroeconomic policies, including erosion of redistributive elements of national tax and transfer systems.

The above implies that nowadays a satisfactory development agenda should respond to these crises by not only eliminating their more harmful consequences but also by ensuring that measures in one area (production of biofuels, for example) do not have negative impacts in others (food insecurity).

Megatrends posing major global challenges

The problems to be faced by the world economy, however, are not limited to those posed by the quadruple crisis. Additional challenges arise from some overall trends that shape the international system in the medium term, as *Rob Vos* argues in chapter 1. Interdependence between countries has increased, intensified and deepened, as a result of globalisation, but that process is taking place in a context of very fragile global governance structures and with clear asymmetries in the international system. As a consequence, the levels of global risk and insecurity have increased. In particular, there are certain "megatrends" that pose significant challenges for the immediate future. Five of them are worth highlighting here:

1. *Disparities in per capita income and wealth levels between countries and citizens have been on the rise on most counts and countervailing forces are generally weak*. The process of globalisation has produced both convergence and divergence in welfare levels: while a few Asian economies are sustaining a process of convergence towards the economically advanced countries, the gaps in income per capita between the richest and poorest countries and the differences among developing countries as a group continue without correction. This "double divergence" has several implications. First, the developing world has become even more heterogeneous than before, making it the more difficult to generalize diagnoses and policy solutions across countries. Diverse situations will require different policy agendas. Second, the persistent differences between the richest and poorest countries not only go against ethical principles shared by the international community, but also causes problems of global governance since it affects the stability of the international system and weakens the legitimacy of international institutions.
2. *A still rapidly increasing and ageing world population characterise contrasting demographic dynamics among countries, but both pose vast economic and social challenges in the decades ahead*. Increased old-age dependency constitutes a main challenge for the sustainability of existing pension and health systems while the decline of the share of the working-age population implies labour shortages in certain sectors of the economy in developed countries. Developing countries, in contrast, still experience fast population growth and will need to address overcrowded labour markets, huge educational demands and disorderly urbanisation processes. The world's growing population also creates

added pressure on the planet's resources, which is at its severest in regions with already vulnerable natural environments. The ageing process may impact savings and investment patterns, altering the growth potential of different countries. The larger share of young people in developing countries creates a demographic dividend in terms of potential growth that will require national and international new policies in order to be exploited fully. As *Ana Luiza Cortez* points out in chapter 7, anticipated demographic trends show that sustained economic growth is needed to support an appropriate distribution of consumption between active and inactive populations. Furthermore, the divergent economic and demographic dynamics among different regions are a source of intense migratory pressures that are likely to continue beyond the current crisis as the causes of divergent population growth will persist for a longer time, as *José Antonio Alonso* discusses in chapter 11.

3. *Environmental degradation is rapidly reaching the Earth's capacity as a sink and a source of livelihood.* Most degradation is a direct consequence of human activity related to continued population growth, ever-increasing economic activity and the predominant wasteful and environmentally unfriendly patterns of production and consumption. This process affects not only environmental global public goods (such as biodiversity, the ozone layer or a stable climate), but also regional and local environmental goods (such as desertification, depletion of groundwater or waste and pollutant product management). As *Hans Opschoor* points out in chapter 5, climate change arguably is the greatest environmental challenge the international community is facing today due to the pervasiveness in terms of its effects on livelihoods and its scale that is intrinsically global. The costs of inaction will be beyond measure. Other environmental challenges, such as those related to the availability of clean water and energy, will need to be on top of any new development agenda.
4. The importance of *global and regional public goods has grown, but the capacity of existing mechanisms of development cooperation and global governance to secure these is blatantly deficient*. Important objectives of what would constitute the post-2015 development agenda have public goods characteristics, such as those related to conditions for life preservation (basic health, peace and security, and environmental protection) or those that promote stable and fair opportunities for economic and social progress (such as financial stability, macroeconomic policy coordination and affordable access to technology and knowledge). It is well known that the provision of public goods of this type cannot be efficiently ensured by

the market, and that therefore some form of collective action is required for their provision. Multilateral organizations offer the best institutional framework to fulfil this task, but there is a widespread feeling that – as they stand – they lack the legitimacy, ability, mandate and resources to carry out that function efficiently. As a consequence, the provision of public goods remains inadequate, making the world less secure and less prosperous than it could be.

5. *The balance of economic power in the world is rapidly shifting.* Rapid economic growth in developing Asia in particular has led to the emergence of new economic powers and this process is likely to continue in the immediate future. As a consequence, the bipolar world equilibrium that dominated the Cold War era has vanished and a more complex multipolar world is now taking shape. These changes open up a window of opportunity for more balanced global governance structures. But neither international institutions nor their policies have yet fully adapted to this new reality.

These five "megatrends" give rise to many other challenges that require an adequate response from the international community. The new development agenda needs to take these elements into account when laying the foundations of a more inclusive and fairer governance of the globalisation process.

New responses

In comparison with previous periods, the main problems the world is now facing are not the result of a high level of poverty, but rather the consequence of the conditions under which material progress is being achieved. Those conditions were also part of the root causes of the recurrent financial turmoil, worsening environmental degradation, and persistent food insecurity. This progress is not only associated with a visible unequal distribution of opportunities among countries and citizens, but also an inability to anticipate and manage the human, financial and environmental risks generated by the externalities and inter-temporal effects caused by the uncoordinated decisions of increasingly more interdependent world. These two characteristics – high levels of both inequality and risk – are at the root of most of the challenges and problems that the international community is facing today.

Based on the assessments of the various chapters in this volume, meeting these challenges would require that future development strategies would need to build on three basic pillars:

- First, we need to *learn from successful national cases in order to build a more effective international development agenda*. An international comparative analysis reveals that there are countries that have achieved accelerated and broad-based economic growth and have undergone favourable social and economic transformations. The strategies that these countries have followed differed substantially from the market-oriented economic policy approaches typically recommended by economic orthodoxy and some international institutions at least until recently. Successful countries were able to define their own path, looking for their particular balance between market and state, international integration and the promotion of national capacities, stability and proactive macroeconomics. Despite the variety of country experiences, it is possible to identify certain "models" or "patterns of development" in these countries' behaviour that could inspire future development strategies, as *Giovanni Andrea Cornia* and *Milica Uvalic* argue in chapter 4. In chapter 8, *Giovanni Andrea Cornia* and *Rob Vos* translate these lessons into possible guidelines for future "pro-growth, pro-poor and pro-environment" development strategies, while recognizing that the integration of the environmental pillar is something all nations and actors will have to experiment with as it has not been a central component of any past experience.
- Second, a *more cooperative and effective international governance system* needs to be designed. This system should be based on more inclusive and representative structures, reflecting the new distribution of world economic power. To improve levels of equity, the global answer should be based on a generalised application of the principle of "common-but-differentiated responsibilities" as defined at the 1992 Earth Summit held in Rio de Janeiro. The principle recognises the reality that countries have different capacities and resources, as well as different historical responsibilities (such as those related to the causes of climate change). Besides that, the new global order should be flexible and leave enough "policy space" to the domestic policymakers and citizens who are more capable – given some broad common principles and objectives (macroeconomic balance, adequate food security, tolerable degrees of inequality and respect for the environment) – to define the specific measures which should be part of their own development path.
- Finally, there is a need to define a *new policies and international frameworks* that allow for: (i) a more balanced distribution of both the benefits of globalisation and the responsibilities for its costs (in short, a

world with a better distribution of development opportunities); (ii) a more comprehensive agenda that takes into account the interdependence of global goals, that demands coherence between local, regional and global levels and between issues (material improvements, social equality and environmental sustainability); and (iii) greater attention to intertemporal trade-offs in terms of equity and security for future generations that are too often the consequences of today's policy decisions aiming to preserve macroeconomic stability, for instance. Such decisions should be balanced with investments in a more equitable and sustainable future, such as in education, health, nutrition, and environmental protection.

Towards a new global development agenda

What have we learned from the MDGs?

Despite many valid criticisms, from a historical perspective the setting of the MDG agenda arguably has been one of the most influential and successful initiatives carried out by the international community in the last half century. As *Sakiko Fukuda-Parr* points out in chapter 2, the MDGs have become the reference points for development policy debates and practices and they have been used in a general way as proxies to judge progress in tackling global poverty.

Several achievements have been facilitated by the establishment of the MDG agenda, but three stand out in particular. First, the international agreement, endorsed by all United Nations member states, to pursue this agenda has undoubtedly had a catalysing effect on the international development community and has focused international resource allocation on the fight against poverty. Second, the MDGs were conceived in a spirit of *global partnership* and in recognition of the fact that tackling the problems at hand would require the involvement of everyone. In this way, the MDGs promoted a shared agenda and a sense of a common mission among developing and developed countries. Lastly, while some of the setting of objectives and targets has been disputed, having *concrete benchmarks* for measuring progress towards the end goals should be considered as one of the key positive aspects of the MDG agenda. It has helped strengthen monitoring and it has brought focus on priority setting by developing countries and on support provided by donors.

That said, before the international community sets itself to defining the post-2015 development agenda, it also needs to draw lessons from

the limitations and shortcomings of the current agenda, as pointed out by *Sakiko Fukuda-Parr* in chapter 2:

- Unintentionally, the MDGs have led to an *oversimplification of the development agenda*. The agenda was built with an explicit focus on fighting extreme forms of poverty. Although poverty reduction should be a central development objective, it has come to the detriment of attention to other equally important development objectives. While part of the United Nations Millennium Declaration, important developmental dimensions, such as political freedom, social participation or the fight against inequality and discrimination were not considered explicit part of the MDGs. Other dimensions were considered only very partially, such as gender equality and environmental sustainability.
- While focusing on end objectives was one of the strengths of the MDG framework, its *silence on the means to achieve them* is seen as one of its major weaknesses. In many instances, this lack of guidance may have led to overemphasis in policy efforts on improving social service delivery (such as in education and health) to the detriment of attention to such matters as building and diversifying productive capacity, job creation, distributive effects of macroeconomic policies, equitable and sustainable management of natural resources, and building a balanced global governance.
- The MDGs were originally conceived as common, global targets to be achieved by the international community. The idea was to leave space for national target setting in accordance with country-specific conditions. In practice, however, they turned out to be applied as a set of "*one size fits all*" targets making each country accountable for pursuing the same internationally agreed targets independent of initial conditions.
- As a consequence of the uniform application, the related system of *monitoring and assessing progress has been perceived as biased against the poorest countries*. By not considering initial conditions of large human development deficits, the one-size-fits-all approach has led to perceptions of failure, especially in African countries where substantial progress was made even though globally set targets were not met. The uniform application also created downsides for many middle-income countries. For instance, the focus on extreme poverty and very basic human needs seemed too limited for countries with already higher levels of social progress. Also, the linearity in the required progress in some goals might not be well founded. For instance, the target of reducing child mortality by two thirds by 2015 would be very challenging in a context of already

very low numbers of child deaths and where such cases are caused by complex health factors.

- Progress in terms of strengthening the *global partnership for development (MDG 8) has been limited* because the MDG agenda lacked concrete quantitative targets for developed countries. More precisely, targets related to MDG 8 were defined rather imprecisely, thereby weakening the accountability for the promised international support for the MDGs. Indeed, many of the commitments made by the international community have remained unfulfilled.
- The process of formulating the MDGs was based on *limited consultations*. They were set through a relatively opaque process, as a consequence of a debate reserved for technical experts with barely any social participation.

That said, beyond the deficiencies highlighted, the main shortcoming of the process of defining the MDGs is the lack of articulation of any kind of national development strategies, as well as for changes in the international context, needed to achieve the social objectives that were set. In fact, the new consensus that was produced around the political priority of fighting poverty was not translated into a debate on alternative development strategies needed to make that objective reality. It was assumed that the MDGs could be implemented by "more international aid *plus* increased domestic social spending" while overlooking the macroeconomic, financial, food security and environmental policies consistent with the MDG targets. In practice, in all these areas, the often-detrimental policies of the past – many in fact responsible for the "quadruple crisis" – continued to take centre stage. The MDGs have sometimes been seen as an agenda pursued by donors and, as a result, the process has come to be perceived as "aid-centric" and "donor-centric". Although generous aid flows and effective delivery mechanisms may well be a continued requirement, the achievement of more inclusive and fairer development also requires a broader redefinition of countries' development strategies and a review of the international frameworks in which they operate. This book focuses on those aspects in particular.

The foundations of a new agenda

Given the above, should new development objectives be defined to replace the MDGs? It was argued that that the MDGs had an important mobilising effect and, even if imperfectly, materialized the normative spirit that sprang up from the Millennium Declaration, defining measurable targets

with a concrete deadline. The MDGs also proved effective in improving accountability in global governance, defining commitments and policies around a group of shared objectives. From this point of view, one can be optimistic about the possibility of defining a new development agenda building on international consensus.

That said, it is not the task of a group of researchers to define that agenda. Rather, countries and their societies should determine a new set of goals and indicators through an open participatory process. There is room, however, to highlight some elements on which that process should be based, by learning from the shortcomings and limitations of previous experience. In fact, as *Sakiko Fukuda-Parr* points out in chapter 2, defining a new development agenda is an opportunity to refocus the goals on a more complete and consistent way to fight against the perverse distributional consequences of economic globalisation, developing the ethical commitments of the Millennium Declaration.

The contributions in this book all convey the message that any new set of objectives should be based on the visionary normative spirit that resulted from the Millennium Declaration. In the Declaration, social objectives are based on universal values, a development concept is proclaimed that is linked to the expansion of capabilities and freedoms of people and a concept of progress is proclaimed based on basic principles of equality and non-discrimination and the recognition of human rights. If the spirit of the new development agenda is to be based more fully on the values and principles of the Millennium Declaration, the process of defining the objectives should be conceptually broader, more consistent and more open than the one that led to defining the MDGs. It should be different in at least four ways:

- First, it should have a *broader vision of the possible objectives*, making room for those that were not considered in the MDGs (equality, democracy, elimination of discrimination, pro-poor growth, fair global governance, and so on), extending the focus beyond the strict limits of fighting poverty that dominated the previous process. The aim should be to implement principles of equity, sustainability and security that should inspire a desirable international order as suggested in the Millennium Declaration. At the same time, the new development agenda should provide answers to the problems presented by the quadruple crisis as well as by the asymmetries that characterise the globalisation process under way, incorporating elements such as the fight against inequality between and within countries, the requirements to promote pro-poor growth

strategies in countries, the need to ensure food security for all, the fight against climate change, the necessary consolidation of democracy and people's participation and global governance reforms to guarantee the inclusive and equitable globalisation process.

- Second, the sense of *global partnership and mutual responsibility* that inspired the Millennium Declaration should be strengthened. From that perspective, objectives should be defined both for developing and developed countries. The goal is to create an agenda based on the principle of common but differentiated responsibilities for all countries.
- Third, it should be *more demanding about the narrative* that accompanies the definition of the international agenda. In this sense, it is important to assume that the present poverty is a result of the asymmetries in the international system and a consequence of inappropriate institutions and policies at the country level. Therefore, achieving the proposed goals will require changes in all these aspects.
- Fourth, the process of defining and monitoring the objectives should also be *more open and flexible*. It is vital that the definition of objectives and shared goals allow countries to adapt those objectives to their specific circumstances. And the monitoring process should also be based on the pace of change (rather than the levels) in countries' development progress in order to avoid a bias against the poorest countries.

Above all, however, the new agenda should be accompanied by a continuous debate and assessment regarding how best to shape development strategies capable of meeting the agreed objectives in all critical dimensions (social, economic, environmental and human security).

National development strategies

What have we learned?

The experience of the 12 years that have gone by since the MDGs were defined allows us to draw some useful lessons. First, after the neo-liberal wave of the 1980s and 1990s, there is greater awareness today that *there are no simple and universal recipes* for development success. None of the paradigms that have dominated economic thought in the last 50 years can claim to offer an optimal solution to the present and future problems. Secondly, case studies of successful economies show that the *process is highly specific to national conditions and based on examples of pragmatism* (rather

than pre-conceived policy dogmas) that combined allegedly antagonistic policy approaches of government interventionism with market principles, openness to international markets with selective forms of protectionism, and fiscal prudence with proactive and countercyclical macroeconomic policies. As *market failures are ubiquitous*, public policies are essential in promoting development. However, *state failure can also be pervasive*, such that it is necessary to promote institutional quality and appropriate incentives for economic and social change, rather than fully relying on "dirigiste" policy models.

To be more precise, experience has shown that the prescriptions of neo-liberal doctrine, which inspired the behaviour of many governments and multilateral institutions in past decades, have not worked as promised. As *Frances Stewart* highlights in chapter 3, the basic neo-liberal model is based on deep flaws in its theoretical foundations and has not delivered its promised growth acceleration. The assumption that economic growth is just the spontaneous result of a universal policy package composed of deregulation, financial and trade liberalisation, doses of privatisation and stable macroeconomics proved largely false. Indeed, on balance it seems that the application of that policy model has been associated with low rates of growth and often with worsening income distribution.

Nevertheless, the fact that growth is not the result of the spontaneous functioning of the market does not persuade even the most heated critic of neo-liberal policies to think that autarkic strategies characterized by high and generalised levels of trade protection could work. In an open world, economies are obliged to take advantage of the dynamic potential of international markets. That said, in order to create competitive capacities, selective and temporary public measures of support to stimulate national production may be necessary. As *Frances Stewart* highlights in chapter 3, those countries which liberalised selectively and retained a strong role for the state were those which performed better.

The present crisis has also showed that strategies that opt for an increasing "financialization" of the economy are not reliable in the medium term. Economies that based their growth on an artificial and temporary rise in asset prices through the intense accumulation of debt, have seen a limited effect on the expansion of productive capacity. Such a process is also unsustainable in the longer term. When asset values fall, the affected economies tend to plunge into a profound crisis, exacerbated by the weight of the debt previously accumulated, as happened in much of Europe in the early 2010s.

Despite their temporary success, policy models pushing for continuous accumulation of significant trade surpluses through artificial wage compression, containing consumption and import demand (as in the case of China, for instance), also do not tend to be sustainable over time. This strategy tends to drive up income inequalities and suppress domestic market expansion, undermining opportunities for technological upgrading and, hence, long-term growth prospects, especially in large economies like China's. When it involves major economies, this strategy tends to become a source of serious global imbalances in that it requires some countries to continually increase their external debt.

Developing countries rich in natural resources must manage that advantage diligently in order to promote economic development through diversification. That obliges the development of productive capacities in those manufacturing and service sectors where innovation and technological change takes place. When the international exploitation of natural resources is contemplated as an alternative strategy to productive diversification, the strategy will be condemned to failure, no matter how large the short-term economic gains may be.

Lastly, a growth strategy that does not account for social equity and environmental protection will be self-defeating over the long run. When economic growth is accompanied by persistent and growing inequality, institutional quality is negatively affected, causing governance conditions in the country to deteriorate. When environmental impacts are not taken into consideration, environmental costs will rise and environmental damage may become irreversible and a major obstacle to further economic development. What is currently being demanded, and this is worth reiterating, is a strategy that is capable of integrating inclusive social and economic development with environmental protection.

In chapter 4, *Giovanni Andrea Cornia* and *Milica Uvalic* present a revealing comparative analysis of development policy approaches using a standardized set of indicators. In the comparison, they take account of differences in political regime and in combinations of economic and social policies to assess different outcomes in terms of key indicators of development performance in the spheres of economic and social development, environmental costs, food security, and democracy. The results show that all development policy models considered in the analysis have tended to yield positive outcomes on some scores, but the larger number of "positive" outcomes are observed in East Asia, resulting from what is labelled as the "East Asian Miracle" (EAM)

policy approach, and, more recently, the "open economy redistribution with growth" (OERG) strategies followed by many Latin American countries during the 2000s. In terms of broader development outcomes, performance in the latter is perceived to be best, even in comparison with the much vaunted Chinese export-led, mixed-economy model or the services-led economic growth under the new liberal policy approach in India, but certainly better than those cases and instances in which the prescriptions of the Washington Consensus were closely followed as in Latin America and Central and Eastern Europe during the 1990s.

Alternative strategies

While we have a fair understanding of the policy approaches that do not seem to work well on all critical dimensions, how much do we know of the strategies that do? Scrutinizing various alternative models allows us to draw some useful conclusions that can be presented as a sort of "common development policy denominator" for alternative strategies, as *Giovanni Andrea Cornia* and *Rob Vos* do in chapter 8. However, before presenting those elements, it could be convenient to offer four broad general comments.

First, development is essentially an *endogenous phenomenon* of economic and social transformation. External elements can condition the path of change – facilitating it or making it more difficult – but the process essentially is endogenous to each society. A potentially successful development strategy requires not only a good technical design, but also broad social support. To a certain extent, a development strategy is a socially shared project of transformation and progress. Second, doctrines tend to be poor guides for success in development. For instance, analysis of the more successful EAM and OERG development strategies reveals that the countries sought *pragmatic combinations* of different instruments and policies. In all successful cases, although the free market had a broad space to operate, the state retained an important role in directing the process of change, in correcting market failures and in improving the overall dynamic efficiency. Third, if we want a strategy that responds to the multiple crises rocking the international economy an *overall coherence* needs to be maintained so that difficult trade-offs are avoided and instruments and policies adopted to tackle one crisis do not exacerbate the effects of others. That means looking for necessary balances between policies aimed at growth recovery and job creation, containing greenhouse gas emissions, improving food security conditions and promoting social equity. Fourth, an effective

strategy needs to be capable of *marrying short-term achievements with long-term development sustainability*. That involves measures aimed at managing levels of risk, whether they are associated with macroeconomic balance (through anti-cyclical policies), the path to growth (looking for sustainable foundations), the social sphere (reducing distributional tensions) or with the environment (mitigating environmental costs).

The degree of interdependence among the current four global crises poses two additional challenges for any effective new development strategy. First, the identification of policies which while addressing each of the four crises do not retard the solution of the other three, promoting at the same time poverty reduction and other human development objectives. Second, the complexity of identifying priorities, given the very different time horizons over which the impact of these policies will be felt obliges difficult trade-offs among, for instance, immediate objectives in terms of growth and job creation, actions in the medium term to fight food insecurity and long-run policies to stabilize greenhouse gas emissions.

Bearing these complexities in mind, *Giovanni Andrea Cornia* and *Rob Vos* offer some of the central elements of a "common denominator development policy", defining a new "pro-poor, pro-growth, and pro-environmental" (pp-pg-pe) development paradigm. The main policy vectors of such approach are:

a. Raising welfare in a socially and environmentally sustainable way

Reducing levels of poverty is highly conditioned on growth and redistribution in countries. It is essential, therefore, to implement a growth strategy that also has equitable effects and can be compatible with sustainability objectives. The following five elements are the basic pillars to this strategy:

- *Mobilization of domestic savings.* If growth is to be based on national foundations with sufficient insulation from global market volatility, domestic resource mobilization should become the main source of financing investment in physical and human capital, infrastructure and environmental protection. Greater mobilisation of domestic savings requires safeguarding macroeconomic stability, promoting the development of a sound, efficient and inclusive financial system, developing domestic capital markets and preserving healthy public finances.
- *Investment in human capital.* Of all of the factors explaining growth, human capital is least prone to decreasing marginal returns. It is also a

driver for promoting productivity and technical change, which underpin competitiveness and growth. Apart from its strictly economic effects, the promotion of human capital also helps to promote social and gender equality, a prerequisite to reach the desired policy and environmental objectives (by promoting more responsible and well-informed consumption and production behaviours).

- *Removal of any remaining anti-agriculture biases and the promotion of sustainable agricultural development for food security.* Underinvestment in agriculture has been one of the root causes of the recent food crisis and problems of food insecurity. Redressing this shortcoming should be central to "pp-pg-pe" strategies. First, strongly increasing agricultural productivity has been a common starting point of strategies of successful dynamic structural transformation. Second, many of the world's poor continue to live in rural areas and directly or indirectly depend on agriculture for their livelihoods. Helping smallholder farmers and their dependents increase productivity thus would have immediate impacts on reducing poverty and hunger. Third, agricultural growth also reduces urban poverty, as a rise in agricultural wages and incomes raises the reservation wage of unskilled workers in cities. Fourth, agriculture is also a sector with large and relatively inexpensive potential for climate change mitigation and environmental protection. Many measures would have negative net costs because of important productivity gains and potential for rural job creation. Low-cost measures include improving soil quality (e.g. by restoring degraded lands) and better management of cropland and grazing lands (e.g. by reducing chemical fertilizer use, reducing tillage, and eliminating burning of crop residues in the field). To take advantage of these opportunities, a broad approach to agricultural development policies is needed, focusing on access to land, extension services, improved inputs, credits and rural infrastructure so as to secure a greater and more predictable marketable surplus and income to farmers and inputs for agro-industrial development. Such measures would need to be complemented with support mechanisms providing farmers with access to technologies for sustainable agricultural production.
- *Active open-economy industrial policies.* Successful development experiences have followed a path of structural change with increasing productive diversification. Strategies underpinning such economic transformations have been based on policies supporting economic diversification through active macroeconomic and industrial policies. Key ingredients include a stable and competitive exchange rate, tax and credit-boosting

measures to stimulate investment, measures to support R&D and attract foreign direct investment, boosting their links to national production, investment in infrastructure or support for public-private partnerships.

- *Environmental and energy policies for low-carbon growth:* Containing the emission of greenhouse gases and other negative environmental impacts is a major challenge for development policy that aims to be environmentally sustainable as well as fighting poverty. For that purpose, a process of innovation and learning has to be ignited alongside efforts to raise the pace of growth, involving traditional sectors (such as agriculture and forestry) as well as advanced sectors. The main problem is that modern energy systems are locked into fossil fuel-based technologies. Therefore, when pursuing a "pp-pg-pe" development strategy, developing and emerging economies will face a double energy challenge: meeting the needs of often still-large shares of the population lacking access to modern energy services while transitioning to low-carbon energy systems. For low-income countries, there may be opportunities by engaging in technological leapfrogging and avoid the resource-intensive pattern of development. For that to occur, cleaner technologies will need to be transferred at affordable cost to these countries, overcoming international and national obstacles. Because of the high initial costs and risk associated with clean energy investments, public sectors will need to take a leading role in promoting the energy transition.

b. Trade and financial openness

A crucial point to elucidate is the degree to which developing economies should integrate into the international markets. Here the answers are very much conditioned by the size of the country and its productive specialization. Nevertheless, some general comments can be made, which necessarily involve a distinction between trade openness and financial openness.

- *International trade*: the successful cases of trade liberalization were not based on a unilateral dismantling of trade barriers or on a generalized protection of national production capabilities. In an increasingly integrated world, international markets offer most developing economies an important destination of the domestic output not absorbed at home, a source of technological upgrading and an important growth driver. However, acquiring the necessary production capabilities to achieve export success does not follow spontaneously from the dismantling of tariffs and quantitative restrictions. An active industrial policy to promote national capabilities is essential to strengthen them. Such a

policy also becomes necessary when the country wants to create dynamic competitive advantages, promoting a continuous structural change in its productive and export supply.

- *Financial openness*: the benefits of financial openness are not clear, especially in the case of short-term capital movements. Although financial opening can facilitate the access to world savings, that openness can also generate sizeable costs in terms of contagion, imported instability and difficulties in macroeconomic management. This is why it is reasonable for countries to set up regulatory mechanisms for their capital accounts. Countries such as Brazil, Chile, Colombia, India, Malaysia and Taiwan Province of China have done this effectively, gaining room for stronger countercyclical policy stances to mitigate the macroeconomic volatility stemming from world market instability.

c. Equitable and non-deflationary macroeconomic policies

In contrast to the idea that macroeconomic policy is dominated by technical decisions, it is worth highlighting the different effects of alternative macroeconomic policies on growth and inequality. From this perspective, the central objective of macroeconomic policy should be to introduce countercyclical measures aimed at reducing the growing instability that has affected many developing countries in recent times and to avoid adopting the standard package of unnecessarily recessionary policies. Given this, the central elements of a new macroeconomic policy are:

- *Exchange rate regime*. Among available options, a managed float seems best suited to promote development objectives. It would combine a certain degree of exchange-rate flexibility with discretionary interventions by the Central Bank in the foreign currency market to preserve currency stability and targeting a competitive real exchange rate to foster export diversification and growth.
- *Countercyclical fiscal policies* whose objectives are to make the business cycle smoother by allowing fiscal interventions that are appropriate to the different phases of the economic cycle. Two things can contribute to the goal of stabilizing of the business cycle: (i) the creation of "stabilization funds", which set aside resources during boom periods and release them during recessionary periods; and (ii) the adoption of "fiscal contingency rules" which improve macroeconomic discipline and allow public expenditure to be increased in the case of unanticipated shocks. Finally, in order to preserve macroeconomic stability, a sound and flexible tax system is necessary.

- *Countercyclical and accommodative monetary policies*. While price stability is important for growth and development, monetary policies should be considerate of the potential costs of too strict an anti-inflationary policy stance, which in a downward business cycle tends to act pro-cyclically with adverse effects on job creation and income growth. More accommodative monetary policies would help avoid these negative effects. Coherence with exchange rate policies can be achieved by allowing monetary sterilization to limit currency volatility and by keeping the exchange rate competitive. Capital account regulation would help enhance the space for independent monetary policies.

d. Redistributive measures

Progressive fiscal and active labour market policies can be effective ingredients in promoting inclusive economic growth and poverty reduction:

- *Redistributive tax and expenditure policies*. Having sufficient tax capacity is the most secure means of the state being able to provide public goods to society and to bring income distribution to a socially desirable level. It is also important for a tax system to be progressive enough and for public policies to underpin universal access to basic services. This policy is also compatible with the implementation of targeted programs (such as conditional financial transfers) to break the poverty cycle of the most vulnerable segments of society.
- *Active labour market policies*. Generating decent employment is one of the most efficient ways of tackling poverty. Employment rewards the asset that poor people most generally possess: their labour. Policies need to drive growth based on a broad social base, which is built by increasing the diversification of production, improving the functioning of labour markets, where necessary expanding public work programs, and increasing the continuous re-training of workers. It is also necessary to make progress in processes of bringing the informal sectors into the formal economy in order to guarantee workers' rights.

This broad set of "common policy denominators" would be relevant for different types of developing economies. Yet, no size fits all. In chapter 8, *Cornia* and *Vos* explore further how to tailor the proposed approach to achieve a "pg-pp-pe" development pathway to varying initial conditions related to the degree of food security, environmental footprints of key economic sectors, economic size, income per capita, prevailing production and export structures, weight of rural and agriculture-dependent population, degree of industrialization, dependence on foreign capital and food imports, and so on.

The case of sub-Saharan Africa

Implementing alternative development strategies will be most challenging in sub-Saharan Africa. Starting from low levels of development, they are vulnerable in many ways despite the progress made during the 2000s and early 2010s. The sub-Saharan African experience has revealed that political stability, institutional legitimacy and peace are pre-requisites for a sustainable development process. Economic and social progress is unlikely in a context of open conflict in which the state is breaking up or there is a general mistrust in institutions. Certain maintenance of basic macroeconomic balance and market norms is also essential. When these prerequisites are subject to random alterations by the authorities, the costs to investment and growth are high.

The economies of the poorest sub-Saharan African countries are largely based on farming. Increasing agricultural production in these countries is therefore a condition for growth and improved food security. Achieving that may require specific aid measures, breaking the neglect the sector has had in the past. It is also important to improve both economic and social infrastructure in these countries, reversing the deterioration it has undergone since the mid-1980s as a result of crisis and subsequent downturns. Investment in infrastructure, when properly targeted, impacts not only growth, by improving the overall efficiency of the economy, but also the redistribution of society's wealth since infrastructure conditions the distribution of production on the ground and provides better access of public services to the population.

Part of the growth of some African countries seems to be linked to growth in the production and exports of commodities driven by demand from fast-growing emerging economies (especially China). Basing overall economic growth exclusively on this demand is not sustainable over time. It is therefore important for countries to use this period of boom in commodities prices to invest in diversifying their production while reducing the risks that trade surpluses can have on macroeconomic stability.

Finally, in all the countries, the social deficits are very high and care needs to be taken to keep active social policies in step with growth, including those that improve basic parameters in education, health and the nutrition of the population. The lack of resources in some countries in the region, and their limited possibility of accessing capital markets, means international aid plays a crucial role. It is important, however, for financial support from the international community to be given in a way that increases the effectiveness of resources and avoids the problems of aid dependency, as *José Antonio Alonso* highlights in chapter 10.

A more enabling international environment

What have we learned?

International economic frameworks have been built in ways that are not able to encourage international growth convergence and environmental sustainability. The most important shortcomings are the following:

- International policies and multilateral regulatory frameworks have been built by and large on the *"level playing field"* principle without considering the extraordinary diversity and heterogeneity of national situations. This approach has had negative effects on countries that traditionally have counted on fewer resources and capacities.
- In a number of areas, such as trade and intellectual property rights, multilateral regulatory frameworks have substantially *reduced the space for national policies*, limiting the ability of countries to determine their own destiny.
- The process of *liberalization has been highly unbalanced* with deregulation having been pushed too far in some areas (financial markets, in particular) and costly shortcomings in others (such as international migration). A more balanced and coherent system is needed.
- Several mechanisms of governance lack *legitimacy*, because of inadequate representation and transparency in decision-making in informal platforms such as the G-8, but also in the G-20, or because the voice and power structure inadequately reflects today's economic realities, such as in the World Bank and the International Monetary Fund.
- There has been a *notable inability to offer the level of security* (human, financial and environmental) required to put highly interdependent global development processes onto a more sustainable path.

In order to address these shortcomings, major reforms in the mechanisms of global governance are needed. The objective should be to create an international order that pursues the greatest human and sustainable development, rather than promoting liberalization as an end itself. In doing so, it is necessary to strike a better balance between international rules setting and the provisioning of global public goods, on the one hand, and allowing sufficient space for national policies, on the other. The international system should also consider the heterogeneity of national situations, and establish the necessary support (based on the principle of common-but-differentiated responsibilities) to enhance development opportunities for the poorest

countries. And finally, it should be a more coherent system that overcomes the inconsistencies that now exist among the global rules in different areas. In that sense, an overarching, representative and accountable mechanism could be necessary at global level for promoting a sustainable and socially inclusive development.

Reforming international frameworks

It is impossible to analyse in detail each of the international frameworks in the limited space provided by this volume, so our attention will focus on a few key areas.

The recent global financial crisis places the reform of the *international monetary system* at the centre of global policy debates. As *Bilge Erten* and *José Antonio Ocampo* point out in chapter 9, the central role played by one national currency, the United States dollar, in the global monetary system is having recessionary effects on the world economy. These result from asymmetric adjustments between deficit and surplus countries during crises and the accumulation of large amounts of reserves as a precautionary measure by developing and emerging economies. The most promising way to overcome this problem seems to be to enhance the role of international liquidity, special drawing rights (SDRs) in particular. Issuance of SDRs remains one of the most underutilized instruments available for international economic cooperation. Placing SDRs at the centre of the international monetary system could free the international monetary system from its present vagrancies emanating from its dependence on the monetary policy of one particular country. Issuing SDRs in a countercyclical way would have the potential of reducing the recessionary bias associated with the asymmetric adjustments. Besides that, SDR allocations could reduce the need for precautionary reserve accumulation, which would represent a lower cost of building self-protection. Finally, there would be ways of including a "development link" in SDR allocations, including a criterion of demand for reserves in SDR allocation or designing mechanisms by which unutilized SDRs are used to *leverage* financing for development or the provision of global public goods. In any case, any reform of the international monetary system should ultimately increase the voice and participation of developing countries in international economic decision-making.

The international community has taken significant steps to improve the effectiveness and coherence of the *international development cooperation* over the last decade, as evident from the Paris Declaration on Aid Effectiveness,

the Accra Agenda for Action, and the Busan Partnership for Effective Development Cooperation. Although not yet fully implemented, these agreements imply a certain rebalancing of the relationships between partners and donors. These changes in development aid doctrine were accompanied by greater aid allocation to the poorest countries. Additionally, official development assistance (ODA) flows increased significantly, reaching an historical peak in 2010. Fiscal austerity measures in major donor countries has led to a reduction in aid flows since and, even at its peak, the volume of aid still fell well short of internationally agreed commitments and what is considered to be needed to help developing countries fight poverty and finance the cost of climate change adaptation and mitigation. Accordingly, there is a need to consider new financial mechanisms to combat poverty and to tackle the new global issues. Additionally, as *José Antonio Alonso* points out in chapter 10, there is an overall perception that the reforms introduced so far have not kept pace with changes taking place in the international arena. Recent trends include the greater heterogeneity of the developing world; the new geographical locations of global poverty, the emergence of new regional and global powers coming from the developing world, the presence of new development aid players—many of them linked to the private sector, and the enlargement of the sphere of international public goods. Coming up with suitable responses to these changes demand a deeper reform to the development aid architecture. Donors should accept that the cooperation system has definitively changed: (i) there is no longer a precise distinction between aid and non-aid instruments nor between donors and recipient countries; (ii) the agenda on fighting poverty should include more active policies to correct international and national inequalities; (iii) along with traditional ODA objectives, new targets for aid delivery should be included for the provisioning of certain global public goods that condition development achievements; and (iv) new financial instruments are needed to raise the required resources for that agenda. The enlargement of the cooperation system requires changes in the governance structure of the system.

In a world of increasing freedom for international transactions, the movement of people through *international migration* is notably subject to restrictive national regulations. Those restrictions do not tend to be in the economic interest of developed countries in need of migrants to overcome labour market bottlenecks or developing countries for which worker remittances are an important source of foreign-exchange earnings. The restrictions have fuelled the growth of the number of undocumented immigrants who are not protected by law and have at best restricted access

to public services in the host country. It has also fed xenophobic sentiments and perceptions of migration as a security problem. As *José Antonio Alonso* highlights in chapter 11, estimates confirm that with current migration barriers, labour is highly misallocated and, as a consequence, the potential welfare gains of a less restrictive policy on migration are huge. Reforming this aspect of international relations would require a more flexible approach, capable of recognizing the developmental impact of international migration while making progress towards a minimum regulatory framework internationally. More precisely, progress needs to be made in: (i) adapting national policies to the real needs for foreign workers that host countries have; (ii) defining a multilateral regulatory regime that assures the rights of migrants; (iii) reducing the costs of remittances and defining fiscal incentives to encourage more productive use of remittances for development purposes; (iv) revising the most aggressive policies that selectively aim at attracting only skilled workers from developing countries and severely restrict opportunities for others; and (v) facilitating geographical labour mobility through the use of temporary contracts.

The process of globalization shows that there is an important gap between the levels of interdependencies among countries and the international capacity to manage the interdependencies and build cooperative answers to collective problems. While markets are becoming increasingly integrated and sophisticated, *global governance structures* continue to be fragmented and most policymaking remains national in nature. Mechanisms for international policy coordination are weak and existing global governance mechanisms lack coherence between them. While there are understandable historical and political reasons that led to the emergence of these shortcomings, failure to address them will become increasingly costly as *Norman Girvan* and *Ana Luiza Cortez* point out in chapter 12.

Girvan and Cortez present the present system of *multilateral trade rules* as a good example of global governance limitations. The current architecture seems disjointed: parts of it have moved forward and pursued the introduction of rules to facilitate an increasing internationalization of production, while other parts seem unable to acknowledge the political consequences of emerging trends and the need to make space for new actors. It is not obvious how the round will evolve. But, independently of the potential negative implications of a failed round for the global trading system, it has been far from clear that the round has been moving in a development-friendly direction. For instance, negotiating proposals on non-agricultural market access would imply a substantial reduction of the gap between

bound and applied tariffs thus further reducing countries' policy space. In that sense, restricting the scope of negotiations to trade issues and giving true priority to those that are high in the agenda of developing countries would be important. More importantly, as far as the ongoing negotiations for the Doha Round are concerned, there is a need to change the overall approach to the negotiations with a shift from seeing trade liberalization as an end in itself to a conditional means to promote development. Recognition of differing initial conditions among developing countries would imply that trade negotiations should focus on diversity rather than imposing uniformity. Similarly, the World Trade Organization (WTO) should more adequately manage that diversity in implementing the rules.

A new global partnership for development

The severity of the multiple crises that are affecting international economy and the importance of the challenges confronting the world economy today require carefully designed, collaborative and coherent approaches at national and international levels. The magnitude and the nature of the problems confronting the world demand a shared development agenda, adapted to the new international challenges. Increased globalization implies that independent decisions taken by individual countries will no longer suffice. To meet the challenges of our times, new national development strategies and new international policies and rules are needed. This new agenda, with its underlying strategies and reforms, should be the base of a new global partnership for development that expresses a shared mission for countries and actors to tackle the devastating effects of the multiple crisis and the emerging new global challenges. The present book aims to contribute to the process of defining new national strategies and international policies that benefit all.

Chapter 1
Globalization at a crossroads: key challenges for the twenty-first century

Rob Vos[1]

1.1 Introduction

The global economic crisis of 2008-2009 exposed systemic failures in the workings of financial markets and major deficiencies at the core of economic policymaking. The rapid spread of the financial fallout in the United States throughout nearly the entire world, affecting jobs and livelihoods, underscored the interconnectedness of the global economy. The ongoing sovereign debt crises in Europe and the political wrangling over the public debt ceiling in the United States, similarly had ripple effects worldwide as visible in the turmoil in financial and currency markets during 2011 and 2012, severely complicating the economic recovery.

The economic and financial crisis came on top of several other crises. Skyrocketing but highly volatile world food and energy prices reflected a decades-long neglect of food agriculture and failure to reign in increasingly speculative energy markets. These crises, though having different root causes, have become closely intertwined with financial market volatility. Climate change is a symptom of the environmental crisis the world is facing. Its consequences are being felt in many parts of the world in the form of more frequent and severe droughts and excessive rainfall; its effects are compounding the other crises. These multiple dramas have unfolded simultaneously and have also exposed major weaknesses in the mechanisms of global governance, which seem inadequately designed to face up to these challenges.

While the strong desire for quick economic recovery is understandable, getting "back on track" would mean returning to an unsustainable path of global development. Sustained and widespread future prosperity will require major reforms in global economic governance and new thinking about global economic development. A central concern of the new thinking will be the need for a focus on sustainable development—entailing an approach that would balance material wealth improvements with protection of the natural environment and ensure social equity and justice—rather than a focus narrowly concentrated on economic growth and private wealth generation based on market incentives.

Global solutions will be required to deal with the global nature of the problems and, given the interdependence of these problems, policy responses will need to be highly coherent at various levels if the international community is to achieve the multiple objectives associated with fair and sustainable global development.

1.2 "The times they are a-changin'..."

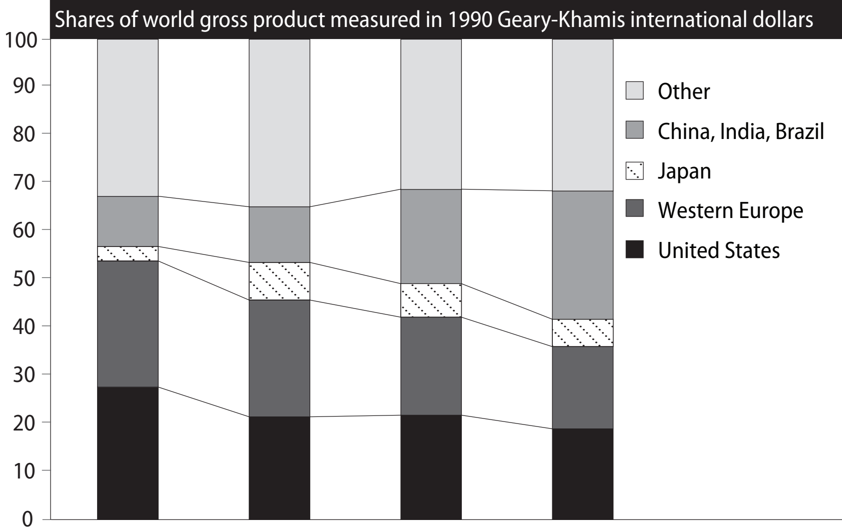
The present challenges emerge at a time that may well represent a watershed in history. Four major changes in the global economy are likely to be dominant in the foreseeable future.

Changing power balance and inequality

First, there are important shifts taking place in the global economy with important implications for the balance of power in the world and global inequality. The rapid growth in developing Asia that is shifting the balance of global economic power is likely to continue (figure 1.1). At the same time, while quite a few developing countries (mostly in Asia) have experienced a significant "convergence" towards the living standards of the now advanced countries, others, especially in Africa, have fallen farther behind even despite relatively robust growth during the 2000s (figure 1.2).

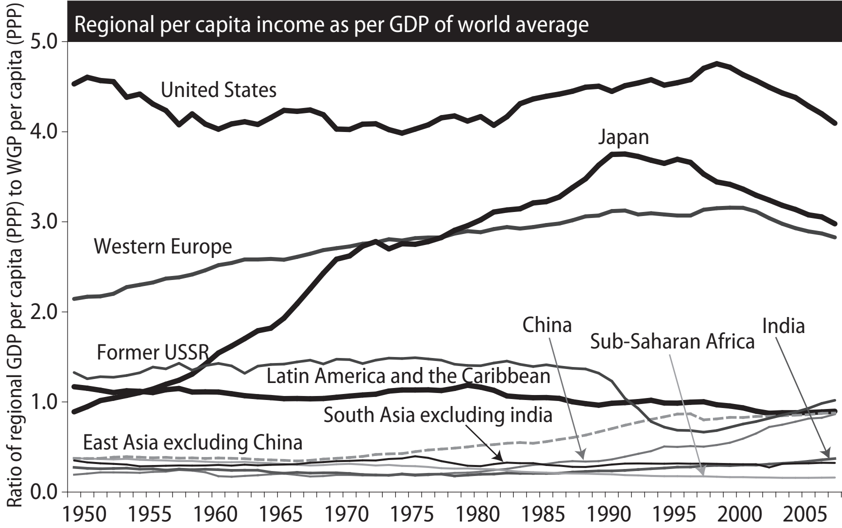
As a result of strong growth performance in parts of the developing world, the number of the poor in the world living on less than $1.25 a day decreased from 1.8 billion in 1990 to 1.3 billion in 2008, but nearly all of this reduction was concentrated in China. In sub-Saharan Africa, the absolute number of poor increased. At the same time, with few exceptions, income inequalities within countries have increased since the early 1980s.[2] Redressing this trend in global economic divergence, so as to prevent its

Figure 1.1
Shifting global economic power, 1950-2008



Source: United Nations (2010b), based on Angus Maddison, Historical Statistics of the World Economy 1-2008 AD.

Figure 1.2
Persisting global income divergence, 1950-2007



Source: United Nations (2010b: figure O.1).

becoming a source of new tensions and insecurity, will be a major challenge in the decades ahead.

Shifting demographics

Second, demographic changes in the coming decades will strongly influence increasing global interdependence. Currently, about 78 million people are added to the world's population every year. This means that, by 2050, the global economy would need to be able to provide a decent living for more than 9 billion people, of which 85 per cent will be living in what are now developing countries. Africa will account for about half of the absolute increase in population between 2010 and 2050 and be home to nearly one quarter of the world population by 2050 at present trends.

Progress in human development worldwide has helped to drastically reduce mortality rates and allow people to live longer. As a result, the world population is ageing rapidly. By 2050, one in three persons living in developed countries and one in five in what are now developing countries will be over 65 years of age. This will put pressure on pension and health systems. Further, the presence of declining and ageing populations in developed regions may result in much larger migration flows than occur today.

Developing countries will have to adapt to growing urban populations. By 2050, 70 per cent of the world's population is projected to live in urban areas and megacities and undergoing further growth will create problems of their own.[3] This will make the creation of a sufficient number of decent jobs more challenging and, if the challenge is left unaddressed, persistent widespread poverty and inequality among urban-dwellers will be sources of social and political instability. It will also put increased pressure on education systems, not only to provide quality education to increasing urban youth, but also to prepare them better for changing requirements of more knowledge based societies while economic policies should be concerned not only with enabling sufficient job creation but also with the quality of those jobs. Vast and persistent youth unemployment, including among the better educated, now observed in many parts of the world may prove political and economic bombshells as witnessed, for instance, in the Arab world during 2010-2012.

Larger urban populations will also change food and land-use patterns, a fact with potentially vast implications. Rising incomes and continued population growth have not only raised food demand, but also altered dietary patterns. This is reflected in increased per capita meat consumption, which has risen by about a quarter over the past decade. While meat is an

important source of protein, under existing production conditions, higher demand would lead to land-use shifts and further deforestation, higher energy use, rising food prices and regional food shortages. Because of rising incomes and spreading urbanization, per capita meat consumption increased from 34 to 43 kilograms between 1992 and 2010. Nearly all of this increase can be attributed to growing demand in Asia, and, to a lesser extent, Latin America. Combined with the growing world population, changing dietary patterns imply that food production needs to roughly double by 2050. Although, global food production has increased at a faster pace (about 45 per cent) than population (about 23 per cent), it has barely kept up with food demand and unequal distribution of the increased food availability was still leaving about 870 million people undernourished worldwide in 2010-12 (FAO, 2012). At the same time, however, almost one quarter of the world population was considered overweight or obese. Most people (65 per cent) live in countries where overweight is a bigger killer than undernourishment.[4] Through its association with sharp increases in the prevalence of chronic diseases, like diabetes and cardio-vascular ailments, unhealthy food patterns are also pushing up health costs in developed and developing countries alike.

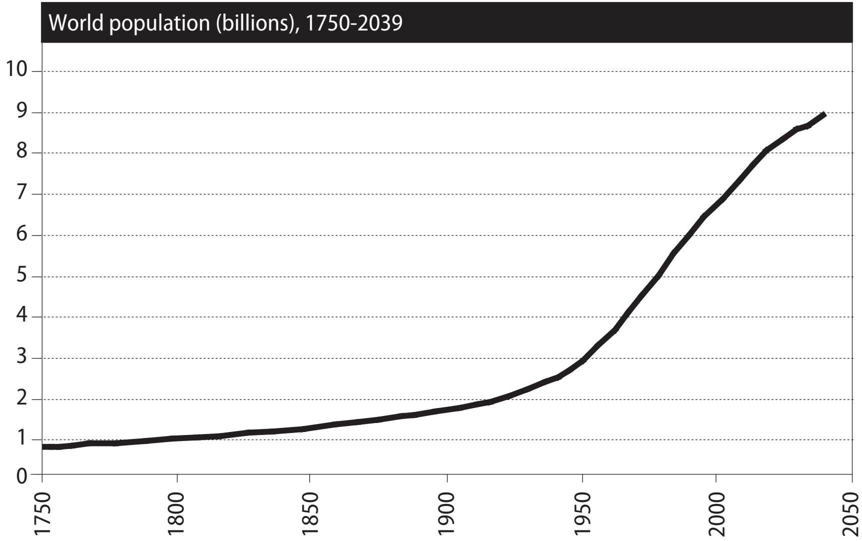
Hitting on environmental limits

Third, the growing world population and income have been supported in part by the degradation of our natural environment. Almost one half of the forests that covered the Earth are gone,[5] groundwater sources are rapidly being depleted, enormous reductions in biodiversity have already taken place[6] and, through the burning of fossil fuels, about 30 billion tons of carbon dioxide are currently being emitted each year.

All of these changes continue to take place at an accelerated pace. Growth of the world population, per capita income, energy and resource use, waste and the production of pollutants (including greenhouse gas emissions) have all increased exponentially since the first industrial revolution. A depiction of these increases assumes the shape of a hockey stick (figures 1.3a-d). The related increase in the level of human activity is threatening to surpass the limits of the Earth's capacity as a source and sink.

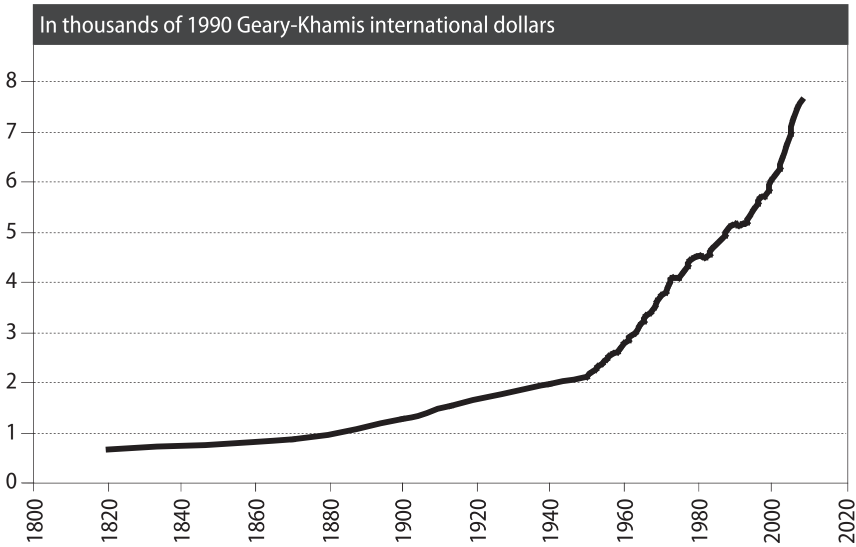
At present, 90 per cent of energy is generated through brown technologies that utilize fossil fuels, with this type of production being responsible for about 60 per cent of carbon dioxide (CO_2) emissions. According to the more cautious scenario (and with a probability greater than 50 per cent), for CO_2 equivalent concentrations to be stabilized at 450 parts per million

Figure 1.3a
Growth of world population, 1750-2039



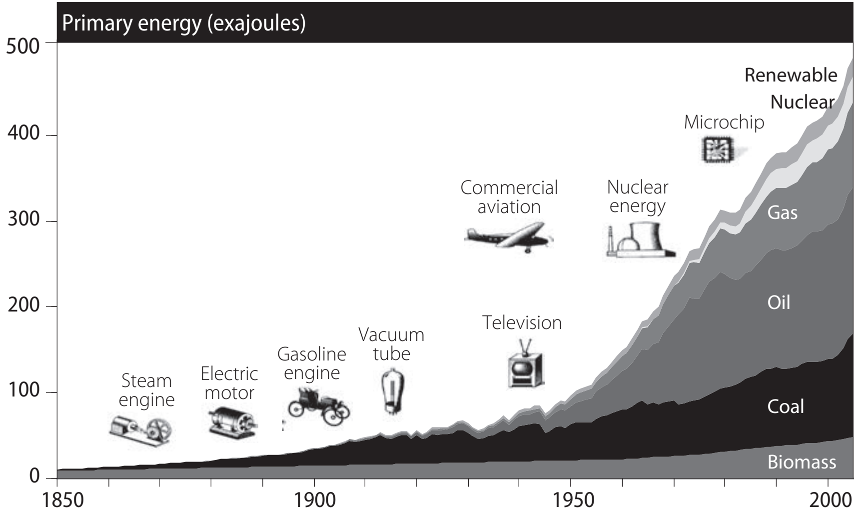
Source: United Nations (2011b), based on data of United Nations Population Division.

Figure 1.3b
Exponential growth of world per capita income, 1820-2008



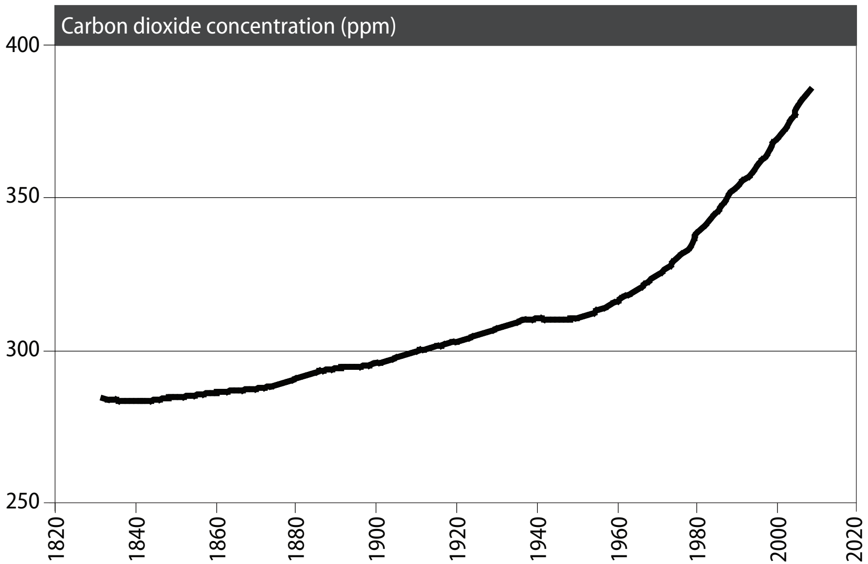
Source: United Nations (2011b: figure O1b), based on Angus Maddison, Historical Statistics of the World Economy 1-2008 AD.

Figure 1.3c
Rise in energy consumption since the first industrial revolution, 1850-2000



Source: United Nations (2009b: figure 2.4).

Figure 1.3d
Exponential rise in atmospheric carbon dioxide concentration, 1820-2010



Source: United Nations (2011b), based on Carbon Dioxide Information Analysis Center (CDIAC) online (http://cdiac.esd.ornl.gov).

(consistent with the target of stabilizing global warming at a 2° C temperature increase from pre-industrial levels), the use of fossil fuels would need to drop by 80 per cent by mid-century. At the same time, 1.4 billion people are "energy-poor", that is, lacking access to forms of modern energy (electricity in particular), which in turn is hampering their economic opportunities and options to emerge from income poverty.

Modern agriculture, which underpins global food security, currently contributes about 14 per cent of greenhouse gas emissions, and the land-use and water management related thereto are not sustainable in many parts of the world. Deforestation is contributing an estimated 17 per cent of global emissions, while causing the loss of habitat, species and biodiversity in general.

The incidence of natural disasters has increased fivefold since the 1970s. This increase can, with a fair degree of certainty, be attributed in part to climate change induced by human activity. Deforestation, degradation of natural coastal protection and poor infrastructure have increased the likelihood that weather shocks will turn into human disasters, especially in the least developed countries.

Continuation along previously trodden economic growth pathways will further exacerbate the pressures exerted on the world's resources and natural environment, approaching limits where livelihoods are no longer sustainable. Thus, business as usual is not an option. Even if we were to stop the global engines of growth, the depletion and pollution of our natural environment would continue because of existing consumption patterns and production methods. In fact, more economic growth, food production and modern energy generation are needed to address still-widespread poverty and ease pressures from ageing populations, among other challenges. Hence there is an urgent need to find new development pathways which would ensure environmental sustainability and reverse ecological destruction, while managing to provide, now and in the future, a decent livelihood for all of humankind.

Changing reality, stagnant governance

Fourth, economic processes are increasingly interconnected at the global level. More and more, both agricultural and industrial production take place through largely unregulated global value chains dominated by international companies. The global crisis of 2008-2009 and its aftermath have made clear how interconnected financial markets are and how quickly problems in one

part of the system can cause shock waves elsewhere. Climate change and increasing migratory flows are challenges with global ramifications. Yet, the policies, rules and institutions established to govern these processes are mostly national, while global mechanisms are strongly compartmentalized. Without reform, tensions will grow between decision-making processes at the national level and those at the global level. The question is how to reform the institutions responsible for global governance so as to make them better equipped to address these challenges coherently while allowing nations and their people to have the necessary space to determine their own destinies.

1.3 Multiple crises, growing interdependencies

The simultaneous occurrence of a financial and economic crisis, persistent food and energy insecurity, and the emerging environmental crisis is no coincidence. The pattern of globalization of the past decades has fortified the interdependencies of the major underlying factors that have led to these multiple crises.

Unleashing global finance

The 2008-2009 global financial crisis emerged on the back of an intrinsically unsustainable global growth pattern. This pattern was characterized by strong consumer demand in the United States, funded by easy credit and booming housing prices. Far-reaching financial deregulation facilitated a massive and unfettered expansion of new financial instruments, such as securitized sub-prime mortgage lending, sold on financial markets worldwide. This pattern of growth enabled strong export growth and booming commodity prices benefiting many developing countries. Growing United States deficits in this period were financed by increasing trade surpluses in China, Japan and other countries accumulating large foreign-exchange reserves and willing to buy dollar-denominated assets, which in turn fuelled mounting global financial imbalances and indebtedness of financial institutions, businesses and households. In some countries, both developed and developing, domestic financial debt has risen four- or fivefold as a share of national income since the early 1980s. This rapid explosion in debt was made possible by the shift from a traditional "buy-and-hold" banking model to a dynamic "originate-to-sell" trading model (or "securitization"). Leverage ratios of some institutions went up to as high as 30, well above the ceiling of 10 generally imposed on deposit banks.

In the context of a highly integrated global economy without adequate regulation and global governance structures, this risky pattern of financial expansion implied that the breakdown in one part of the system thus would also lead to failure elsewhere. It is this systemic failure that was at the root of the Great Recession of 2008-2009. The deleveraging that followed the recent crisis brought down established financial institutions and led to the rapid evaporation of global liquidity directly affecting the real economy in developed countries, while the economies of developing countries were hit through collapsing global trade, plunging commodity prices and reversals of capital flows.

Debt, leverage, collateral value and expected asset prices have become dominant drivers of the global business cycle. The growing "financialization" has exacerbated an already strong pro-cyclical stance of market agents. This behaviour underlies the recurrence of self-inflating bubbles driven by expectations of rising asset prices and by and large detached from improved prospects of real income gains or losses or of the value of the underlying real assets. Intrinsic to financial market behaviour, lenders and investors would tend to underestimate risks in the upswing and overestimate these in the downturn. During the 1990s and 2000s, these attitudes were fortified by the financial innovations in the derivatives markets that promised security against downside risks. This led to ever-stronger fluctuations in asset prices: strong asset inflation and extended financial booms in the upswing and steep asset deflation and financial collapses during the downswing. This was already visible during the crises in emerging markets of the 1990s, and such factors turned a broad-based boom into a worldwide bust at the end of the 2000s. Typically, systemic financial crises are resolved by shifting much of the cost to tax payers and saddling governments with new debt, which then may constrain recovery of output and employment as became evident through the sovereign debt problems in Europe and the United States in the early 2010s.

The shift from an income-constrained to a financial asset-backed economy has been supported by the liberalization of international capital markets. Indeed, the links between domestic financial markets and capital flows are much stronger in developing countries, many of which opened their capital accounts prematurely in the 1990s. These flows have been strongly pro-cyclical. Their effects are often transmitted through public sector accounts, especially through the effects of available financing on government spending and through the effects of interest rates on the public debt service. But the stronger effects typically run through private spending and balance sheets. During booms, private sector deficits and borrowing

tend to rise and risky balance sheets accumulate, riding on perceived success, typically reflected in low risk premia and spreads. Reversals in such perceptions lead to a cut off from external financing and provoke sudden increases in the cost of borrowing, inducing downward adjustment.

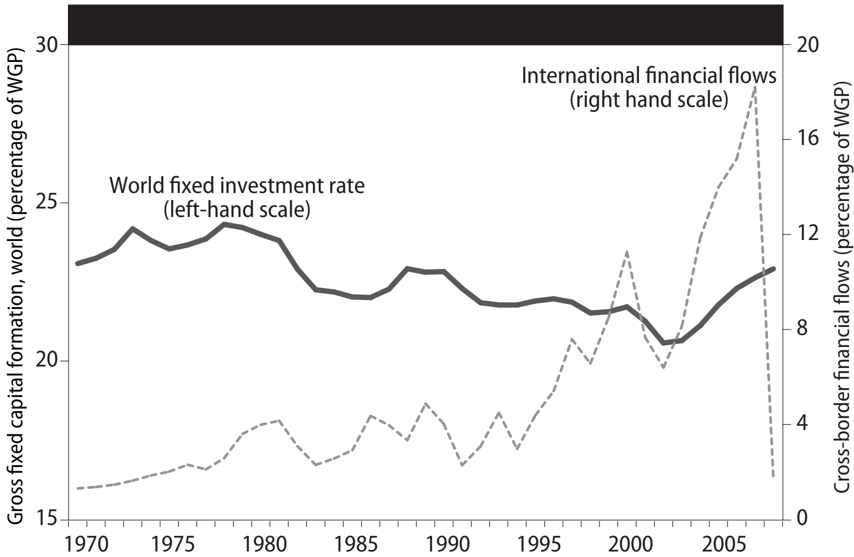
The shift towards export-led strategies in the developing world has accentuated this pattern. The growing influence of financial calculation has meant that commodity price volatility operates in an even more exaggerated pro-cyclical manner, which is further amplified by pro-cyclical policies that, among others, expand fiscal expenditures during the boom and reduce spending when prices are down. The latter is reinforced by the conditionality linked to international financial assistance during crises, which involves orthodox, pro-cyclical macroeconomic stabilization policy packages.

These financial dynamics have far-reaching implications for the real economy. Episodes of exceptionally rapid economic expansion driven by financial bubbles can bring periods of growing prosperity, but they can also end very suddenly leading to deep recessions or even longer periods of stagnation. Vulnerability to a sharp reversal of flows varies, but in many emerging markets, it is often triggered by factors beyond the control of recipient countries, including shifts in monetary policies or the bursting of a housing and financial bubble in a major developed economy.

The suggestion that the growth of cross-border financial flows would trigger a greatly improved investment climate is belied by the global trend of weaker capital formation since the 1990s (figure 1.4) and the increased volatility of investment relative to that of output. This applies to both developed and developing countries. Financial booms and crises tend to give rise to lop-sided investment patterns. These investments often involve little more than rearranging existing assets through leveraged buyouts, stock buybacks and mergers and acquisitions, or are in sectors susceptible to speculative influences, such as property markets. Unlike earlier cycles, these booms have delivered few benefits in terms of rising wages and employment. However, increased access of households to credit has meant that consumer spending can increase, even with stagnant incomes, as (rising) levels of indebtedness substitute for (falling) household savings. But as balance sheets adopt smaller margins of safety, the system becomes more and more fragile.

With few exceptions, this heightened volatility has resulted in average rates of capital formation still well below those enjoyed in the 1970s. Infrastructure investment and additional manufacturing capacity appear hardest hit, both critical to improving the resilience of countries against

Figure 1.4
Increasing global financialization, declining fixed investment rate, 1970-2009



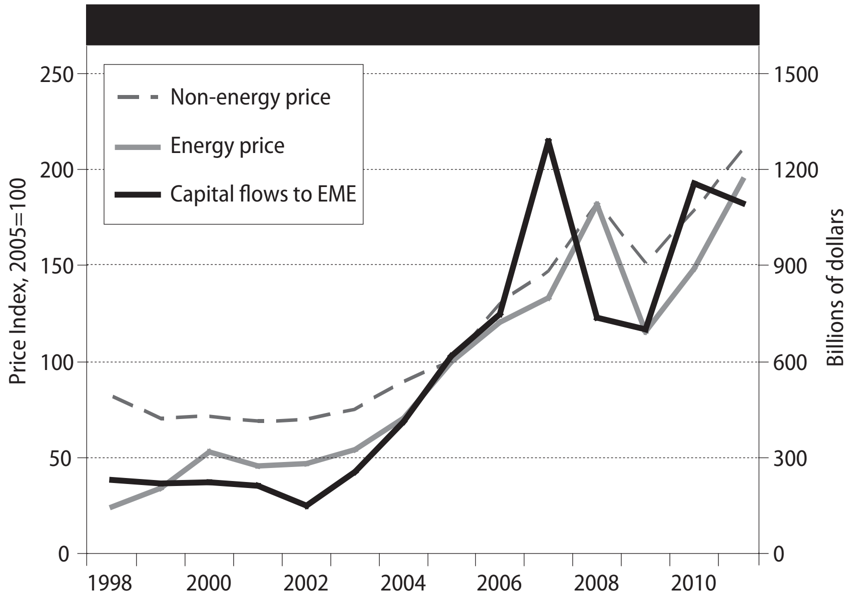
Source: UN/DESA.

external shocks. Moreover, losses of investment, employment and income incurred during recessions are not fully recovered when the economy turns up, pulling down the longer-term average (United Nations 2008; Vos 2010).

The process of financialization has exacerbated business cycle swings through its impact on commodity markets. Even though the precise impact is still subject to debate in the empirical literature, the growing importance of financial investment in commodity futures markets is generally seen to put an upward bias in commodity prices and to exacerbate volatility (see e.g. United Nations 2011a: box II.1; UNCTAD 2011; and United Nations 2012: box II.2). At the same time, this seems to have further strengthened the pro-cyclical co-movement of capital flows to developing countries and international commodity prices (figure 1.5 and Akyüz, 2011).

Exchange rate volatility is further exacerbating commodity price volatility. Most commodity trading is in United States dollars and traders tend to ask for higher prices in case of a depreciation of the world's major reserve currency (figure 1.6). The FAO estimates that for each 1.0 per cent dollar depreciation agricultural commodity prices increase by between 0.3 and 0.8 per cent depending on the commodity (Sarris, 2009). As the dollar

Figure 1.5
Net private capital flows to emerging and developing countries and global commodity prices, 1998-2011

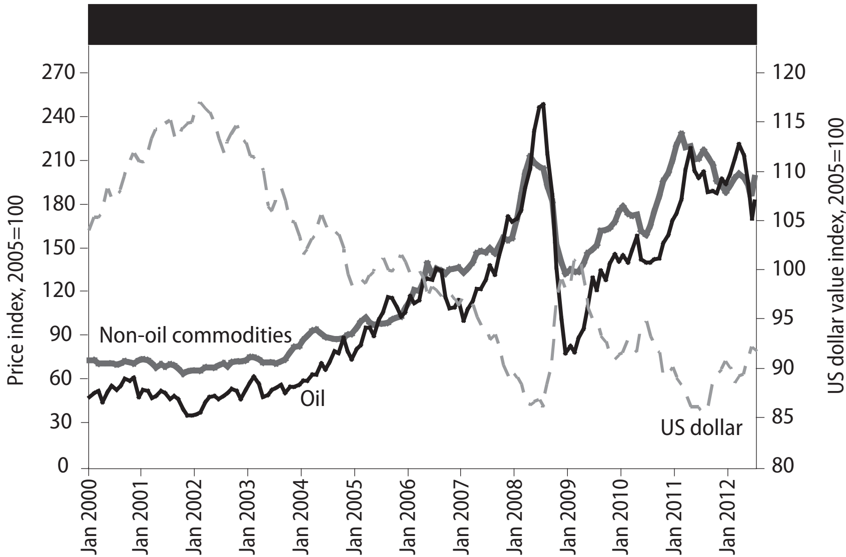


Source: UNCTAD Statistical database and IMF, World Economic Outlook, database (April 2012).

has been on a downward trend surrounded by substantial volatility, this has strengthened the upward shift in commodity prices since the early 2000s.

After the Asian financial crisis and spurred by export-led growth, developing countries have accumulated vast amounts of foreign-exchange reserves, for an important part to provide stronger buffers ("self-insurance") against capital flow and commodity price volatility. International reserves held by emerging and other developing countries totalled more than $7 trillion at the end of 2011, after adding another $1 trillion in a single year (United Nations, 2012). These buffers indeed have helped many developing countries (but more so for some than others) to steer with some resilience through the 2008-2009 global crisis. At the same time, however, the reserve accumulation by developing countries has been part and parcel of the problem of the global imbalances and helped finance widening deficits in the developed world, the United States in particular. This, in turn has been a factor in the longer-term trend for the dollar to depreciate. The downward trend has been subject to substantial volatility, with periodical upward swings during episodes of financial turmoil when the dollar is sought as

Figure 1.6
International commodity prices (LHS) and the United States dollar (RHS)[a]



Source: UNCTAD Statistical database.
a Nominal effective exchange rate.

a financial safe haven. When combined with economic slowdowns, as happened in the second half of 2011 and first half of 2012 for instance, a stronger dollar then exacerbates downward pressure on commodity prices and capital outflows from emerging economies.

Emergence of a debt-dependent trading system

Over the past 20 years, the volume of trade has grown on average by 9 per cent per annum with particularly rapid growth in the period 2002-2007, averaging 14.5 per cent per annum and faster still in developing countries. Four significant forces have helped shape the pattern of international trade in this period: the rise of export-orientated industrializing developing countries; the growth of intra-firm trade in global supply chains (itself made possible by new information and communication technologies and expanded capacity and skill in developing countries); rapid trade liberalization for goods and services, embodied in both multilateral and bilateral agreements; and the explosion of unregulated financial flows.

These factors are often treated separately, but in a globalized world they need to be seen as closely interconnected.

At one end of the global supply chains are mostly low-income countries that continue to be highly reliant on more traditional export sectors. Obtaining sustained gains from trade remains a challenge for these countries. In this sense, the contrast between East Asia and other regions is striking. The share of primary products, resource-based and low-technology manufacturing in the total exports of East Asia declined from 76 per cent in 1980 to 35 per cent in 2005. China alone reduced its share from 93 per cent in 1985 to 44 per cent in 2005. Other regions have been less successful in transforming the structure of their production for exports. South American countries still rely on primary products and simple manufactures (around 78 per cent of exports in 2005, down from around 90 per cent in 1983). In Africa, the concentration of exports in low value-added products is even greater (83 per cent in 2005). Volatility in commodity prices strongly influences the business cycle in these countries. Strongly booming world market prices of primary products, especially from 2006, and their subsequent collapse from the start of the global financial crisis, have made this fate once again painfully clear. Figure 1.8 shows that long-term growth rates of countries at the lower end of the global value chain are well below those at the higher end, and hence have been a source of perpetuating global inequality.

Creating more dynamic gains from trade also remains a challenge for many developing countries which did manage to diversify into the exporting of seemingly “high-tech” manufactures. In many cases, however, this apparent switch to high-tech exports hides the fact that many countries are rather engaged in mostly low-tech assembly activities than in the exporting of the final good itself. In many cases, production takes place within enclaves, connected though trade and foreign direct investment (FDI) flows to other parts of a corporate supply chain, but with only limited ties to the domestic economy.

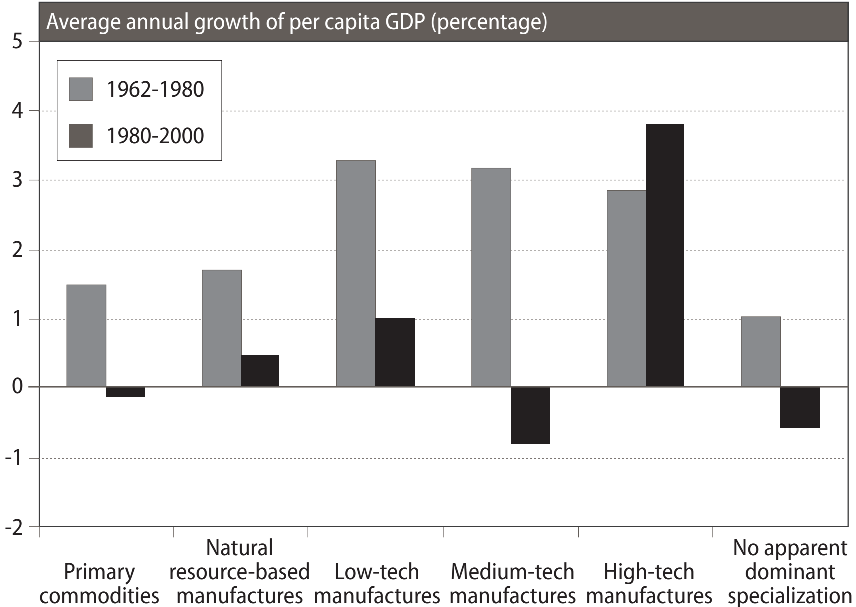
The spread of intra-firm exchanges through global value chains explains much of the indicated growth of world trade, albeit with the final product still destined for a small number of markets, dominated by the United States. However, given that wages have since the 1980s been largely stagnant in the United States and sluggish elsewhere, this growth of trade has coincided with rising levels of household debt and dwindling domestic savings in a number of large industrial economies along with ever-widening global imbalances.[7]

These shifting patterns of international trade have been closely associated with a new global business strategy adopted by many larger firms in the

industrialized countries, which emphasizes a focus on “core competence” and a greater attention to shareholder value (Milberg and Schöller, 2008). This focus has driven firms to break up the production process and take advantage of low-cost offshore production for all but the highest value-added aspects of production. At the extreme this has created manufacturing firms that do no manufacturing at all, such as The Gap or Dell Computers. The focus on shareholder value has meant an increase in the use of profits for dividend payments, stock buybacks and mergers and acquisitions. In this context, offshoring has served the new business model in two ways. First, it has led to cost reductions and thus increased mark-ups over cost, despite the fact that firms face stiff price competition in product markets. Second, by limiting the scope of the firm and especially its domestic operations, offshoring has reduced investment needs, increasing its ability to return value to shareholders. This has supported the “financialization of non-financial corporations” in many industrialized countries, oftentimes at the expense of productive investment, while imports from developing countries were steadily rising. This interplay of financial and corporate dynamics has had far-reaching implications for the real economy, particularly in advanced countries. In many countries, the rise of the financial sector has coincided with the introduction of more flexible hiring practices and less secure employment conditions. Episodes of exceptionally rapid economic expansion driven by speculative financial flows have brought periods of growing prosperity, but have often ended very suddenly in recession or longer periods of slow growth. Moreover, as noted earlier, losses of investment, employment and income incurred during recessions have not fully recovered when the economy turns up. In developing countries, the new business model has provided both new opportunities and risks. By tapping into the global value chain one way or another, they have been able to diversify their economies and trading partners. At the same time, the more flexible business model has made them vulnerable to changes in strategies of multinational companies.

In all, however, the combination of these factors together spell considerable income and job insecurity, even under conditions of relatively strong expansion. A clear sign of this has been the failure in the majority of advanced industrial countries for the growth of labour compensation to keep pace with labour productivity, but the same trend is apparent in emerging markets as well. Increasing income inequality has been the flip side of this development.

Figure 1.7
Export specialization and GDP per capita growth, 1962-2000



Source: United Nations (2006).

Food, energy and climate crises

Growing global interdependencies also have left their imprint in strong and perverse feedback mechanisms that are undermining food and energy security worldwide and have deepened environmental problems. As detailed further in chapter 5 of this volume, the chronic food and nutrition crisis deepened at the start of the twenty-first century, as increasing and volatile food prices and, subsequently, the global recession undermined the food and nutrition security of the poor and threaten their livelihoods. The food security crisis was mainly the consequence of neglect of investment in agriculture in developing countries and inappropriate agriculture energy subsidization policies in developed countries. On balance, global food markets have become increasingly tight. This led to significant price increases during the 2000s and world market prices have become highly volatile because of their sensitivity to supply shocks and the growing influence of financial factors in commodity markets. More intense and more frequent adverse weather events, likely associated with climate change, recurrently cause poor harvests and enhanced price volatility, exacerbated

by the earlier described financialization of commodity markets. Prices of basic grains have been further pushed up by demand for those crops for use in heavily subsidized biofuel production in developed countries (see e.g. Vos, 2009). Stimulus of biofuel production in turn has been a response to the felt need to enhance energy security and substitute fossil fuels for renewable and cleaner primary energy sources. The climate change mitigating effect of biofuel use is being partly offset, however, by modern agriculture's own contribution to greenhouse gas emissions (see above and chapter 6 of this volume), while at the same time affecting food security.

People on the move

An estimated one billion people are considered international or internal migrants.[8] International migration today affects every region of the world, with South-to-South migration as significant as South-to-North movements. Movements of people can be associated with multiple factors, including the search for better educational and job opportunities and working conditions, flight from poverty, conflict, human rights abuse, hunger, discrimination and environmental degradation and natural disasters. Unless reversed, the mega trends sketched above suggest migratory pressures should be expected to increase substantially moving forward. International migration is bringing benefits to both countries of origin and destination, including remittances, knowledge sharing and mitigation of labour shortages. It also comes with important costs to migrants themselves and the societies they live in, as migrants often face much less secure job situations, discrimination, and less than full access to health, education and other social services, while vast migration inflows has been a source of political and social tensions in many recipient countries.

1.4 Shifting development paradigms?

Views about what types of international arrangements would best serve global and national development goals have changed with the shifts in the thinking about the factors conducive to growth and development in countries at low levels of development. In the 1950s and 1960s, development had been perceived in terms of a process of economic growth. Lack of capital and lack of industrial and entrepreneurial capacity were seen as major obstacles to growth. To overcome these obstacles, strong government leadership was seen to be critical to steer the development process in the right

direction by conducting the policies and mobilizing the resources needed to lift binding constraints on economic growth. This was to be achieved through, for example, public investments aimed at building infrastructure, trade protection and industrial policies designed to promote import substitution and develop entrepreneurial capacity, and through attracting development assistance in lifting foreign-exchange constraints. In the aftermath of the Great Depression, public management of the economy had emerged as a primary activity of governments, including in the developed countries. Building on Keynesian theoretical insights, Governments made employment, stability and growth important subjects of public policy and took responsibility for assuring their citizens a degree of economic well-being, with such steps leading to the creation of the welfare state. In Europe and Japan, industrial policies were key elements in post-war reconstruction.

The first generation of development economists, many of whom were associated with the United Nations system, such as Paul Rosenstein-Rodan, Michal Kalecki, W. Arthur Lewis, Gunnar Myrdal, Hans Singer, Raúl Prebisch and Jan Tinbergen, likewise thought in terms of broad, integrated macrostrategies (Meier and Seers, eds., 2001) and saw development as a transformational process. Poor countries would need to move away from a dependence on primary exports and the rural economy and develop manufacturing industries in order to foster more dynamic growth processes; major investments in infrastructure and new activities would be needed to create the right initial conditions. To describe the non-marginal changes that would need to occur, these economists used metaphors like the "snowball" (Lewis), the "big push" (Rosenstein-Rodan), "dynamic linkages" (Hirschman) and the "take-off" (Rostow). Different views existed on how best to induce the necessary change, but the dominant one was that the developmental state should be the prime mover.

In the 1950s and 1960s, some modifications to the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF) policies aimed at accommodating developing-country interests. In 1955, for example, developing countries were granted special treatment in the GATT, allowing them to protect particular industries and introduce quantitative restrictions so as to address balance-of-payments difficulties. In 1963, the Compensatory Finance Facility was introduced by the IMF for countries suffering sudden shortfalls in export revenues. Rather than facilitate industrial capacity building over the long-run, these exceptions to multilateral trade rules addressed mainly short-term adjustment issues. The European Economic Community also granted trade preferences to

its former colonial territories and set up a fund to offset commodity price fluctuations (Stabex), thereby moving further away from the original GATT principles towards a multiplicity of uncoordinated preference regimes (Toye, 2010).

A number of developing countries managed to successfully navigate their way amid such hurdles in international rules-setting and pragmatically implemented sets of policies promoting modern growth strategies. High rates of economic growth were achieved in large parts of the developing world, sometimes with sustained success, as in parts of Asia. The industrial development that was behind high tariff protection and other Government support also led to substantial average welfare increases in Latin America during the 1950s and 1960s, followed, however, by relative stagnation starting in the 1980s and 1990s. Yet, the many instances of failure to create industries in developing countries that could survive on their own after decades of state support, to effectively overcome foreign-exchange constraints, to generate sufficient employment and to reduce poverty and inequality, led to reassessments of development policies and cooperation. The "basic needs approach to development", for instance, suggested reorienting Government intervention towards more direct support for employment generation and securing access for all to social services (ILO, 1976). Similar approaches emphasized interventions on behalf of the poor to reduce income inequality and increase gains from aggregate economic growth (Chenery and others, 1974).

Inequities in the rules and mechanisms for global economic governance were seen by some as constituting another key factor accounting for the lack of success of the development effort, which perception led to the struggle in the 1970s for a New International Economic Order (NIEO). Under this banner, there were calls for, inter alia, more national policy space for developing countries, regulation of foreign direct investment (FDI), international commodity agreements to protect the purchasing power of developing-country exports, lowering of the costs of technology transfers, more development assistance and greater voting power for developing countries in the multilateral institutions (Jolly and others, 2004). However, none of these proposals would become dominant in actual policy approaches.

In the meantime, significant shifts took place in the global context. The confidence in the dollar's peg to gold ebbed during the late 1960s, with persistent, and widening, United States balance-of-payments deficits and with European countries running increasing surpluses while remaining

reluctant to revalue their exchange rates. This situation also exposed the inherent weakness of a global reserve system effectively linked to the national currency of just one country. The system of fixed exchange rates and capital controls was abandoned, but the dollar standard remained in effect. Exchange rates were allowed to float—or not—by country choice and major countries agreed to hold dollar reserves in the United States.

The lifting of many restrictions on cross-border financial transactions led to a surge in private capital flows, including to developing countries. As real interest rates were low in the period of high inflation of the 1970s, international borrowing from private sources, lending banks in particular, became an attractive external financing option for governments in many developing countries, especially middle-income countries, compared with aid flows and multilateral bank lending which were often subject to restrictive policy conditions. As private capital flows proved strongly procyclical and as borrowing conditions abruptly changed at the end of the 1970s, many developing countries ended up saddled with unserviceable debts. The debt crisis had come to be perceived as another failure in the development effort, reflecting unsound fiscal management and failure to create dynamic export sectors which could have kept debt service-to-export ratios within sustainable bounds.

Influenced by these events, another, diametrically opposite approach—commonly referred to as the "Washington Consensus", inasmuch as it reflected the policies of the multilateral institutions and decision makers based in Washington, D.C. (Williamson, 1990)—gained prominence in the 1980s and 1990s. It argued for reconsideration altogether of a role for governments in managing economic development for governments were viewed as having distorted markets through their interventions and poor management of public finances. In this context, development policies would need to become more concerned with macroeconomic stability and to rely much more on deregulated markets and private initiative not only in productive activities but also in the provisioning of social services. The market reforms would be conducive to "getting the prices right" and provide the necessary incentives for businesses and households to improve efficiency and invest in a better future. Different levels of success in achieving development were no longer explained by differences in initial conditions, but rather by whether the "right" policies (market-friendly, fiscally sound) or the "wrong" ones (interventionist) had been conducted.

Sustained rapid economic growth in a number of countries in developing Asia was held up in the 1980s and 1990s as exemplifying the success of

the market-oriented, export-led development strategies advocated by the Washington Consensus. In reality, however, the development policies behind these growth successes, especially in their early stages, resembled much more the recipes associated with the dirigiste paradigm of early development thinking and were not unlike the policies that had, in earlier times, promoted modern development in Western Europe and Japan. These development policies involved, inter alia, agrarian reforms, investments in human capital, selective trade protection, directed credit and other government support for developing industrial and technological capacity while exposing firms gradually to global competition.

Many other developing countries were strongly hit by the debt crisis and had to turn to the IMF and the World Bank for structural adjustment loans which came attached with strict conditionality regarding fiscal adjustment and the initiation of market-oriented policy reforms. Trade liberalization and capital-account liberalization were key components of the reforms. Together with a further lifting of remaining restrictions on cross-border capital flows, this approach set off a new wave of growth in private capital flows to developing countries and further strengthened the trend towards production within global value chains.

The advance of deregulated financial globalization and the pro-cyclical nature of private capital flows also enhanced the risk of financial crises—crises witnessed by many emerging market economies during the 1990s and early 2000s. As these crises inflicted hardly any hurt on the economies of developed countries, many analysts determined their cause to have been the policy mistakes made by the governments of the (Asian and Latin American) countries affected. The crises served to expose the limited capacity of the IMF to signal the risks whose build-up could lead to financial crises, as well as its limited lending capacity and consequent inability to come to the rescue when a crisis of significant magnitude did strike. Developed-country governments, especially that of the United States, had to contribute resources in an ad hoc fashion to make up for this deficiency. Few saw the emerging market crises as evidence of growing systemic risks with potentially global repercussions and of the need for a fundamental reform of the IMF to enable it to fulfil its function as guardian of the financial stability of the global economy (see, for example, De Gregorio and others, 1999). Although the IMF did move to strengthen its early warning information system, little else was done to build in better safeguards against financial crises. In fact, after the Asian crisis of the late 1990s, further measures were taken to liberalize financial sectors worldwide, giving greater scope to

financial innovation and permitting high leverage ratios. Successful Asian exporters with large trade surpluses had already been accumulating dollar reserves on an increasing scale before the financial crises in their region, and continued on an even larger scale thereafter, motivated in part by the desire to provide greater self-insurance against future external shocks and crises. The reserve accumulation undervalued the currencies of the countries concerned, contributing to widening trade deficits in the United States, while at the same time helping to finance those deficits. Asian trade surpluses were thus recycled through the financial system in the United States which recycled portions back again to emerging market economies in the form of cross-border financial investments. This dynamic helped keep inflation and interest rates down worldwide and contributed to strong global growth during much of the 2000s; at the same time, however, it also inflated asset bubbles, induced excessive risk taking in financial sectors and was conducive to widening global imbalances, thereby planting the seeds of the global financial crisis of 2008.

The World Trade Organization (WTO) within which the GATT was subsumed in 1995, became the most substantial addition to the mechanisms of global economic governance during the period of the 1990s. The WTO moved towards setting tighter common rules designed to reduce barriers to international trade. Under the WTO, trade negotiations were broadened to encompass issues of importance to development prospects, such as trade in agricultural products heavily subsidized by developed countries; and some types of industrial policy for development, especially for the poorest countries, were permitted. While the WTO has become a near universal body, negotiations under the so-called Doha Round have stalled not only owing to disagreements over the issue of creating more space for developing countries to enable them to use subsidies and other measures in support of the build-up of their export industries, but also because of the question of how to level the playing field for developing countries in respect of intellectual property rights so as to ease their access to technology, among other controversial areas. Meanwhile, a proliferation of economic partnership agreements and bilateral and regional free trade agreements has been complicating the multilateral trading system and generating inconsistencies, thus making achievement of a fairer trading system all the more challenging.

Adopted at the turn of the new century, the United Nations Millennium Declaration conveyed the rediscovery of the insight that market-based growth strategies were insufficient by themselves to solve the problem of widespread poverty and that well-functioning institutions and effective

social policies were needed to ensure adequate provisioning of health care and education and to prevent the social exclusion of many. The decision to put Poverty Reduction Strategy Papers (PRSPs) at the centre of debt relief initiatives for the poorest countries was a reflection of the same insight. Nonetheless, trade and financial liberalization and fiscal prudence remained central to policy reforms in developing countries and the policy conditionality attached to multilateral lending. Policy shifts were more visible in the social arena, as reflected, inter alia, in the human development focus embodied in the Millennium Development Goals (MDGs) that emanated from the Millennium Declaration (see chapter 2 of this volume) and the greater priority in national development policies for education and health spending, the introduction of innovative cash transfer programmes and support for microfinance schemes. Despite the existence of a broader development strategy as embodied in PRSPs, these social policy changes were often not well coordinated with economic policies (see e.g. Gottschalk, 2005; Vos and Cabezas, 2006; and Vos, 2011).

1.5 Where do we go from here?

The experiences of the past decades have shown that there are no simple recipes for development success. Clearly, none of the dominant paradigms within the realm of development thinking that have emerged over time can take credit for having served as a blueprint for successful development. What worked in certain past contexts may not work equally well elsewhere. For one thing, the world has become increasingly integrated and the space available to countries for jump-starting their development in relative isolation has become commensurately smaller. The expanding role of FDI and global value chains in driving world production, trade and technology development has limited the scope for wielding old-style industrial policy instruments by national governments; and multilateral trading rules have imposed restrictions on domestic support measures for developing export industries. Further, freely flowing private capital flows have made macroeconomic stabilization much more challenging. Rules for intellectual property rights and quality standards have increased the cost for many developing countries of absorbing new technologies, becoming globally competitive and introducing greener production processes to combat and adapt to climate change. This does not mean that there is no policy space at all, but rather, that the narrowed scope in this regard is posing much greater challenges to policymakers today.

As the global food, energy, environmental and financial crises have exposed the systemic flaws inherent in the functioning of deregulated global markets, a tide has turned in the thinking about public policies. By intervening in the ways required by the crises, Governments have dealt a blow to the conventional wisdom underpinning the Washington Consensus. Their actions have led to a reassessment both of the role of the state in driving national development processes and of how national policies should be coordinated at the regional and global levels in order to engender outcomes consistent with objectives of global financial stability, shared prosperity and sustainability of the world's natural environment.

The present core set of institutions and rules for managing the world economy were established more than 60 years ago. Since then, the world has changed beyond recognition while the mechanisms for achieving global economic governance have either changed little or adapted but slowly. Because of the complexity and interconnectedness of today's global challenges, a new balance must be found between international rules-setting and the provisioning of global public goods, on the one hand, and the creation of the space needed by nations to determine their own destiny, on the other. The task will not be easy: it will require a new kind of thinking and the striking of a new balance between decision-making processes at the national level and those at the global level.

National development strategies

There are no simple recipes for development success. Sustained, rapid economic growth in a number of countries in Asia was held up in the 1980s and 1990s was, as indicated, strongly influenced by interventionist policies of the dirigiste development paradigm.

In the present-day context the space for repeating such experience has become much more limited. The national development strategies laid down in the PRSPs mostly kept market reforms and liberalization and opening to global markets as the mainstay of economic policies. Greater policy shifts were visible in the social arena, entailing greater priority for education and health spending, the revisiting of user-fee schemes, the promotion of programmes believed to reduce poverty, for example, in microfinance and land titling, and the introduction of innovative cash transfer programmes, which provided incentives to poor and vulnerable populations to invest in human development by making receipt of the transfers conditional on keeping children in school or on use of health facilities by mothers

and children. Yet, typically, social policies remained largely marginal to economic policies. Macroeconomic policies, for instance, remained narrowly focused on stabilization of price levels, government budgets and current-account deficits instead of on stabilization of employment. This has not only limited the scaling up of MDG-oriented public spending, but has exacerbated the impacts of external shocks on employment and income growth, causing increased economic insecurity and placing a larger burden of adjustment disproportionately on the poor and vulnerable. Similarly, trade and financial policies remained committed to further integration with global markets, enhancing competitiveness and growth objectives, but in most instances yielding few benefits in terms of employment creation, poverty reduction and enhancement of economic security.

As a result, many countries are not on track to achieve the MDGs by 2015, the deadline set by the international community. Moving forward, these goals should remain a focus, because even if all of them were to be achieved by 2015, significant human development challenges would remain: millions would still need to be lifted out of extreme poverty, and important educational needs extending beyond access to primary schooling and the high prevalence of acute and chronic diseases would still need to be addressed.

Indeed, a post-2015 framework would need to do significantly better given the fact that the still-large human development deficits will need to be overcome in a context of persistent food insecurity, the threat of climate change, population ageing and other demographic shifts. In today's context, the more successful development experiences suggest that the way forward would start with designing national *sustainable* development strategies tailored to country-specific conditions; it would be "pro-poor, pro-growth, and pro-environment" as argued in chapter 8 of this volume.

A more enabling global environment

Effectively implementing such strategies will not be feasible without a more enabling global environment. National development strategies will need to be supported by stable aid flows, especially for low-income countries with limited access to other sources of financing; by a fair multilateral trading regime allowing the countries space for building domestic production capacity and pursuing sustainable development goals; and by stable and predictable international financial markets. Such coherence between the

national and the international arenas of policymaking is not present under today's rules and mechanisms for global governance.

Over time, a highly fragmented aid architecture has emerged. This has raised transaction costs and undermined national policy space. Each donor tends to undertake its own identification missions, negotiate the terms of the projects to be sponsored, impose its own accounting methods, define its own conditions, and conduct its own monitoring and evaluation. This not only increases the direct cost of providing aid but also tends to affect the institutional capacity of recipient countries, which complicates the pursuit of coherent, long-term development policies by Governments. Aid fragmentation has also rendered the flow of resources less predictable and more volatile, thereby making the management of budgetary processes highly dependent on aid flows all the more challenging. The delivery gap in respect of fulfilling the commitments to support the MDG agenda has become all the more poignant with the calls for additional assistance to the poorest countries in addressing their food security problems and climate change. More generally speaking, reconciling national development priorities with the taxpayer-approved objectives of donor countries has been difficult. What would be needed is a much stronger commitment by donors to accepting the principle of needs-based allocations and alignment of aid flows behind national development strategies. Under this approach, sustainable development strategies would provide the framework for policy coherence at the national level and also determine the nature of the financing gaps to be filled by aid flows and the timing required. Alignment with other sources of development financing could occur as part of the same process, while additional targets may need to be set to ensure sufficient resource mobilization for supporting climate change mitigation and adaptation efforts in developing countries, aid for trade and the delivery of global public goods.

Meanwhile, in many countries, aid flows have been overtaken by other resource flows, including foreign direct investment and worker remittances. Remittance flows nowadays triple the annual amount of official development assistance provided by traditional donors that are members of the OECD's Development Assistance Committee (DAC). Remittances may increase substantially as a source of development finance in the future (see chapter 10). At present, however, even if important to many low-income countries in macroeconomic terms, transaction costs for migrant workers and families to wire money to relatives back home remain high and incentives and mechanisms to channel resources to developmental investments tend to be weak in most countries. There are effective ways to

overcome this problem as studies have shown (see chapter 10 and Sharma and others, 2011, for instance). A more complex issue (because of its political ramifications) is arriving at a proper international framework to guide the international mobility of labour. The lack of a coherent regulatory multilateral framework for international migration has been labelled as "the big hole in the traditional development agenda" (Clemens, 2011). The key to achieving development of international framework regarding migration is to find incentives that attract both home and host countries to take part in cooperative action. Since it is often difficult to find sufficient mutual rewards in the field of migration alone, it may be necessary to make changes in other areas of international relations, including trade, technology and finance.

A number of options are available for creating a more stable financial system and a better environment for sustainable growth. Four areas of reform would need to be considered. First, further improvements to international financial regulatory framework are needed to stem excessive risk-taking and capital flow volatility, including through appropriate capital controls and macro-prudential regulatory reforms imposing counter-cyclical biases in rules for reserve requirements and loan-loss provisioning. Second, as new systems of regulation are being elaborated, there is a need for a fundamental revision of existing mechanisms of compensatory financing designed to cope with external shocks. Such revisions should ensure more adequate availability of and easier access to international liquidity, especially for developing countries. Third, a new global reserve system could be created, one that no longer relies on the United States dollar as the single major reserve currency (see chapter 9 of this volume). The dollar has proved not to be a stable store of value, which is a requisite for a stable reserve currency. Nonetheless, motivated in part by needs for self-insurance against volatility in commodity markets and capital flows, many developing countries accumulated vast amounts of such reserves during the 2000s. Hence, a new system needs to be developed that facilitates better pooling of reserves at the regional and international levels and permit the emission of international liquidity (such as SDRs) to create a more stable global financial system. Such emissions of international liquidity could also underpin the financing of investment in long-term sustainable development, as suggested above. And fourth, none of these reforms will work effectively, however, if the democratic deficit undermining the credibility of the Bretton Woods institutions is not repaired. The governance structure of the IMF and the World Bank must be reformed so as to more adequately reflect changes in the weights of actors in the world economy, and to be more responsive to current and future

challenges, thereby strengthening the legitimacy and effectiveness of these institutions. A new multilateral agency would need to be created to enforce the rules to be established for better and more comprehensive international financial regulation and supervision. The new multilateral financial authority would also need to ensure coherence between the global financial regulatory framework and multilateral trade rules.

Repairing deficiencies of the present multilateral trading regime (with or without the conclusion of the Doha Round) is another major challenge. Since the establishment of the WTO, the main emphasis has shifted towards setting common trade rules, as reflected in the trade liberalization that has taken place worldwide over the past two decades. This has progressively restricted the space available to developing countries for utilizing trade policies to foster economic development. There has been progress in providing developing countries, especially the least developed countries (LDCs), with greater duty- and quota-free access to developed-country markets for their products through the application of the most-favoured-nation treatment. Yet, important barriers to market access persist for developing countries. Also, agricultural subsidies in advanced countries remain high and continue to limit production and income opportunities for farmers in developing countries. While further progress needs to be made in enhancing world market access for developing countries and reducing agricultural support measures in developed countries, multilateral rules will need to be recalibrated in order to increase the space available to developing countries for building production and trading capacity.

Achieving coherence between trade and climate policies is a recently recognized challenge. In the absence of corrective measures, trade that is more open will likely lead to increased greenhouse gas emissions (for example, those generated through transportation of goods). Furthermore, national policies designed to address climate change may affect world prices and production, trade and livelihoods in other parts of the world. Domestic price subsidies to stimulate biofuel production in Europe and the United States, for instance, have impacted on land use, contributed to world food prices' upward drift and caused increases in poverty in large parts of the developing world. More generally, at present there is no level playing field in terms of the capacity of countries to conduct national climate change policies, which will have implications for international competitiveness. For instance, countries lacking resources and affordable access to carbon-efficient technologies possess a competitive disadvantage compared with those that are able to support industries in meeting climate change mitigation targets,

inter alia, through duties levied on the basis of the carbon content of products imported from countries not undertaking comparable mitigation efforts. In this way, climate-trade links would be used as a basis for protectionism. In addition, existing multilateral trading rules constitute hurdles to technology transfers to developing countries. Such obstacles also make the development of industries using green technologies more expensive. The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS) will need to be revisited to allow for the affordable transfer of technologies to developing countries so as to enable them to adapt low-carbon and energy-efficient production methods. To further ensure a level playing field in the area of policies supporting green production, compensatory schemes will have to be established to cover the incremental costs of introducing cleaner technologies in developing countries.

Towards a fairer and sustainable globalization?

The international community must face a key fact, namely, that the pattern of uneven development brought about by globalization so far has been sustainable neither economically nor environmentally, nor has it been feasible politically. Hence, business as usual is not an option. Retooling the rules of the game for a fair and sustainable global development is therefore necessary. That, however, will not be sufficient. It is also about the players. Players will need to agree on the common global sustainable development goals to be pursued and will need to be convinced that cooperation will provide net benefits for all—benefits serving present and future generations. However, within any scheme of international cooperation, net benefits may be perceived as not being equal for all; and any expected unevenness in outcomes may impede the reaching of effective global solutions. Because of differences in living standards, and therefore in capacity to pay, some countries will be expected to shoulder larger shares of the total costs of providing global public goods, which may reduce their incentive to cooperate in providing them. Hence, with respect to establishing multilateral agreements, the pattern of burden sharing will be as important as the extent of the benefits to be conferred by the public goods.

Notes

1 This chapter has greatly benefited from research undertaken at the UN Department of Economic and Social Affairs, in particular that in the context of the World Economic Situation and Prospects (see United Nations, 2009a, 2010a, 2011a, 2012) and the World Economic and Social Surveys of 2006 (on diverging growth and development), 2008 (on economic insecurity), 2009 (on climate change and development), 2010 (on global economic governance), and 2011 (on technological transformation for a green economy) (see United Nations, 2006, 2008, 2009b, 2010b, and 2011b). I am grateful to my staff at the Development Policy and Analysis Division for their research and work going into those studies. They are not responsible for any remaining errors and the views expressed in this paper do not necessarily coincide with theirs neither with those of the United Nations.

2 Aggregate measures of global income inequality, which combine within- and between-country income inequality, show clearly increasing trends over the past decades. The trends are starkly unambiguous when China is not included (Bourguignon and Morrison, 2002; Milanovic, 2005 and World Bank, 2006).

3 Megacities are high-density metropolises with a population of 10 million inhabitants or more. The number of megacities increased from 10 in 1992 to 21 in 2010. In other words, over the past two decades a megacity has been added every two years. Fifteen of 21 megacities are located in developing countries.

4 Data based on World Health Organization (2011), Obesity and overweight, Fact Sheet No. 311 (http://www.who.int/mediacentre/factsheets/fs311/en/).

5 Since 1990, forest area has decreased by 300 million hectares, an area larger than Argentina. Most losses were in Latin America and Africa, while there was some recovery in North America, Europe and parts of Asia.

6 The Living Planet Index, which reflects changes in the health of the Earth's ecosystems, has declined by 30 per cent between 1990 and 2010. Biodiversity in the tropics is declining most dramatically, which is seen to be associated with high depletion rates of primary forests and transformation of forest into agriculture land and pasture (WWF 2010).

7 See United Nations (2009a).

8 United Nations Department of Economic and Social Affairs, Population Division, *Trends in international migration stocks: migrants by age and sex*, POP/DB/MIG/Stock/Rev.2010 (New York, 2011).

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Chapter 2
Should global goal setting continue, and how, in the post-2015 era?

Sakiko Fukuda-Parr[1]

2.1 Introduction

The 21st century began with an unprecedented commitment to a new consensus on ending poverty as the central purpose of international development. World leaders from 189 countries, including 147 Heads of State and Government, gathered at the United Nations General Assembly to define the central challenges for the new century. They adopted the Millennium Declaration (UN 2000 A/RES/55/2) which stated their determination to work towards development and poverty eradication, peace and security, environmental conservation, democracy and human rights. They pledged to "spare no effort to free our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty" (paragraph 11). They further emphasized that the global reach of these commitments went beyond their own national borders to people worldwide, notwithstanding the primary responsibility that governments have for their own citizens.

The Declaration was a visionary document that reiterated the shared values of solidarity, equality, dignity and respect for nature as the basis for their consensus and was exceptional for its clear vision and articulation. It was also particularly powerful because it went beyond vision and values and included a concrete action plan by setting ambitious and measurable goals with a clearly defined deadline. One year later, the Secretary-General

published his implementation plan, the Road Map document (A/56/326), which contained, in an annex, a list of goals derived from the Declaration. These were structured and elaborated as 8 goals, 18 targets and 48 indicators and packaged with a catchy new name, the Millennium Development Goals (MDGs).[2] The purpose of this list was to "harmonize reporting on the Millennium Declaration" (p.55, paragraph 1).

The expiration of the MDGs in 2015 raises several questions: should they expire, be renewed with an extended deadline, or be replaced with a new set of global goals?

The objective of this chapter is to argue for the last option. The expiry is an opportunity to correct some of the deficiencies of the MDG approach, and to set new goals that more adequately reflect the equitable growth and human rights-based development strategy set out in the Millennium Declaration. The next section gives a short review of the MDG experience over the decade, highlighting both important contributions and critical issues that have emerged. The third section aims to explain the MDGs as a policy instrument in the context of the political economy of international development cooperation. The fourth section proposes an approach to setting post-2015 goals based on the ethical commitments of the Millennium Declaration. The final section concludes.

2.2 The MDG experience, 2001-2011

The MDGs are global goals. Since the 1960s, such goals have been set at UN conferences to draw attention to important but neglected global priorities (Jolly, 2004). They are, in fact, an important part of agendas set at these gatherings of the world's countries where common objectives are defined and priority actions enumerated; time-bound and quantitative goals make the commitments concrete, make it possible to monitor implementation and progress, and provide a framework for developing strategies. The essential function of the MDGs is to serve as benchmarks for monitoring the Millennium Declaration. However, there is no consensus on how the MDGs should be used. As later sections of this paper will elaborate, they are frequently interpreted—inappropriately—as planning targets or as normative objectives.

MDGs and development priorities

According to Weiss, Jolly and Emmerij (2009), the MDGs were among the most important United Nations ideas that changed the world. Like most UN

resolutions, the MDGs could have fallen into oblivion within a few weeks or months of their introduction, but they continue to dominate international debates on development. The MDGs have become the standard reference point around which international debates on development revolve. They are used as a proxy to judge progress in tackling global poverty. The UN, the World Bank and numerous other international bodies monitor MDG implementation and issue annual reports with detailed data. The International Monetary Fund (IMF) systematically includes data on MDG targets in their country reports along with key macroeconomic performance indicators. UN meetings to review progress in achieving MDGs have become frequent high-profile political events that are significant for a country's prestige and international standing. Political leaders make speeches defending policy initiatives with warnings such as: "without such-and-such action the MDGs will not be achieved". Economists write research papers on macroeconomic policy choices and evaluate them against contributions to achieving MDGs. Local NGOs advocate national budget reforms "to achieve the MDGs", however critical they may be of these goals, because the MDGs are the accepted standard for evaluating policy. Media reports on poverty refer to the failure to achieve MDGs as a demonstration of pervasive abject poverty. In other words, MDGs have become a convenient shorthand for ending poverty and, to a certain extent, for achieving development.

It is widely acknowledged that the MDGs raised awareness about global poverty as an urgent challenge and a priority for global action. They have helped to maintain development as a priority, not only at the UN, but also in other fora such as meetings of the G-8 and G-20. Moreover, since their introduction in 2001, the MDGs have become increasingly accepted and consolidated as the legitimized framework for debates on international development. Even those who initially opposed them or hesitated to embrace them now use them.[3] In so doing, MDGs have shaped the international development debates in several ways.

First, the MDGs institutionalized the moral imperative of ending poverty—their broad purpose as a whole or a package—as an international norm (Fukuda-Parr and Hulme, 2011).[4]

Second, the MDGs have come to reshape the consensus understanding of "development" to mean ending poverty. Although ending poverty has been long considered an essential purpose of development—advocated, for example, by World Bank President Robert McNamara in the 1970s—the dominant view had understood development as transforming economic structures and creating capacity for sustainable growth (Fukuda-Parr and

Hulme, 2011; Gore, 2010). However, as I will explore later in this chapter, this recent reconceptualization of development has also had perverse effects on development policy debates by over-simplifying the challenges involved.

Third, the MDGs have helped define poverty to mean multidimensional deprivation in the lives of people, including such dimensions as education, health, environment, food, employment, housing, and gender equality—or "human poverty".[5] Since the 1990s, the question of how poverty should be defined and measured has been a subject of much controversy. Though it is now widely recognized that poverty is a multidimensional phenomenon and a human-centred concern, the most frequently used definition has been based on consumption, and its measurement defined as the money-centric headcount below a threshold level of income.[6]

MDGs in national and international policy

National governments and donor agencies consistently refer to MDGs as an important part of their policy frameworks. What this has meant in practice ranges from rhetorical adoption, such as referring to them in general policy statements, to instrumental adoption, such as using the targets to drive resource allocation and policy shifts. For example, as part of the MDG implementation effort, the UN Millennium project made a major effort to assist Governments with the necessary cost and programme investments to achieve the 2015 targets. In most cases, these estimates were controversial and were not incorporated into national planning, budgeting and resource mobilization processes such as the Poverty Reduction Strategy Papers, national development plans and budgets. In fact, in a 2008 study (Fukuda-Parr, 2008) I reviewed 22 Poverty Reduction Strategy Papers (PRSPs)[7] under implementation and found that they consistently referred to the MDGs as a major national development objective, but not all included timelines or action plans for achieving the targets. Moreover, those that did were selective about which of the 8 goals and 18 targets were incorporated in the papers. While many included income poverty, primary education, child mortality and water goals, other goals (e.g. decent work, food and nutrition, gender equality, environmental sustainability, and global partnerships issues of trade, technology and financing) were consistently neglected. Additionally, many PRSPs adopted a strategy of economic growth and social sector investments without considering distributional challenges. Implicitly, PRSPs have assumed that aggregate national economic growth and social sector expansion would lead to the achievement of the goals through a

process of "trickle down" without acknowledging the considerable evidence that macroeconomic policies may have distributional impacts that can undermine poverty reduction. Only one of the PRSPs reviewed mentioned inequality and gave attention to the most vulnerable.

The same study (Fukuda-Parr, 2008) reviewed policy frameworks of 21 bilateral donors and found all consistently mentioned MDGs as overall objectives. Environmental sustainability, education, health and global diseases as well as income poverty were the goals most cited. Priority was also given to governance, including human rights and democracy, as well as peace and security that are chapters of the Millennium Declaration but were not included in the MDGs.

None of the donors have incorporated the MDGs in their frameworks for allocation of resources and for programming purposes. Nonetheless, there has been a perceptible increase in funding for social sectors and within these

Table 2.1
ODA commitments by DAC donors, 1990-2010

$millions, constant 2010					
	1990	*1995*	*2000*	*2005*	*2010*
Social infrastructure and services	19,844	20,231	20,919	34,174	44,333
Production sectors	10,322	6,755	4,405	5,997	8,977
Agriculture	..	2,142	2,219	3,042	5,372
General budget support	1,155	1,291	561	1,826	2,365
Education total	8,631	7,307	5,522	6,656	9,470
Basic education	..	775	1,166	1,910	2,510
Health total	2,441	2,845	2,385	4,076	5,116
Basic health	..	1,266	1,329	2,532	2,945
Food crop production	..	83	66	102	239

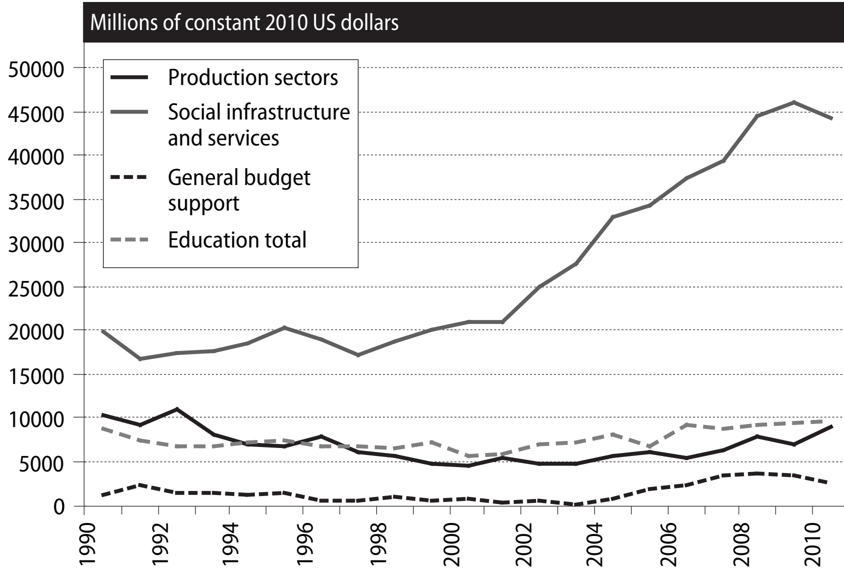
Source: United Nations (2011a) http://mdgs.un.org/unsd/mdg/Resources/Static/Data/2011%20Stat%20Annex.pdf accessed April 14, 2012.

Table 2.2
ODA allocations of DAC donors to MDG priorities, 1999-2009

Per cent of sector allocable ODA							
	1999	*2001*	*2003*	*2005*	*2007*	*2008*	*2009*
Basic social services (MDG indicator 8.2)	10.1	14.0	15.7	15.9	19.9	..	21.0
Aid for trade (MDG indicator 8.9)	..	38.5	29.0	30.7	27.7	34.4	28.9

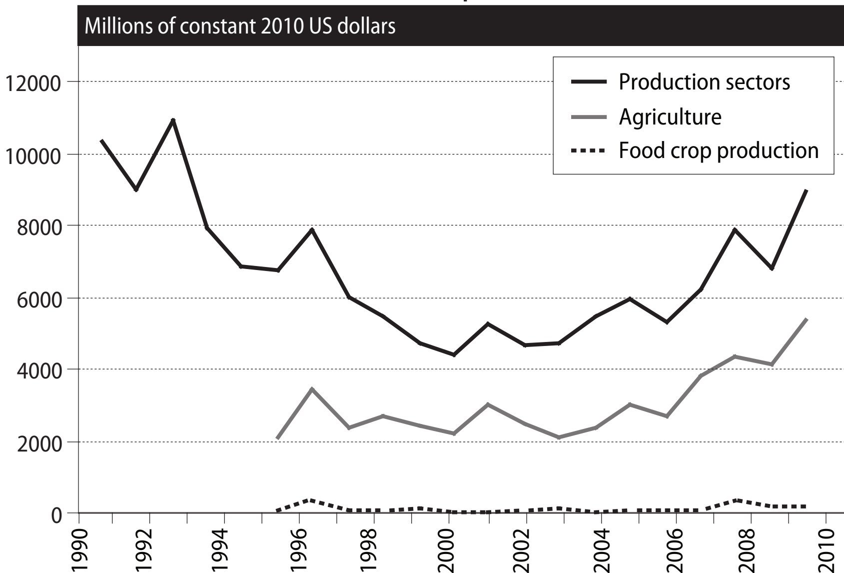
Source: United Nations (2011a) http://mdgs.un.org/unsd/mdg/Resources/Static/Data/2011%20Stat%20Annex.pdf accessed April 14, 2012.

Figure 2.1
Sectoral allocation of ODA commitments, 1990-2010



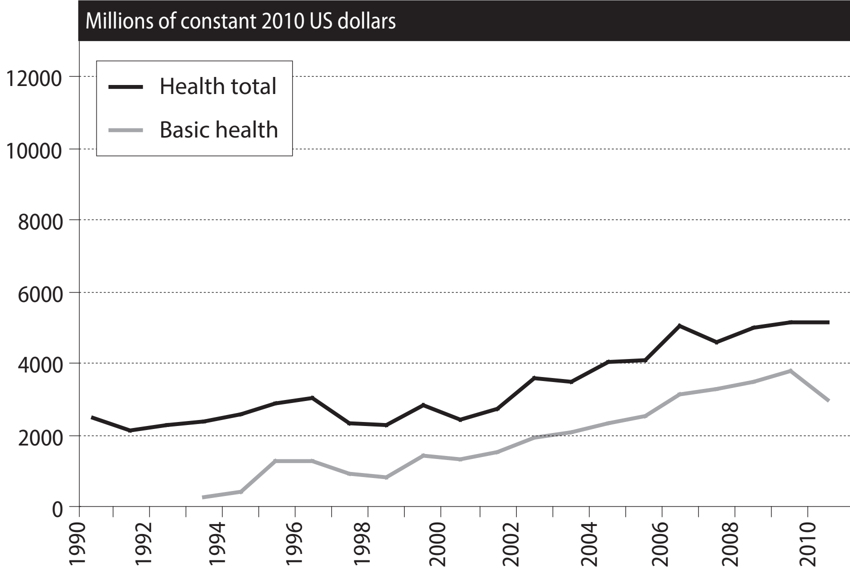
Source: United Nations Population Division (2011).

Figure 2.2
Allocation of ODA commitments to production sectors, 1990-2010



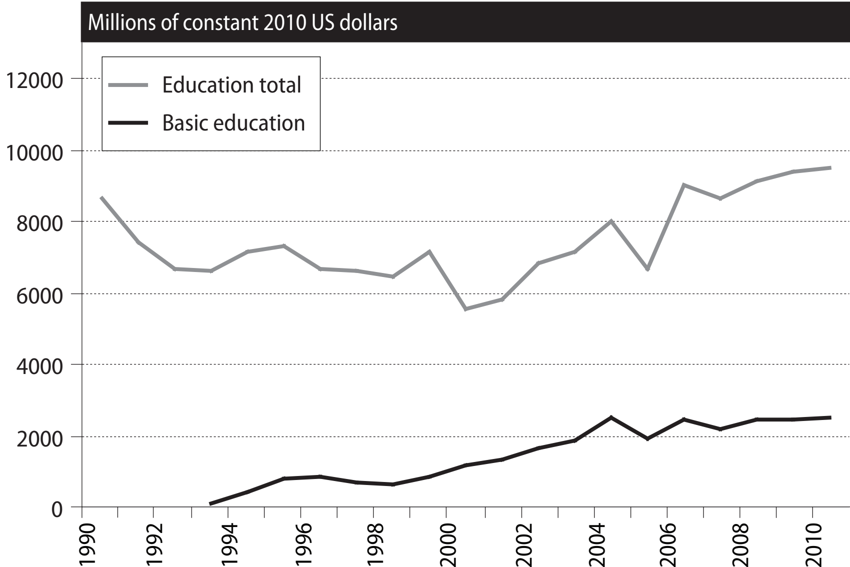
Source: United Nations Population Division (2011).

Figure 2.3
Allocation of ODA commitments to health sectors, 1990-2010



Source: United Nations Population Division (2011).

Figure 2.4
Allocation of ODA commitments to education, 1990-2010



Source: United Nations Population Division (2011).

sectors to primary basic services (see tables 2.1 and 2.2 and figures 2.1-2.4).[8] ODA for other MDG priorities, notably food production and agriculture, which are important for reducing hunger and malnutrition and for reducing rural poverty, also increased but less markedly. Increased ODA allocation to primary basic services took place at expense of other sectors. The proportion of aid allocated by member countries of the Development Assistance Committee (DAC) to basic social services increased from 10.1 per cent in 1999 to 21.0 per cent in 2009 while the proportion of ODA for building trade capacity declined from 38.5 per cent in 2001 to 28.9 per cent in 2009.

The years following the introduction of the MDGs were striking for the ambitious and high-profile political commitments made by the G-8 countries, such as the pledge to double development aid to Africa (or 0.51 per cent of their GNIs) made at the Gleneagles Summit in 2005. However, they have largely not been implemented (United Nations, 2011a: p. 12. figure 3) though a few countries have made significant increases in their support to Africa.[9] Moreover, no significant international poverty initiatives were launched, and the rich countries have not shifted their positions on critical international economic policies including trade, finance, investment and technology transfer. As the title of the United Nations MDG Gap Task Force 2011 report, "The Global Partnership for Development: Time to Deliver", makes clear, donor countries have fallen far short of implementing their Goal 8 targets for aid, trade, debt and technology (United Nations, 2011a). So far, the only tangible progress in these areas has been the reduction of the debt burden of the poorest countries. Multilateral trade negotiations—the Doha Round, labelled the "development round"—have become deadlocked, largely over differences between developing and developed country positions. Aid commitments have increased in volume, but these trends started before 2000 and have slowed since 2006. Moreover, ODA flows remained at 0.31 per cent of donor GNI in 2010, the levels reached in the 1980's and far short of the UN target of 0.7 per cent of GNI. There has been substantial reallocation to the Least Developed Countries (LDCs)—from $21 billion in 2000 to $29 billion by 2009 (2009 prices and exchange rates). But this is still only 0.10 per cent of donors' GNI compared with the UN target for ODA to LDCs of 0.15-0.2 per cent of GNI (United Nations, 2011a: p.10, table 1).

Beyond national governments, the MDGs have spawned numerous responses on the part of local governments, civil society and businesses across the world. For example, in Ecuador, local governments used MDGs

as a framework for establishing priority action plans. In Brazil, the MDGs mobilized the national petroleum company to initiate social projects. The numbers of people participating in the "Stand Up Against Poverty" campaign has mushroomed into millions. There are numerous other examples, though it is difficult to assess the magnitude and scope of these diverse and disparate initiatives.

Surprisingly, the consensus on poverty as a policy priority has not led to fundamental debates about policy alternatives for faster poverty reduction. Over the last half-century, many ideas have marked the evolution of development thought and driven historical shifts in theory and strategies. Some examples include the concept of basic needs in the 1970s, structural adjustment and neoliberal reforms in the 1980s, and human development in the 1990s, all of which brought elements of theoretical ideas with practical policy strategies. However, the consensus on poverty as a priority has not been accompanied by shifts in policy strategies. Despite greater focus on social sector investments to meet basic needs and on social protection, development strategies continued to follow the 1990s approach that emphasized macroeconomic stabilization and liberalization as the priority objective through the application of "Washington Consensus" policies to promote aggregate economic growth through private investments.

To be sure, important studies have examined past policy approaches and there have been many departures from the structural adjustment programmes of the 1980s.[10] Social investments and protection, including initiatives such as conditional cash transfers, have emerged as important priorities. But the core macroeconomic strategies have remained unchallenged. The Washington Consensus policies aimed at macroeconomic stabilization and liberalization have continued to dominate, supplemented only by emphasis on social investments and increased volumes of aid to achieve the targets. New strategies have emerged not from mainstream thinking and advice from the international development community, but from innovation within developing countries that have not been in IMF policy based lending programs. These approaches have included not only alternative growth strategies, but also poverty reduction strategies, particularly in Brazil and several other Latin American countries which have achieved reductions in inequality along with economic growth. What's more, these policy approaches have been more interventionist in promoting expansionary macroeconomic policies, expanding employment, and raising incomes of the poorest such as targeted conditional cash transfers.

MDGs and development outcomes

Did the new commitment to ending poverty lead to improved outcomes? It is impossible to attribute outcomes to the MDGs amongst the multitude of factors that have driven poverty and development trends. But the problem remains that while world leaders made commitments to do their utmost, the pace of progress has been too slow and unevenly distributed among countries and goals (tables 2.3 and 2.4).

The United Nations and other international agencies assess progress made against the 2015 targets, focussing on the level of achievement. According to the 2011 UN MDG Progress Report (United Nations, 2011c), globally, the 2015 targets for income poverty (goal 1) and water (goal 7) are on track to be met, while steady progress is being made towards targets for child mortality (goal 4), and global diseases (goal 6). Primary school enrolment has been advancing, but the pace has begun to slow down and the goal of universal enrolment may not be achieved. More alarmingly, there has been either stagnation or regress for some goals and targets. For instance, the proportion of people who are hungry (goal 1) has plateaued at 16 per cent since 2000/2002 and the number of undernourished people grew from 817 million in 1990/92 to 830 million in 2005/2007; employment and decent work (goal 1) have shown a setback in many countries; progress has been slow in gender equality and empowerment, other than in primary education (goal 3), and in reducing maternal mortality (goal 5).

Levels of achievement are not a good measure of whether the MDGs may have resulted in better development progress. Countries have different starting points, and, for many countries, achieving the MDGs may not be feasible even if they were to adopt improved efforts resulting in better performance (Clemens et al., 2007). In another paper (Fukuda-Parr et al., forthcoming), my co-authors and I have argued that the criterion for success should be improvement in performance to be measured by the pace of progress. We proposed a methodology for this criterion and made estimates for 24 MDG indicators.

Our findings were disappointing at the country level, but more encouraging for sub-Saharan Africa and South Asia as regions. We found improved performance by a majority of countries for just 5 of the 24 indicators studied. On the other hand, the majority of sub-Saharan African countries showed improved progress for 16 indicators. At the global level, the pace of progress improved for under-5 mortality rate, measles immunization and gender parity in primary schooling, but not

Table 2.3
Summary of Global and National MDG Progress

	Improvement since 1990?	***Distance progressed to global goal (100% = goal attained)***	***On Track?***	***Faster Progress 1990-2000/ 2000-8***	***Faster than Historical Patterns?***
Global Progress					
Poverty	Y	80	Y	Y	..
Undernourishment	Y	77	N	N	..
Primary Education	Y	90	N	Y	N
Gender Equality*	Y	96	Y	N	N
Child Mortality	Y	69	N	Y	Y
Maternal Mortality	Y	57	N	Y	Y
Drinking Water	Y	88	Y	N	..
National Progress					
	% of Countries Making Progress	***% of Countries on Track***	***% of Countries Faster Progress than pre-MDGs***	***% of Countries out-performing historical patterns****	
Poverty	63	47	51	..	
Undernourishment	55	25	..	..	
Primary Education	75	55	35	68	
Gender Equality*	61	89/82**	46	56	
Child Mortality	95	36	32	51	
Maternal Mortality	83	30	..	33	
Drinking Water	73	66	34	..	

Sources: Kenny and Sumner (2011) based on Fukuda-Parr and Greenstein (2010), Leo and Barmeier (2010), World Bank (2011) and estimates by Melamed (2012).

Notes:
* Represents the proportion of developing countries for which the appropriate data is available.
** Gender Equality for primary and secondary education, respectively.

Table 2.4
Global poverty estimates, 1990-2015

	Population poor (%)			*People poor (millions)*		
	1990	*2005*	*2015*	*1990*	*2005*	*2015*
US $1.25 poverty line						
East Asia and Pacific	54.7	16.8	5.9	873.3	316.2	119.0
China	60.2	15.9	4.8	683.2	207.7	66.1
Europe and Central Asia	2.0	3.7	1.2	9.1	17.3	5.8
Latin America and the Caribbean	11.3	8.2	4.7	49.6	45.1	29.1
Middle East and North Africa	4.3	3.6	1.3	9.7	11	4.8
South Asia	51.7	40.3	22.4	579.2	595.6	379.3
India	51.3	41.6	22.4	435.5	455.8	276.8
Sub-Saharan Africa	57.6	50.9	35.8	295.7	388.4	344.7
TOTAL	41.7	25.2	14.4	1,816.6	1,373.5	882.7
TOTAL MINUS CHINA	..	..	..	1,133.4	1,165.8	816.6
US $2 poverty line						
East Asia and Pacific	79.8	38.7	19.7	1,273.70	728.7	399.4
China	84.6	36.3	15.4	960.8	473.7	213.4
Europe and Central Asia	6.9	8.9	4.5	31.9	41.9	21.4
Latin America and the Caribbean	19.7	16.6	10.7	86.3	91.3	66.3
Middle East and North Africa	19.7	16.9	7.2	44.4	51.5	26.2
South Asia	82.7	73.9	57.1	926.0	1,091.5	967.2
India	82.6	75.6	56.9	701.6	827.7	702.0
Sub-Saharan Africa	76.2	73.0	57.7	391.2	556.7	555.6
TOTAL	63.2	47.0	33.1	2,753.5	2,561.5	2,036.1
TOTAL MINUS CHINA	..	..	..	1,792.7	2,087.8	1,822.7

Source: World Bank (2011: 11). Reproduced from Melamed (2012).

for attended births or safe drinking water. For income poverty, the pace improved in all developing regions. South Asia and sub-Saharan Africa—the two regions with the highest concentrations of poverty—showed consistent improvement and performed better than the other regions. In sub-Saharan Africa, progress has been made at a faster rate for all but one indicator for which data are available since the MDGs were introduced. In South Asia, improvements have accelerated for all indicators, except child mortality and child malnutrition. While it is not possible to attribute the improved progress to the MDG initiative, the record of improvement is encouraging.

The controversies

The MDGs have generated critical debates among both development practitioners and researchers, particularly when they were initially introduced. The numerous points that have been raised can be categorized into two sets of issues: (i) those that concern the composition of the goals, targets and indicators, and (ii) those that relate to the development and implementation processes.

With respect to the composition of the lists, critics have raised the following issues:

i. *Poorly designed as development goals*: The methodology for setting the goals has been inconsistent and apparently arbitrary (Easterly, 2009; Saith, 2006), the levels set are unrealistic for many countries (Clemens et al., 2007) and biased against countries with low starting points (Clemens et al., 2007; Easterly, 2009; Fukuda-Parr, forthcoming).

ii. *Composition is too narrow and excluding important dimensions of development*: The publication of the MDGs led to strong reactions from many constituencies whose agendas were left out, including: reproductive health rights particularly as the Development Assistance Committee (DAC)/IDGs included this agenda; gender inequality that was only reflected in the primary education goal; employment; governance; the macroeconomy and structural change (Chang; Gore); and in more recent years, climate change. In 2005, three new targets and 12 new indicators were added to the list in response to some of these criticisms. Concern for the narrow and unbalanced composition of the targets continues to be raised. While the MDGs

draw on chapter III of the Millennium Declaration, they leave out the objectives of chapters IV (environment), V (human rights, democracy and good governance), VI (protecting the vulnerable) and VII (meeting the special needs of Africa).

iii. *Lack of attention to important norms and principles, in particular falling short of human rights standards*: The human rights community has been highly critical of the MDGs (Alston, 2004). Although the MDGs overlap with many economic and social human rights, they lack some of the key human rights principles including: concern for the most vulnerable and the marginalized; removing discrimination and respecting the equal rights of all; participation; accountability; and standards for rights that require universal access to services (OHCHR, 2008).

iv. *Lack of attention to equality*: The MDGs do not reflect important ethical concerns expressed in the Millennium Declaration for the poorest of the poor and the most vulnerable. Similarly, the principles of equality, empowerment and participation have not been adequately reflected (Fukuda-Parr, 2008; Nelson, 2007; Saith, 2006).

v. *Unbalanced international political economy*: Goal 8 is weak and lacks hard quantitative 2015 targets. It is also narrow in scope. It is a poor reflection of the agendas advocated by developing countries, notably those related to the asymmetric rules of global trade, international investment and finance, the reduced policy space and quality of aid. From the onset, many developing countries were skeptical of the MDGs for fear they would present another set of conditionalities, while imposing a stronger accountability framework for the developed countries.

vi. *Distortion of national priorities*: From the start, many civil society groups in developing countries expressed dismay with the MDGs for undermining their advocacy and policy dialogue with their governments. For example, some of the goals such as universal primary education took the agenda backwards in countries where the challenge was to improve quality in primary schooling and advance access to secondary education. This led one activist to rename the MDGs as the "Most Distracting Gimmick" (Antrobus, 2001).

Critics have raised a number of issues with respect to the process of formulation and implementation, as follows:

i. *Lack of broad consultation in formulation*: The MDGs were introduced in the 2001 report of the UN Secretary-General, derived from the Millennium Declaration. Both documents built on the outcome documents of the UN development conferences of the 1990s, but the selection of these outcomes for these documents did not involve wide consultations. This led to criticism from civil society organizations (Bissio, 2003) and lukewarm responses from developing country governments.

ii. *Global or national goals?* An important debate has emerged over the applicability of the goals at the country level and remains unresolved. Some have argued that the global goals should be adapted at the national level (Vandemoortele, 2009), while others have held that they should be achieved in each and every country (Sachs, 2005). The Millennium Declaration and subsequent UN official documents leave the question unanswered. In practice, the UN monitoring reports[11] apply the goals to each country, though many countries have also adapted the goals to their national contexts. Applying them at the national level and holding governments accountable is highly problematic, since they impose a one-size-fits-all set of 2015 targets for countries with hugely divergent starting points, constraints, financial resources and capacity (Clemens, 2004; Easterly, 2005; Fukuda-Parr et al., forthcoming).

iii. *Criteria for success and methodology of measuring progress*: The methodology for assessing performance used by official national and international monitoring reports focuses on the level of achievement relative to the target. This method is biased against countries with low starting points. A more appropriate metric would be to focus on the pace of progress as discussed above (Fukuda-Parr, et al. forthcoming). Countries that have committed to doing their utmost should be held to account for making faster progress towards ending poverty. It does not make sense to apply a set of one-size-fits all targets to countries of enormously divergent conditions and means, and to judge their success and failure.

iv. *Aid-centric process*: Development aid has been a major focus of much of the MDG debates and their use. They are applied to developing countries and not to developed countries, and the international monitoring efforts focus on the performance of developing countries, rather than the challenge of poverty worldwide.

Lessons of the MDG experience

The MDGs created a narrative that has raised global awareness of poverty as a compelling moral challenge requiring urgent action. The narrative has become a consensus framework for debate on international development. The MDGs are widely accepted among the main stakeholders, including national governments, donor agencies, international NGOs, and local civil society groups, regardless their views about the MDG relevance as a development strategy. The importance of this new awareness and consensus should not be underestimated considering that the pursuit of development priorities in the globalized and democratically governed world requires the public at large to share commitments to these priorities as ethical imperatives of a common humanity. However, considering the transformative vision for the twenty-first century laid out in the Millennium Declaration, and the strength of the political commitments made there, the evolution of development outcomes and thinking in the decade since 2000 has been disappointing. The MDGs drove attention to poverty as a priority but did not in turn drive transformative strategies and results.

These shortcomings and the controversies point to three important lessons for the future. The first is the need for consensus on how global goals should be used based on a clearer understanding of goal setting as a policy instrument. The controversies about their justification as planning targets and application at the country level reflect an incorrect interpretation of MDGs as economic planning instruments which was not their intended purpose. The MDGs are derived from the Millennium Declaration, which is a normative document that defines how the world *should* look. It is a result of political negotiations, not a technocratic process of modelling development interventions to guide resource allocations in a manner that is realistic and feasible. Applied to development policymaking, the Declaration offers a framework for evaluating progress and assessing priorities. The 8 goals, 21 targets and 60 indicators, are best interpreted as benchmarks for monitoring implementation, not as hard planning targets. According to UN officials involved in drafting the Millennium Declaration,[12] the original idea behind including some quantitative targets in the Declaration was to give concreteness to the development agenda. The MDGs were not intended to apply to each and every country, rather to monitor global progress and to encourage donors and national governments to make greater efforts to end poverty (Fukuda-Parr and others, forthcoming). It is not surprising that they are considered as overambitious for many countries since they did not originate from a technocratic planning process based on consideration

of economic variables necessary for achievement of social and economic outcomes. The same misinterpretation has led to confusion about whether the MDGs should be applied at the country level, and to measuring success by the metric of shortfall in achievement rather than pace of progress.

Second, a broader set of goals is needed to more adequately reflect the essence of the Millennium Declaration which embodied a global consensus on the need for globalisation to be a positive force for improving human well-being of all people and countries. It envisioned a transformative agenda that was multidimensional, aiming at development that is sustainable and equitable, encompassing not only growth and poverty reduction but also security, democracy and human rights. The MDG experience demonstrates the power of numbers to create narratives and make performance judgements. The consequence of the MDGs has been to over-simplify the idea of development and foster a policy agenda narrowly focussed on social investments that neglected important objectives such as inequality, climate change and democratic governance that are central development challenges.

Third, a more participatory process of formulating the global goals is needed to create a consensus on goals that are universally relevant, not just for the least-developed countries. At the same time, the consensus on the MDGs would have been unlikely without the active involvement of the World Bank and the bilateral donors as well as UNDP. The MDGs were unusual in involving the development agencies in contrast to most other goals set at the UN.

2.3 MDGs in context: the political economy of development cooperation

A review of the MDG experience would not be complete without an analysis of the politics that drove and shaped their origins, creation and application.

Origins of the MDGs: controversies over structural adjustment

In an earlier article co-authored with David Hulme (2011), I explained the motives that drove leaders of the international development community—heads of the World Bank and UN development agencies, the European development ministers and others—to create the MDGs and invest in promoting them. To summarize, their creation was motivated by the need to forge a united community to defend international development as a

global project and to reverse the declining support for development aid. During the 1980s and 1990s, the development community was divided by sharp controversies over the structural adjustment lending programs of the World Bank and IMF that were conditioned on the adoption of Washington Consensus policy reforms. These controversies pitted the NGOs and academics against the World Bank and IMF, but also involved UN agencies such as UNICEF and some stakeholders within national governments, which advocated alternatives. Moreover, development agencies became internally divided as individuals took divergent positions. The MDGs-poverty narrative could help unify this divided community, since no one could argue against ending poverty as a moral concern. It was particularly important for the UN leadership and the development ministers of major bilateral donor countries to put an end to these controversies, because they faced declining support for international development within their respective constituencies. With the end of the cold war, the geo-political interests no longer sustained support for aid budgets.

These motivations led bilateral donors to introduce the International Development Goals (IDGs), a list of six quantitative goals with timeframes for achievement, in three areas: economic well-being, social development, and environmental sustainability and regeneration (OECD, 1996). As Colin Bradford of the United States delegation explained, it was important to tell a story of aid that spoke directly to conditions of people's lives to win over the "parliaments and publics".[13]

The IDGs were effective in articulating the meaning of international cooperation for development and had gained traction in raising awareness in the donor countries. They were a concrete articulation of a consensus donor vision of development published in the 1996 statement of the Development Assistance Committee of the OECD (OECD DAC, 1996) entitled *Shaping the 21st Century: Contribution of Development Cooperation*. The statement gave three reasons why rich countries should support development: the humanitarian purpose of ending dire dehumanizing poverty; enlightened self interest in a world free of threats of terrorism, global disease, political instability, and uncontrolled migration; and solidarity for joint action to solve common challenges such as environmental sustainability. This vision contrasts with the agenda that emerged from the UN development conferences of the 1990s which gave considerable attention to the need for structural transformation of the economies of developing countries.

The IDGs developed considerable traction and demonstrated the effectiveness of a simple list of concrete goals to communicate a compelling story

of development. They had already begun to pay off as the secular decline in aid commitments began to be reversed. The World Bank and UN agencies began to support them and, in 2000, published a joint document monitoring their progress using the IDG framework. They inspired the UN to include goals in the Millennium Declaration. But the IDGs could not be "owned" by all stakeholders since they were invented by the bilateral donors.[14] The MDGs built on the IDGs to forge a broader consensus, including the Bretton Woods institutions, UN agencies and national governments.

The MDGs could build a narrative behind which dissenting stakeholders could stand united and argue for development aid. For example, Lord Mark Malloch Brown, then UNDP Administrator, who played a central role in moving to build the Millennium Declaration into the MDGs and to create an implementation plan, recounts the view that the MDGs could bridge the divide between the UN and the World Bank over structural adjustment.[15] The consensus on the MDGs can be attributed precisely to the fact that they allowed the protagonists from the 1980s and 1990s—IMF, World Bank, US Treasury, UNICEF, NGO networks, and academics on both sides of the issue—to exchange views over structural adjustment and to agree on the purpose of development while disagreeing on the means. It allowed bilateral development ministers, who needed to retain the support of all of these stakeholders, to sidestep the dilemma. Still, why did the developing countries buy into the Millennium Declaration that included the global goals? Ambassador Rosenthal of Guatemala, who was one of leading figures in coordinating the negotiations, explains that the priority for the developing countries was to keep the development issue a high priority on the UN agenda, on par with the political issues.[16]

The post-2000 aid architecture: new narrative, new instruments, old policies

The divisions over structural adjustment programmes centred around the issues of conditionality as an aid modality, liberalization and privatisation as economic growth strategies, while the social dimensions of the process focussed primarily on the consequences of fiscal austerity and stabilization measures on the poor and the vulnerable and on social investments. While economic arguments over macroeconomic policy choices drove the controversies, the social dimensions commanded a moral high ground. In this context, the narrative of poverty as the overarching purpose of international development provided a way out for all sides

of the controversies. Consensus could be reached on the ends without resolving differences over the means. It is therefore not surprising that the Millennium Declaration and MDGs define the ends, but not the means. As a consequence, the Washington Consensus policies did not disappear, but continued as a part of a broader agenda behind the headline of the MDGs. It is also not surprising that the last decade has seen little from the World Bank by way of new proposals and new policy strategies to foster economic growth combined with social justice that addresses poverty, inequality and the fulfilment of human rights.

MDGs are thus a key feature of the new aid architecture that was put in place in the late 1990s. The MDG narrative justifies aid on humanitarian grounds. The consensus defines the relationship between donors and recipients as a partnership, constructed in pursuit of a shared commitment to end poverty. For this purpose, donors would support national strategies that would integrate the MDGs and be elaborated in the national Poverty Reduction Strategy papers (PRSPs). The partnership is to be guided by principles of mutual accountability and respect for national ownership. Donor support would be provided to implement the PRSPs through the IMF new Poverty Reduction and Growth Facility (PRGF) along with other multilateral and bilateral support and debt relief under the Highly Indebted Poor Country (HIPC) debt reduction initiative.

These elements, introduced towards the end of the 1990s, replaced the controversial structural adjustment lending programs of the 1980s while also retaining their core policy elements and instruments. The PRSPs and the Poverty Reduction Growth Facility (PRGF) replaced the Policy Framework Papers that spelled national policy agendas, including key economic policy reform measures. While these reform agendas are not found consistently in the PRSPs, they are included in the PRGF and HIPC agreements and condition the release of financing under these arrangements. The principles of ownership and mutual accountability expressed in the Paris Declaration on Aid Effectiveness[17] would guide partnership between donors and the developing country governments. But the policy space for aid-dependent countries remains limited under financing conditionalities. The underlying economic development strategies continue to be driven by the Washington Consensus agenda aimed at macroeconomic stabilization and liberalization. To this end, the MDGs added a basic needs agenda, emphasizing priorities for social investments and commitments for partnership.

2.4 Global goals after 2015

New directions

While the MDGs will expire in 2015, the promises of the Millennium Declaration remain unrealized, and the extent of global poverty and the slow pace of progress remain unacceptable in today's world of prosperity. The benefits of global economic integration have been as unevenly distributed since 2000 as in the previous decade—the gaps between the rich and poor within and between countries remain considerable.

It may be argued that global goals would not be worth setting after 2015, because the MDGs did not have adequate impact on shifting policy. Nonetheless, the MDGs have demonstrated the power of global goals and the value of comprehensive development goals in raising awareness, maintaining political support for development, and in coordinating policy debates. Without the MDGs, it is likely that the Millennium Declaration would have been shelved soon after its adoption along with numerous other decisions by the General Assembly. For these reasons, new global goals should be set to advance the implementation of the Millennium Declaration, but they need to be pursued with the institutional weight of the UN Secretary-General and with the UN investing in efforts to promote and mobilize support for them. The UN has set many global goals since the 1960s, but none has had the reach—or the investment—of the MDGs.

What should be in the new goals? The expiry of the MDGs in 2015 presents an opportunity to correct the deficiencies of the current list and emphasize new priorities, which are becoming clearer as the 21st century advances. It is also an opportunity to build goals consistent with their function as normative instruments to promote inclusive and equitable development, rooted in the ethical commitments of the Millennium Declaration.

Ethical commitments of the Millennium Declaration: shared values, human rights and the UN development agenda

In setting out a vision of the 21st century, the Millennium Declaration expresses shared social objectives based on universal values. The first chapter of the Declaration states that the following "fundamental values to be essential to international relations in the twenty-first century" (United Nations, 2000: paragraph 1): freedom, equality, solidarity, tolerance, respect

for nature, and shared responsibility. The Declaration commits governments to pursue a particular pattern of growth and development—one that is equitable and human rights based. The core theme of equality is articulated throughout the document and reflects not only equality within countries, but also between countries. This includes gender equality (paragraph 6), equitable and non-discriminatory trading and financial systems (paragraph 13), with special attention to the poorest and vulnerable people (chapter 6) and the needs of Africa that face multiple challenges (chapter 7). And most importantly, it includes the ideal of inclusive globalization, the central theme which is articulated in paragraph 5 as follows: "We believe that the central challenge we face today is to ensure that globalization becomes a positive force for *all* the world's people. For, while globalization offers great opportunities, at present its benefits are very unevenly shared, while its costs are unevenly distributed."

Human rights principles

The ethical framework of the document derives from the consensus international norms set out in the UN Charter that have evolved over the decades and been codified in international law. The framework goes beyond the economic concept of development "with equity" and seeks a world that is not only more peaceful and prosperous but "just" (paragraph 1). It draws explicitly on international human rights norms and principles, which are reflected throughout the document; to the core principle of "human dignity and freedom, equality and equity" (paragraph 1), the respect for economic, social, cultural, civil and political rights (paragraph 25). It reaffirms commitment to the UN Charter (paragraph 1), the Universal Declaration of Human Rights (paragraph 25), to the Convention on the Elimination of All Forms of Discrimination against Women (paragraph 25), and the Convention on the Rights of the Child (paragraph 26). Interestingly, it also refers to the right to development (paragraph 24), the only international human rights concept that addresses development as a process.

The 1986 Declaration on the Right to Development affirms development as a fundamental human right, and is important for two reasons. First, it defines development as a "constant improvement in the well being of individuals" (UN 1986, Preamble). Second, it articulates responsibilities for development as involving not only individual, but collective actions of states. It not only states desirable development objectives, but also the obligations of states: "as leaders we have a duty therefore to all the world's

people, especially the most vulnerable" (paragraph 2). The Declaration commits to strengthen international cooperation (paragraph 26).

For these reasons, the development strategy that the Declaration commits to is "human rights based", characterized by the realization of all human rights (economic, social, cultural, civil and political) as its objective; the well being of the individual as the focus and unit of assessment; the application of core principles of equality and non-discrimination, empowerment and participation in the development process; and rooted in the norms of international human rights law. This contrasts with the concept of development that focuses more narrowly on economic growth and the improvement of living conditions, including meeting basic (material) needs. This conceptual framework for evaluating the development process is closely related to and overlaps significantly with the capability approach to development, or human development, which is based on the concept of development as expansion of the capability of individuals to lead lives they value developed by Amartya Sen.[18]

The UN development agenda

These ethical values, and the theme of human centred, equitable and sustainable development, have been reflected in the origins of the Millennium Declaration and MDGs in the UN conferences on topics ranging from environment to children to habitat held throughout the 1990s. The Internationally Agreed Development Goals (IADGs) and the UN Development Agenda are comprised of the full set of goals emerging from the 34 summits and conferences held up to 2005.

Taking place in an era of active debates about structural adjustment and liberalization, these conferences were particularly concerned with the consequences of this policy shift on poor people and poor countries. These meetings raised the common concern that reflected a strong voice of civil society and developing country governments[19] that the benefits of globalization were not broadly shared. The major commitments of these conferences were combined in a single package in the 2000 Millennium Declaration, while the MDGs are a select list from the broader list.

As highlighted in the UN retrospective of the 1990s conferences, *The United Nations Development Agenda: Development for All* (UN DESA, 2007, p. iii), the resulting UN development agenda is strongly embedded in the UN ethical values and fundamental purpose, namely, human freedom and dignity, solidarity and burden-sharing, equality, and tolerance, and can be

seen as a concrete means to implement the UN Charter. According to José Antonio Ocampo, "Two elements have permeated the content and character of the Agenda since its inception. First, a fundamental concern for equity and for equality of all persons, as human beings and as citizens... [T]he second essential element [is] partnership. The conference process has engaged all the key stakeholders: governments, United Nations system organizations, other intergovernmental and non-governmental organizations, civil society, and the private sector" (UN DESA 2007, Preface, p. iii).

Setting new goals, measuring progress

Like the MDGs, the purpose of the goals, targets and indicators beyond 2015 would be to harmonize reporting and to facilitate monitoring of progress towards the achievement of the Millennium Declaration. But a new approach is needed to setting the goals, targets and indicators. First, in order to redefine progress in alignment with the Declaration's vision of development as inclusive, equitable and sustainable, the scope must expand beyond the current focus on poverty and chapter 3 (development and poverty eradication). It should also reflect chapter 1 (values and principles) and acknowledge the important ways in which development and poverty eradication are intertwined with the challenges of peace and security (chapter 2), environment (chapter 3), human rights, democracy and good governance (chapter 4). Moreover, goal setting should be framed with a methodological coherence. Finally, the new approach should include some critical means as well as ends that consider the drawbacks of the MDGs.

Evaluating progress in human well-being

The new approach to setting goals should also build on a coherent framework in development thinking about the nature of progress and what we have learned from development economics research in the 1990s. The following considerations are worth highlighting.

First, the multidimensionality of human well-being needs to be fully acknowledged. The work of Amartya Sen is particularly helpful in defining progress as the expansion of capabilities and freedoms—or human development approach—and in emphasizing the multidimensionality of essential instrumental freedoms to encompass economic facilities, social opportunities, political freedoms, transparency guarantees and security (Sen, 1999). Sen's capabilities approach to development is closely related to human rights-based development and essential capabilities overlap

considerably with the core human rights, including economic, social, cultural, civil and political areas (Sen, 1999; Vizard, et al. 2011).

Second, there is need for protection against downside risks. The work on human security[20] (Ogata and Sen, 2003; UNDP, 1994) and on vulnerability and poverty (World Bank, 2000) has highlighted the importance of protection from threats of sudden changes in core life conditions. The recent crises in global financial, fuel and food markets have highlighted these threats as important challenges of the 21st century as global market integration proceeds, exposing the risks of instability and its contagious effects across countries.

Third, sustainability must be considered and addressed. The threats to sustainability arising from environmental deterioration have become acute with the advent of global warming. Sustainability is an overriding challenge, where failure is likely to threaten all dimensions of human development, and requires major shifts in policy as well as in international cooperation.

Fourth, there is need to pursue equality of opportunities and rights. For all the reasons already elaborated, equality is a principle that is central to the normative framework of the Millennium Declaration. In practical terms, policy strategies that respect equality provide for equality of opportunity and non-discrimination in the fulfilment of human rights.

Fifth, the international environment for development and the role of "partners" needs to be clearly articulated. They should also be made more concrete than Goal 8 and broadened to incorporate objectives of stable market environment necessary for human security, and agendas for systemic reform consistent with the principles of democracy and equity.

Sixth, while goals should be set as targets to be achieved globally, countries should be encouraged to adapt the goals to their national contexts, through a process of democratic consultation. Without such adaptation, the goals are both biased against countries with low starting points and under-ambitious for those with high starting points. They would distort not only government priorities, but also the efforts of civil society to hold authorities accountable for their development performance. Previous global goals set by the UN followed this approach, and the MDGs were the first goals whose applicability to country levels was left ambiguous.

Seventh, goal setting should involve a participatory process of consultations with national Governments worldwide, and with civil society organizations at national, regional and global levels. The MDGs drew on the goals already adopted by the UN development conferences that had involved widespread consultation among civil society and government

in the national and regional preparatory conferences. In the absence of such process, it is all the more important to set in place a process of broad consultations at national, regional and global levels. The implementation process will be as important as the composition of the goals; the new goals should build on the increasing use of the MDGs by civil society to demand more of government. Furthermore, formal structures would strengthen accountability. At the national level, one approach would be to set up national commissions that would work out the implications of policy goals, and monitor implementation.

Finally, the new goals should apply not only to developing countries, but to all countries, since human poverty, inequality and exclusion are challenges facing developed countries as well.

2.5 Concluding remarks

The recent history of the MDGs reveals much about the history of development thinking and agendas in the first decade of the 21st century. It highlights the advent of development reconceptualized as poverty reduction, opening up to a concept applicable regardless of the stage of industrialization and diversification, and levels of income and technological capacity. It further underscores the role of ideas in shaping political support for development locally and globally as well as in shifting economic and social policies.

The MDGs were the first comprehensive development goals and were effective in drawing attention to poverty eradication as a global norm and priority, and provided a common framework for debate and action. They encouraged and, no doubt, contributed to, greater support for social investments in sub-Saharan Africa, but did not lead to changes in policy strategies or to addressing systemic issues that create unequal opportunities for people and countries.

The corollary to these policy trends has been the failure to address the systemic problems of protecting developing countries from the negative consequences of global market integration. More specifically, international cooperation to protect the poor against the consequences of climate change and the crises of global financial, fuel and food markets has been wholly inadequate. Seen in this light, the MDGs could arguably have provided a convenient cover behind which the economic model of the 1990s could be pursued. The MDGs perhaps co-opted the language of human development, and the social impact of adjustment while defanging critical debates about the impact of the liberalization agendas on poverty and inequality. The need

for alternative macroeconomic policies that would favour distribution, job creation for the unskilled, and reduce inequality no longer resonates with policymakers as urgent issues.

The impact of the MDGs brings home the importance of narratives, and the power of quantitative indicators as a communications tool that can have far-reaching impacts. It is also a lesson in how reshaping the definition of terms can have positive and perverse consequences. The ability of the term “MDGs” to frame international development policy debates—and the concept’s staying power and reach—can only be explained by the power of numbers to communicate complex ideas by simplification, abstract ethical values by reification, and to convey (misplaced) scientific precision and certitude. By contrast, the definition of development is ambiguous and fraught with controversies over definitions, measurement and strategies. What’s more, the process of development is complex—involving human creativity and effort, social cooperation and mobilization, economic investments and political commitments—and the challenges are multidimensional and location-specific, often requiring high-risk solutions. Quantification renders such complexity into a set of numbers, intangible factors into concrete goods and outcomes, and risk-prone processes into a predictable technological solution. But sociologists who study indicators as “technologies of governance” go even further, pointing out that quantification is “not merely a strategy for describing the social and natural worlds, but a means of reconfiguring them. It entails the imposition of new meanings and the disappearance of old ones” (Porter, 1994: 338).

Indeed, the MDG experience highlights the difficulty of translating ethical norms as expressed in the Millennium Declaration into international policymaking. The MDGs were powerful and convincing to “the parliaments and publics” around the world because they conveyed a compelling case for ending poverty as an ethical priority. Yet ethical norms and principles are not strategies for changing policy behaviour. Thus, development professionals set about implementing the Millennium Declaration by interpreting the MDGs as if they were technocratic economic policy tools. Entrenched in the tradition of a “positivist” science driven by quantification and evidence, they incorporated only chapter 3 of the 8 chapters of the Declaration in the MDGs, picking out those objectives which were measurable and for which data were available. The ethical principles laid out in chapter 1 of the Declaration were forgotten in the spirit of “only what can be counted counts”.

By articulating the complex challenges of development in eight goals and concrete targets for 2015, the MDGs have drawn unprecedented

attention to poverty as an urgent global priority. But the simplification and quantification reduced the development agenda to meeting basic material needs and stripped of the Millennium Declaration's vision for development with social justice and human rights. It effectively left out mention of equity, empowerment of people, sustainability, and building sustainable productive capacity for economic growth. The simplified narrative has no room for understanding poverty as related to the underlying power relations within and between countries and the asymmetries in the global economy. It leaves little room for addressing issues that have long been on the agenda of developing countries, such as their lack of voice in international economic negotiations—at the World Bank, the World Trade Organization and other institutions of global governance. It also remains silent on the issues that have long been on the agenda of critics of standard macroeconomic frameworks for their distributional consequences. The new global goals thus need to redress these shortcomings and find a way to use the power of numbers to recapture the ethical principles and norms of the Millennium Declaration.

Notes

1 I am grateful for comments from the workshop on Alternative Strategies for the Post-2015 Era held at the UNICEF Innocenti Research Centre in Florence, Italy on 7-8 December 2011, particularly the comments by Ana Cortez and Jose Antonio Alonso. The paper draws on collaborative work with Frances Stewart on the Report of the UN Committee for Development Policy on its fourteenth plenary session to the Economic and Social Council, and with Joshua Greenstein on MDG progress measurement. The usual caveats apply.

2 In 2005 the list was expanded to include 21 targets and 60 indicators.

3 For example, initially many NGOs were hesitant to espouse the MDGs because they did not agree with the list of goals, targets and indicators or objected to the lack of adequate consultation in the way they were drawn up, or because they replaced agendas that they were pursuing. But over time, they have become more broadly accepted and some of the initial critics have begun to use them as the consensus framework for development efforts. For example, the human rights community initially ignored or criticized them (Alston, 2005) but changed course and adopted a more constructive approach to use the MDGs to pursue a human rights and development agenda (OHCHR, 2008).

4 The MDG narrative meets the criteria of a norm that has become well established according to the trajectory of international norm dynamics elaborated by Finnemore and Sikkink (1998). Norms emerge, then cascade, and then reach the final stage of becoming "institutionalized". At this stage, norms take on "a taken-for-granted quality and are no longer a matter of broad public debate" (p. 9). The mechanisms that keep the norm alive at this stage are "habit" and "institutionalization". The main actors are the professions and bureaucracy who uphold and adhere to the norm in order to conform to a recognized standard. In contrast, it is the idealistically committed "norm entrepreneurs" who drive the emergence of a norm, and states and organizations that promote its "cascade". See Fukuda-Parr and Hulme (2010).

5 "Human poverty" was introduced by the 1997 UNDP Human Development Report and refers to multiple capability deprivations (UNDP, 1997).

6 See Stewart and others (2007) for a detailed review of alternative definitions and measures of poverty.

7 PRSPs are prepared by governments of low-income countries and serve as a framework for reaching agreement with the donors on development priorities and financing requirements. The study included all "second generation" PRSPs existing at the time of the study.

8 The MDGs are associated with dramatic increases in aid funding for social investments, but this is continuation of a trend that started prior to the introduction of the MDGs. If there is causation, we might ask if donor policies drove the MDGs rather than the other way round.

9 The United States doubled aid to sub-Saharan Africa between 2004 and 2009, one year ahead of the pledge; Canada doubled funding from 2001 levels; Norway surpassed the pledge to maintain ODA at 1 per cent of GNI, and Switzerland increased its ODA to 0.41 per cent of GNI.

10 See, for example, the 2005 World Bank study: *Economic Growth in the 1990s: Learning from a Decade of Reforms.* While such studies take a critical view of the policy approaches of the 1980s and 1990s, and introduce new perspectives that focus particularly on the role of institutions and the diversity of country conditions, they

are focused on growth rather than on poverty, and do not challenge the fundamental economic strategy.

11 The annual progress reports report global and regional aggregates. Country progress is tracked in the on-line system that also rates whether or not countries are on track to achieving the 2015 targets: http://www.mdgmonitor.org, accessed 28 January 2012.

12 Interviews with John Ruggie, former Assistant Secretary General in the Office of the Secretary-General, 6 August 2008, Cambridge Massachusetts; with Andy Mack, former Director in the Office of the Secretary-General, 11 September 2008 by telephone. Ruggie and Mack were principal authors of the Secretary-General's report, *We the Peoples* to the General Assembly. The last chapter of this report was transformed, with modifications, into the text of the Millennium Declaration.

13 Interview with Colin Bradford, New York, 16 October 2008.

14 This was patently apparent when the NGO community vigorously protested the UN Secretary General joining the World Bank and the OECD in signing the 2000 progress document, Better World For All http://paris21.org/sites/default/files/bwa_e.pdf accessed 29 January 2012.

15 Interview with Lord Mark Molloch Brown, 27 June 2008, London.

16 Interview with Ambassador Gert Rosenthal, 25 August 2008, New York.

17 Available at http://www.oecd.org/dataoecd/15/3/46874580.pdf.

18 Both Sen (2004; 2011) and Nussbaum (2011) have written about the close connection between capabilities and rights. See also the 2000 Human Development Report (UNDP, 2000) that explores the theoretical overlaps between capabilities and rights, and the policy implications for development. See also Vizard and others (2011).

19 These conferences were also noteworthy for their unusually open processes (UN DESA, 2007). Unlike most UN debates that involve only governments, these conferences opened up to broader involvement of civil society groups. They were involved in the preparatory meetings organized by national governments and UN agencies at country and regional levels. Civil society groups were often included in official national delegations and involved in inter-governmental negotiations.

20 I refer to human security as vulnerability threats from political and other types of violence, natural disasters, disease, environmental degradation, hunger, unemployment and economic downturn. The concept has become increasingly used in the academic and policy literature but with divergent definitions. They range from a narrow conception focussing on threats from political oppression and war—or "freedom from fear"—to a broad conception that encompasses all sources of threats including "freedom from want". While the concept continues to be contested amongst academics, recent debates in the UN have converged on using the term human security in the broad perspective. See United Nations (2010). Human Security, Report of the Secretary General, 8 March 2010 (A/64/701).

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Chapter 3
Do we need new development models? The impact of neo-liberal policies

Frances Stewart[1]

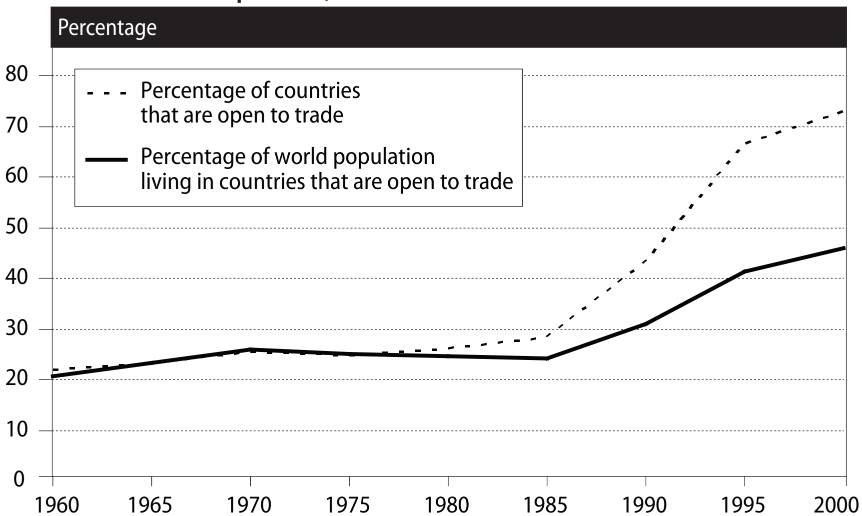
3.1 Introduction

From 1982 onwards the neo-liberal model dominated the policies of most developing countries, led by the International Financial Institutions (IFIs). The debt crisis of the 1980s provided the opening that gave the IFIs the power to insist on their policy package in most African and Latin American countries. Asian countries managed to retain more autonomy, and although they moved in the direction of a more market-oriented system, generally speaking they retained an important role for the state. The fall of communism in the late 1980s provided a further opening, and the former socialist countries joined developing countries in adopt non-interventionist market-oriented policies. Consequently, the 1980s and 1990s saw a widespread and growing adoption of neo-liberal policies (figure 3.1).

The agreement on the Millennium Development Goals (MDGs) might have interrupted this policy path by changing the objectives of development and monitoring policy outcomes in relation to the goals. Yet for the most part, macroeconomic policies and market-oriented mesoeconomic policies went unchallenged, and the MDGs (and the Poverty Reduction Strategy Papers, or PRSPs, which supported them) were interpreted as involving only social sector policy and not economic policy. This was encouraged by the fact that while the MDGs included a poverty objective they

contained nothing about inequality or indeed about economic growth. Consequently, until the crisis of 2008, the 2000s were also a liberalizing era for much of the world. This was, however, greatly modified by the fact that many African countries (because of rising commodity prices), and Latin American countries (because accumulated reserves allowed them to become much more independent of IFI policy advice) were able to steer more independent courses (see Cornia, 2011). Moreover, in addition to promoting the acceptance of human development as the overriding objective of development, the MDGs provided a nudge towards a different approach to *assessing* development: clearly, neither stabilization nor economic growth in and of themselves are adequate criteria.

Figure 3.1
Trends in trade openness, 1960-2000



Source: Wacziarg and Welch (2008). Openness is defined by the Sachs-Warner conditions. Sample includes 141 countries.

The neo-liberal policy package

The package is well known, brilliantly presented by Williamson in his aptly named Washington Consensus (Williamson, 1990). The macro- (and meso-) package includes a balanced budget; elimination of import quotas and reduction of import tariffs to a uniform low level; elimination of controls over investment or the allocation of domestic credit; financial market liberalization with market-determined interest rates; tax reform away from direct taxation to indirect; and a change in indirect taxes from taxes on trade

to taxes on consumption in the form of a uniform (or near uniform) value-added tax; privatization of publicly owned assets; institution of western-style private property rights; and liberalization of capital markets, removing restrictions on international flows of capital. Without being explicitly acknowledged in the Washington Consensus, a fundamental underlying assumption was that the role of the state should be greatly restricted, in terms of economic planning, of ownership of industry and provision of services. In all these areas, it was argued that the market would perform much better (Krueger, 1978; Lal, 1983; Little, 1982; Little and others, 1970).

This chapter will (i) briefly review actual policy changes in different parts of the world; (ii) present a summary of major criticisms that have been made of the neo-liberal policy package; and (iii) indicate through some descriptive data how countries fared on different indicators, how the policy reforms affected major economic and social indicators, looking both at data "before and after" policy reform and comparing countries with differing degrees of policy reform; and (iv) review some of the empirical econometric assessments that have been made of the model.

3.2 Policy reforms towards the Washington Consensus, 1980s and 1990s

From 1980-2000, the neo-liberal policy consensus had a major effect in most parts of the world, especially Africa and Latin America where the IFIs were most dominant. There were changes elsewhere, but they tended to be more selective. Here we confine our attention to the period up to 2000 because after that, many countries, notably in Latin America, modified the package (Cornia, 2011). In addition, a commodity price boom up to 2007, due to the rapid growth of demand in India and China together with a sustained boom in the rest of the world, supported African economic growth and allowed African economies more freedom from the constraining influence of the IFIs. Below we list some major changes in policy adopted in the 1980s and 1990s.

Exchange rate regimes

As shown in table 3.1, there has been a pervasive move from fixed to managed or free-floating exchange rates as documented by Ghosh and others (2002; reproduced by Cornia, 2011). Easterly shows that this change in regime was associated with a depreciation in the real exchange rate (figure 3.2).

Table 3.1
Exchange rate regimes from 1970 to 1999

Percentage of countries			
	1970–1979	*1980–1989*	*1990–1999*
A. Pegged regimes[a]	84.8	68.4	46.6
B. Intermediate regimes[b]	11.0	22.5	26.4
C. Free floating[c]	4.3	9.1	27.0

Source: Cornia 2011 derived from Ghosh, Gulde et al. (2002).

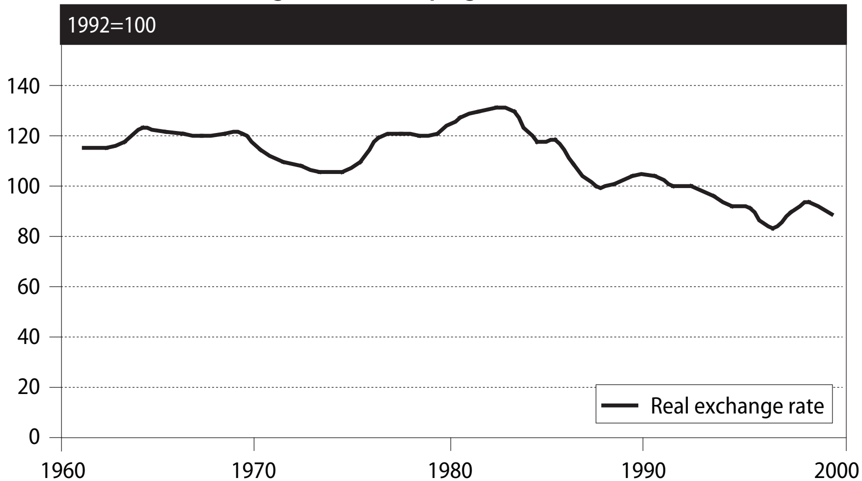
Note: a includes hard pegs, and single currency and basket pegs; b floats with ruled-based or discretionary interventions; c floats with light or no interventions.
Based on data for 167 countries.

Tariff reforms

A major aspect of the reform package was a move towards liberalizing imports, reducing and then abolishing quantitative restrictions (QRs) where they were prevalent, and reducing the average tariff rate, while on the export side, there were steps to reduce the taxation of exports.

Investigating trade liberalization in 32 countries in four regions between 1985 and 1992, Dean and others conclude that "[t]rade liberalization has indeed occurred extensively and sometimes dramatically" (Dean

Figure 3.2
Median real exchange rate, developing countries, 1960-2000



Source: derived from Easterly (2001).

and others, 2004: 95). In Latin America, tariffs fell most sharply with an average reduction of 35 per cent between the late 1980s and early 1990s in eight major Latin American countries, from 44.0 per cent to 14.7 per cent. In Sub-Saharan Africa, over the same period, QRs were abolished or reduced, falling dramatically in half the countries investigated (Ghana, Kenya, Madagascar, Mali, Nigeria and South Africa), while tariffs also fell but less markedly. In East Asia, QRs' coverage fell where they had been high (Philippines and Korea) and remained low elsewhere. In four South Asian countries, both QRs and tariffs fell.

Table 3.2 shows the change in average tariff rates for the countries studied by Dean and others (2004) and Cornia (2011) between 1982-90 and 1998-2002.

Fiscal reforms

A critical component of the reform package was to reduce the large budget deficits prevalent in the early 1980s to not more than 1 or 2 per cent of GDP. The emphasis was placed on achieving this through reductions in government expenditure, rather than increases in taxation.

As shown in figure 3.3, on average the budget deficit was reduced from the high of the early 1980s, but did not fall as much as had been hoped.

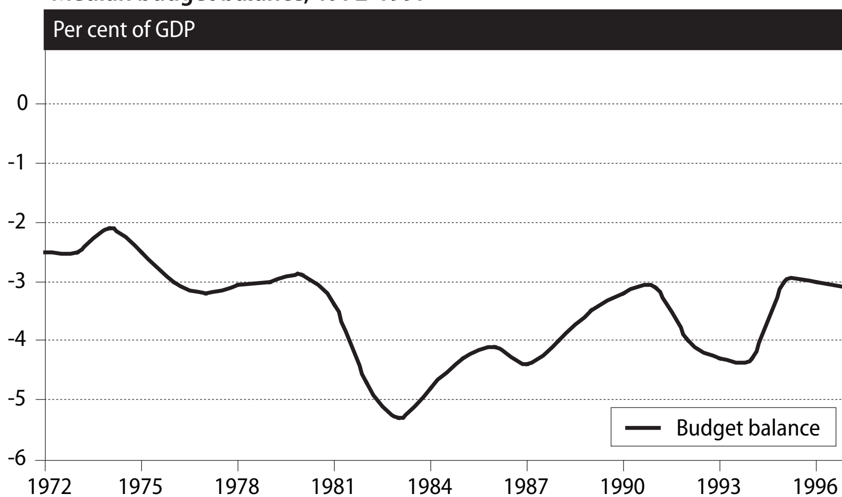
Taking developing countries as a whole, tax revenue as a percentage of GDP rose slightly from the 1970s to the 1980s (from 16.2 per cent to 17.3 per cent), and fell marginally in the 1990s (to 17 per cent). As a result, increasing taxes did not contribute to the improved fiscal position (Bahl

Table 3.2
Average tariff rates on imports, 1982-1990 and 1998-2002

Region	*Average tariff rate*		*Ratio of 1998-2002 to 1982-1990*
	1982-1990	*1998-2002*	
South America	40.0	12.2	0.31
Central America and Mexico	46.6	8.8	0.19
Sub-Saharan Africa	26.7	14.5	0.54
MENA	29.7	17.3	0.58
South Asia	62.9	20.8	0.33
East and Southeast Asia	20.3	15.5	0.76

Source: Cornia (2011) derived from Ghosh, Gulde et al. (2002), and Dean, Desai and Riedel (1994).

Figure 3.3
Median budget balance, 1972-1997



Source: derived from Easterly (2001).

and Bird, 2008). Regional analysis indicates some rise in the tax ratio in both the 1980s and 1990s in Asia, a fall in the ratio in Africa both in the 1980s and 1990s, and a big fall in the ratio in Latin America in the 1980s with a recovery in the 1990s (Cornia, 2011 on the basis of Martarano, 2011). As the package demanded, there was a move from direct to indirect taxation and away from taxes on international trade (table 3.3).

Changes in government expenditure as a percentage of GDP are shown in table 3.4. In the 1980s, expenditure fell by over two percentage points in Africa, on average, though more individual countries saw rises than falls. There was a small recovery in the 1990s. Asia too saw a big decrease

Table 3.3
Trends in the composition of taxation in developing countries, 1980-2000

Percentage share of total tax revenues			
	Income taxes	*Indirect taxes*	*Taxes on international trade*
1980	28.6	29.3	30.7
1990	27.6	34.9	25.6
2000[a]	28.3	40.1	19.0

Source: Bird and Bahl (2008), derived from IMF Government Financial Statistics (2003).
a Limited data.

Table 3.4
Government expenditure, 1980-1998

Per cent of GDP			
	Government Expenditure as % GDP		
Region	***1980***	***1990***	***1998***
Africa	28.5	26.3	27.6
No. of countries increasing	..	10.0	10.0
No. of countries decreasing	..	7.0	7.0
Asia	19.1	16.8	15.2
No. of countries increasing	..	6.0	5.0
No. of countries decreasing	..	5.0	6.0
LAC	16.8	15.5	16.6
No. of countries increasing	..	7.0	12.0
No. of countries decreasing	..	8.0	3.0

Source: Bird and Bahl (2008), derived from IMF Government Financial Statistics (2003).

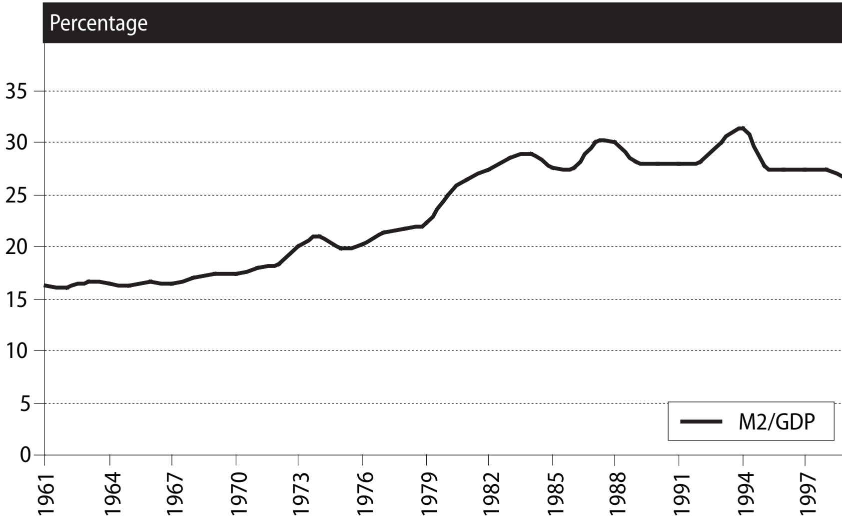
between 1980 and 1990 and a further decrease in the 1990s to the very low rate of 15 per cent. Latin America showed the same pattern as Africa, with a smallish decrease in the 1980s and a smallish rise in the 1990s. Latin American countries had very low ratios, with 9 countries having ratios of expenditure to GDP of less than 20 per cent.

Financial and capital account liberalization

Typically, reforms to liberalize the domestic financial markets occurred first and subsequently reforms of external capital accounts were introduced. Easterly (2001) shows the degree of financial deepening (rising M2/GDP ratio; see figure 3.4a) and rising real interest rates (figure 3.4b) that occurred.

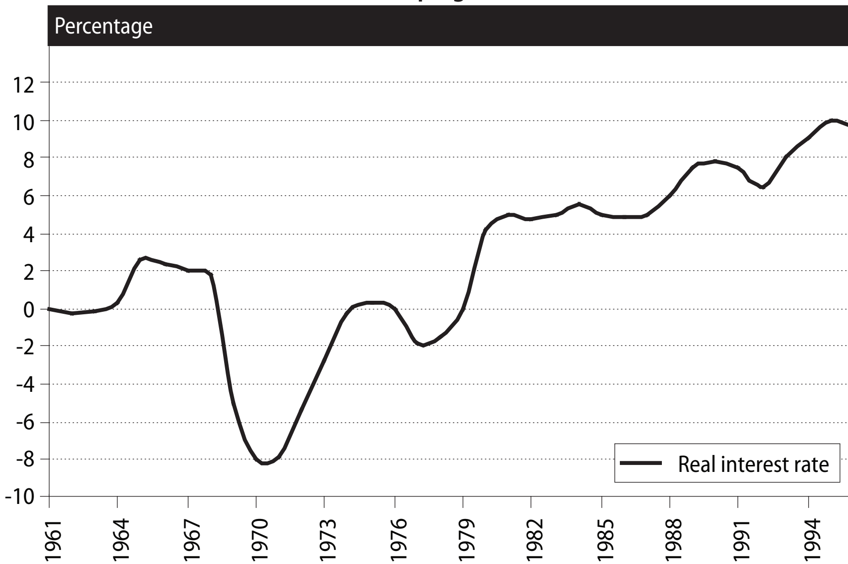
Financial liberalization reforms (domestic and international) were documented by Adam (1999) for some African economies; by (Morley and others, 1999) for Latin America; and (Williamson and Mahar, 1998) for nine industrial and twenty-five developing countries. (Escaith and Paunovic, 2004) give an index of the extent of capital account liberalisation in Latin American countries, showing variation among countries and over time (figure 3.5).

Figure 3.4a
Median of M2/GDP, developing countries, 1961-1999



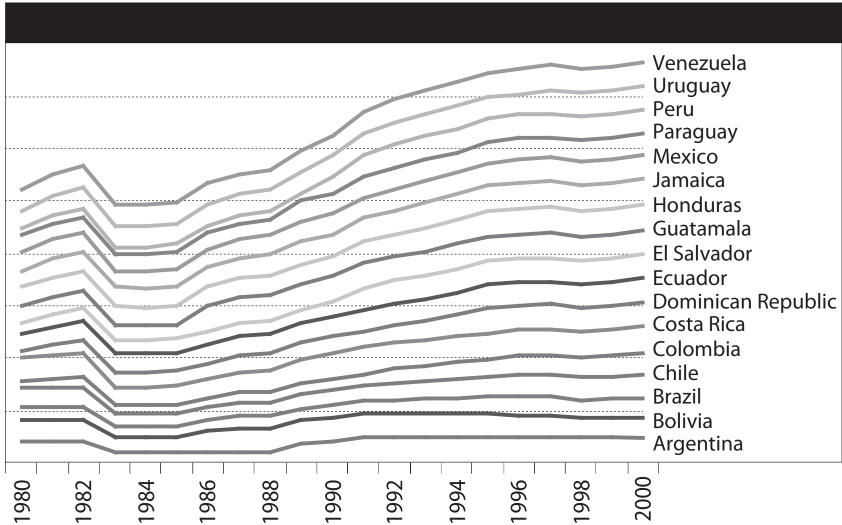
Source: derived from Easterly (2001).

Figure 3.4b
Median real interest rate in developing countries, 1961-1996



Source: derived from Easterly (2001).

Figure 3.5
Trends in capital account liberalization in Latin America, 1980-2000



Source: Escaith and Paunovic (2004).
Note: Not comparable across countries. Countries are listed in alphabetical order. It reflects trends in individual economies.

Privatization

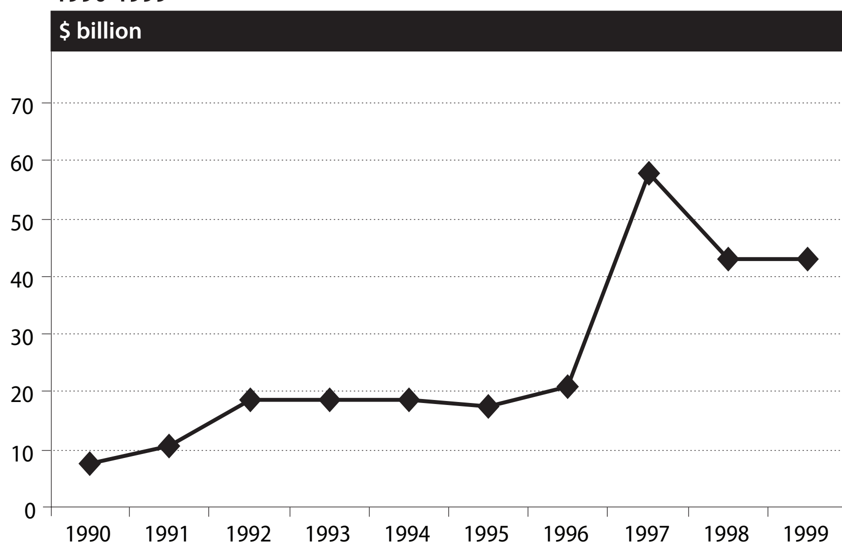
Privatization formed part of the policy package from an early date, but only really got underway from the 1990s (figure 3.6).

To summarize: the 1980s and 1990s saw a major move towards the adoption of each element of the Washington Consensus model, though, obviously, the pace of change and the details varied across countries.

3.3 General criticisms of the neo-liberal package

The neo-liberal model is justified by the assumption that a free market maximizes efficiency, produces a welfare optimum, raises savings, investment and technology change, and consequently leads to a higher rate of growth. As is well known, there are huge theoretical flaws in this view leading to many market failures. Consequently, the model has to be defended pragmatically—i.e. on the argument that it works better than alternatives—rather than on the basis of theory. Here, I will briefly consider some of the theoretical flaws in the model; and then some of the more pragmatic arguments.

Figure 3.6
Estimates of amounts raised by privatization among developing countries, 1990-1999



Source: OECD (2000).

The most important theoretical flaws concern (i) the neglect of externalities; (ii) the assumption of perfect and complete information; (iii) the assumption that there are no significant scale economies, either static or dynamic; and (iv) the view that income growth is the single objective of development and consequently income distribution and other objectives, including sustainability, can be ignored.

As is well known, the view that the market leads to a welfare optimum ignores externalities (Stewart and Ghani, 1991). A Coasian-type bargain in which private agents make deals concerning externalities such that they are effectively internalized rarely occurs because of heavy transaction costs and imperfect information. Consequently, the market tends to result in underinvestment in goods with high externalities (such as health, education and infrastructure) which are essential for economic growth as well as for well-being. It is therefore generally accepted that the state should support the production of goods with high externalities. Yet the model, as adopted, involved tight control of state expenditure and thus limited countries' capacity to offset underinvestment in vital sectors with government expenditure. The significance of externalities has become even greater with the increasing importance of environmental issues.

A critical assumption behind the model predicting that the market will maximize efficiency is that of perfect information. Yet, as Stiglitz has shown, this assumption is fundamentally incorrect, and once one allows for imperfect, and generally asymmetrical, information, the market model does not lead to an efficiency optimum. (Greenwald and Stiglitz, 1986; Stiglitz, 1994; Stiglitz, 2002).

Another assumption is the absence of relevant-scale economies, including learning economies as well as pure-scale economies. Yet the existence of such economies means that there can be corner solutions, implying that the marginal conditions which lead to a welfare optimum do not apply. While in countries with large markets (such as the economies of many of the advanced countries) such economies of scale and learning may not be sufficient to prevent competitive equilibrium or inhibit development, in the small economies of many developing countries there are serious implications, especially given their huge learning gap compared with developed countries: a market model may lead to monopoly or oligopoly and also keep economies in the activities where they have a static comparative advantage and prevent them catching up in sectoral terms or in productivity relative to more advanced countries (Chang, 2002; Lall, 1987).

If we combine any of these flaws in the assumptions underlying the basic model with the theory of the second best, which shows that if one of the conditions for an optimum equilibrium does not apply, then we cannot assume that meeting the other conditions will improve the situation (Lipsey and Lancaster, 1956-1957). Thus, the theoretical foundations of the model, which underlie the Washington Consensus policy prescriptions, are not valid.

Although not explicitly stated, it appears that maximizing the level (or growth) of aggregate income is the single assumed objective of development, given that the focus of the model is on market efficiency and neglects income distribution. Let us first consider income distribution before moving to wider objectives. It is clear that maximizing incomes irrespective of distribution could lead to a highly undesirable situation, with high and even rising levels of poverty despite market efficiency. The usual response to this criticism of the model is that one should leave the market to maximize output, and the state can then redistribute to achieve the desired income distribution. There are clearly strong political economy reasons for viewing this as an implausible scenario, since those who initially benefit from the productive system are likely to put up strong resistance to having their gains removed from them and distributed to those who have not benefitted. Moreover, most redistributory mechanisms involve marginal

taxation which acts as a disincentive for efficient allocation of resources. Even though, in theory, lump sum taxes can be devised which do not act as disincentives at the margin, these are too complex even for developed countries and have nowhere been fully adopted. Moreover, apart from political and efficiency constraints on redistribution, the model, as adopted, includes a shift *away* from more progressive taxes (i.e. from direct to indirect taxes) and thus involves a likely *reduction* in any redistributory activity by the state. However, in most economies the redistribution brought about by taxes alone is very small, and it is through public expenditure that the state influences income distribution (Chu and others, 2000; Goñi and others, 2008). However, in many cases, the model included policies restraining public expenditure, which frequently benefit the poor more than the rich relative to their original income (Cornia, 2004). Consequently, we cannot assume that the state can be left to correct any undesirable distribution effects of the market model.

In addition to the effects on income distribution among households (vertical distribution), there can also be unequalizing effects on horizontal inequality (distribution among groups). This includes ethnic and religious groups—indigenous peoples, in particular, are often bypassed by the market (Langer and Stewart, 2012; Thorp and Paredes, 2010)—and also across genders. The neo-liberal model has often been criticized for ignoring the care economy, resource distribution and power relations. One consequence is that the market often increases rewards to activities controlled by men ("cash" crops in many African economies), while increasing the burden on women (by cutting social spending) (Cornia *et al.*, 1986; Elson, 1991, 1995; Gladwin, 1991; Haddad and others, 1995).

In addition, the view that development should be solely concerned with maximizing income (even if appropriately distributed) has been widely criticized for neglecting human objectives, including health, education, leisure, security and the environment (Sen, 1980; Sen, 1999; UNDP, 1990). If we accept that the aim of development is to expand capabilities or freedoms, there may be only a weak link between achieving a market optimum and promoting development.

These are fundamental flaws in the welfare theory underlying the model. But it might be argued that the reason for introducing the model was not because anyone believed it would actually maximize welfare, but because it was thought that it would work better than the previous more state-oriented strategy (often known by market aficionados as "dirigisme"). If that is so, we need to judge the model in more pragmatic ways. This section

will provide an overview of more pragmatic criticisms of the various policy reforms embodied in the model. The subsequent sections will review some empirical findings.

Here the argument starts with deficiencies of the state-oriented model about which critics made the following points:

- The large budget deficits led to high rates of inflation which in turn were bad for growth (by causing uncertainty and hence lowering investment) and poverty.
- Overvalued exchange rates combined with heavy protection discouraged exports and led to inefficient production, because of protection from competition.
- Planning, protection and public ownership of industry led to rent-seeking and inefficiency.
- Repressed financial markets kept interest rates too low with the consequence that savings were discouraged and were inefficiently allocated, and choice of technique was too capital-intensive, leading to unemployment and underemployment.
- Controls over the international movement of capital prevented capital flowing to where it would have highest returns, which was presumed to be the developing countries, given their capital scarcity.

In addition, it was accepted that while the model did focus on incomes to the neglect of income distribution and of wider social objectives, in practice, trickle down would occur because 'growth is good for the poor' (Dollar and others, 2001) and 'wealthier is healthier'(Pritchett and others, 1993).

There is, of course, something in most of these criticisms of the pre-reform model; hence, the need for careful empirical appraisal of the consequences of the neo-liberal model in comparison with pre-reform policies. But there are also important pragmatic defects in the model (and in the above arguments).

The adverse impact of fiscal deficits and of inflation has been much exaggerated by critics: there is very little evidence that inflation below a quite high rate (around 40 per cent) has an adverse impact on growth (Bruno and Easterly 1998) (Ghosh *and others*, 1996; Khan and Senhadji, 2000; Templar, 2000), while the frequently expressed view that inflation is especially bad for the poor (who are ignored for the most part but enter this part of the argument) has little empirical backing. The connexion clearly depends on who the poor are and which prices rise most, which varies across societies. Any costs must also be considered in relation to the counterfactual – i.e. policies

taken to rein in inflation may be more damaging to the poor than inflation itself. Nonetheless, large budget deficits weaken domestic control over the economy, are associated with large trade deficits and high indebtedness, and hence can lead to periodic crises and heavy dependence on foreign loans and assistance.

Yet accepting the need for lower fiscal deficits than in the pre-reform era does not mean these need be achieved via *expenditure cuts*. Public expenditure plays a vital role in supporting economic infrastructure and in "crowding in" private investment, and in supporting social expenditure which contributes to meeting social objectives as well as to long-run growth through enhancing human capital (Ahmed and Miller, 1999). The major criticism of the fiscal part of the neo-liberal model, therefore, is its emphasis on expenditure cutting rather than revenue-raising and in many cases, the *speed* of the adjustment demanded.

With respect to resource allocation (domestic and for trade), the model assumes that resources would flow freely and painlessly from one use to another. While this might plausibly work within a large and well-established manufacturing sector, because of infrastructural needs, learning economies and economics of scale, such movement would be likely to be slow and costly in low-income countries—and, in particular, require high rates of infrastructural and other investment, especially where the shift in resource allocation involved a movement into new industries. Yet without such a shift, the policies are likely to lead to unemployment the underutilization of capital equipment rather than an increase in output via an improvement in the efficiency of resource use. For countries with an undeveloped manufacturing sector, import protection of some sort may well be essential to enable industrialization to occur, as argued in the nineteenth century by List (1841) and in recent years by Chang (2002) among others.

The arguments concerning the implications of financial repression assume that savings are responsive to interest rates, which has often been questioned; while the argument that international capital is likely to flow towards the poorer capital-deficient countries if global capital markets are freed does not work for low-income countries, which do not offer high rates of return because of their deficiencies in infrastructure and human capital, and weak industrial and service linkages. Moreover, free capital movements may threaten the macroeconomic stability of middle-income countries.

Finally, the assumption that poverty reduction and broader societal objectives are best achieved via maximizing growth is not consonant with many other findings. While, on average, the poor may benefit somewhat from

higher growth, the relationship is uneven across countries. Where income distribution is highly unequal and worsening, the poor may not benefit at all; conversely, countries can reduce poverty with low growth if it is accompanied by low inequality and appropriate policies. Moreover, rising inequality is undesirable even if accompanied by falling poverty, since evidence suggests that it increases criminality, reduces life satisfaction, and increases political instability, and, where horizontal inequality increases, it raises the chance of civil war (Alesina and Perotti, 1996; Fajnzylber and others, 2002; Graham and Felton, 2005; Stewart, 2008). Similar arguments apply with respect to the "wealthier is healthier argument" (UNDP, 2010) has shown the very low correlation between rising income per capita and improvements in health, for example (UNDP, 2010). Research into achievements on different dimensions of human development shows low correlations across country between income per capita and many other dimensions (Ranis and others, 2006).

Thus there are flaws both in the theoretical underpinnings of the model and in the more pragmatic arguments that have been advanced in its defence. At the end of the day, however, the actual consequences of the reforms for growth, distribution and stability determine the desirability of the neo-liberal reforms.

3.4 How did countries fare?

This section provides an aggregate picture of what happened in the "liberalizing era" compared with the more state-oriented and interventionist era. For this purpose we take data from 1960-1980 for the interventionist era; and from 1980-2000 for the liberalizing era. We stop at 2000 for two reasons: first because quite a number of countries after that date modified the model, as shown by Cornia for Latin America (Cornia and Martorano, 2011); and, secondly, because the boom in commodity prices, largely due to the expansion of Chinese demand, altered conditions radically for many countries, including relaxing the pressures for reform in many African countries. Nonetheless, we include data for post-2000, but focus on it less in interpretation.

In addition, we attempt to compare countries that have adopted more extensive and deeper neo-liberal reforms, compared with those with few or no reforms. For this purpose, we draw on the work of Sachs and Warner (1995) and Wacziarg amd Welch (2008). Sachs and Warner classified countries as "open" if they met all of the following conditions:

- Average rates of tariff of less than 40 per cent;
- Non-tariff barriers of less than 40 per cent coverage;
- Black market exchange rate not more than 20 per cent lower than the official rate;
- No state monopoly on major exports;
- No socialist economic system.

Clearly, these criteria are arbitrary and Rodriguez and Rodrik (1999) have shown that conclusions about associations with openness (e.g. growth rates) depend on the particular definition of openness adopted and changes of the definition, as the definition indeed changes. Wacziarg and Welch (2008), using their own definition, showed how the Sachs/Warner conclusion—that more open economies have higher growth rates—does not hold for the 1990s. Wacziarg and Welch updated the Sachs/Warner classification to account for factors relevant to the 1990s, but the fundamental criticism of arbitrariness, made by Rodriguez and Rodrik, remains valid. Nonetheless, lacking an alternative, below we use a modified version of the classification, putting countries into four categories:

Category 1: "Early liberalizers" (pre-1980) of which there are 12 countries, including well-known cases such as Chile, Hong Kong SAR, and the Republic of Korea.

Category 2: "Forced liberalizers", which includes 47 countries that enacted reforms in the 1980s and 1990s under pressure from the IFIs. Some liberalized selectively and others bought the whole package (or had it imposed on them) differing in terms of the pace with which they introduced reforms and the extent to which the state acted as a strategic planner. This group is far the largest (as would be expected given the prevalence of reforms in the 1980s and 1990s noted above). As it is difficult to differentiate these subcategories without more information, there is some arbitrariness to this category.

Category 3: The "selective reformers", including China, India and Vietnam, all of which maintained a strong state role and were highly selective in terms of which reforms they implemented.

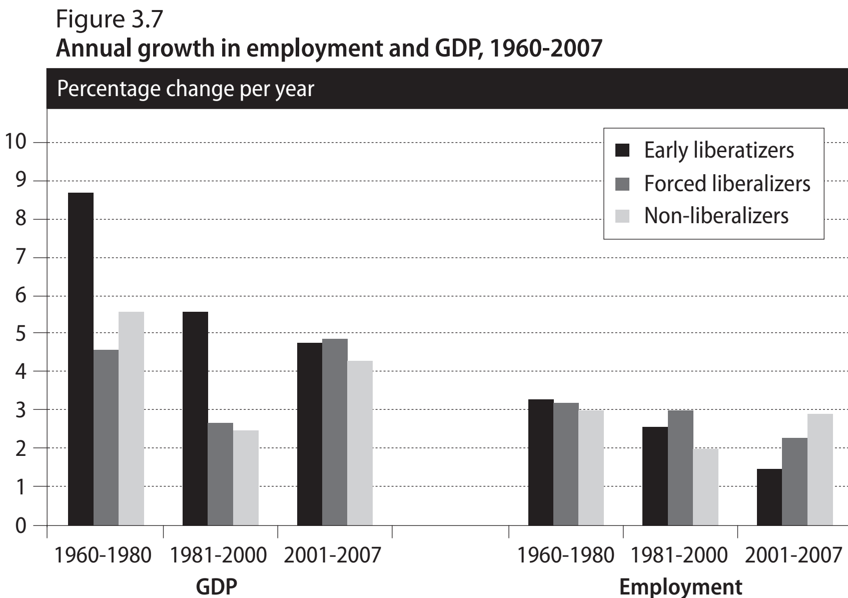
Category 4: The "non-liberalizers" (or post-2000 liberalizers) of which there are 27 countries.

Appendix table A3.1 details the classification. The transition countries have been excluded. Going beyond the usual criteria, we used the following to assess performance:

- Growth rate of GDP and employment
- Investment ratio
- Diversification measured by industrial value-added as a per cent of GDP and the share of primary exports in total exports
- Inequality
- Life expectancy
- Expenditure on education as a per cent of GDP
- Carbon emissions per person.

As can be seen from figure 3.7, growth in output and employment slowed down everywhere, except for the selective liberalizers (in this case data are only available for China), during the liberalizing era (i.e. 1981-2000 compared with the previous decades). The sharpest falls were in the most open category (1), followed by the least open (4). The investment ratio also fell in the second period (while it rose in the first) everywhere except among the selective liberalizers (figure 3.8). Diversification increased everywhere between 1960 and 1980, measured by industry value-added as a per cent of GDP. In the liberalizing era, it remained unchanged in the early liberalizers and the selective liberalizers, rose quite sharply in the non-liberalizers, but fell slightly in the forced liberalizers (figure 3.9).

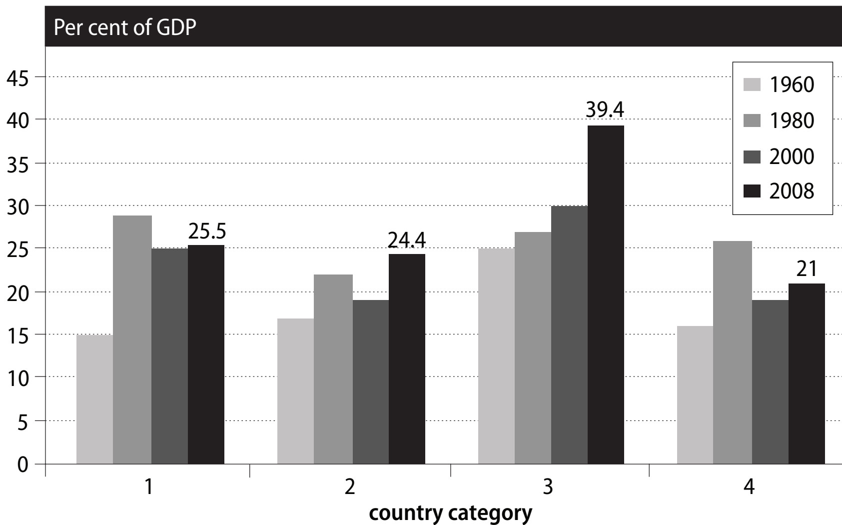
Figure 3.7
Annual growth in employment and GDP, 1960-2007



Source: World Development Indicators.

The Gini coefficient fell on average in every category during the interventionist era, but rose sharply in the very open economies and the selective liberalizers during the liberalizing era (figure 3.10). However, it remained more or less stable on average for category 2 and category 4 countries (forced liberalizers and non-liberalizers). Life expectancy improved in both eras (figure 3.11), but the rate of improvement slowed down in the liberalizing period, especially among the forced and non-liberalizers. Education expenditure as a percentage of GDP continued to increase in the liberalizing era, at a slower rate in categories 1 and 3, and a faster rate in categories 2 and 4 (figure 3.12). In absolute terms, by 1999, the most open economies had the highest rate, followed by the closed economies. As may be expected, increases in CO_2 emissions reflected growth rates, with the highest increase in the open economies and among the selective liberalizers (figure 3.13).

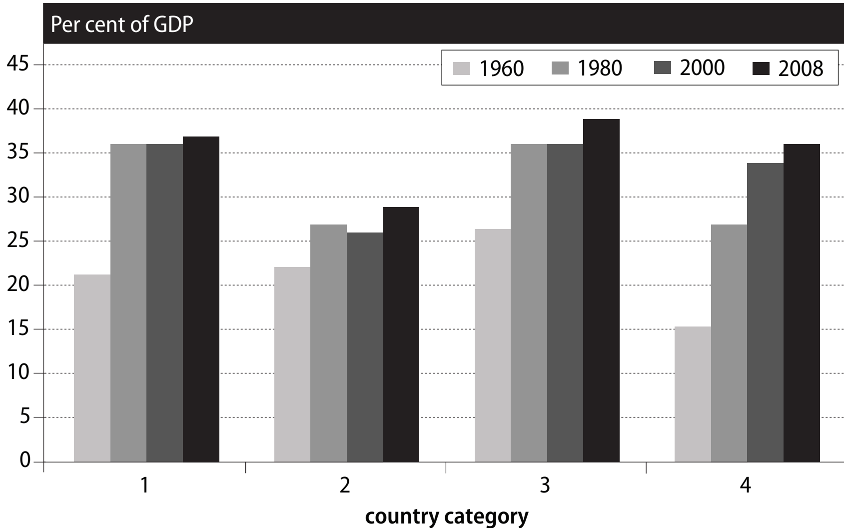
Figure 3.8
Investment by country category, 1960-2008



Source: World Development Indicators.

Table 5 summarizes the above information by showing how the various country categories rank on different criteria. On economic criteria, the selective liberalizers do the best and the non-liberalizers do the worst. On social criteria, the forced liberalizers seem to do the worst, although the

Figure 3.9
Industry value-added by country category, 1960-2008



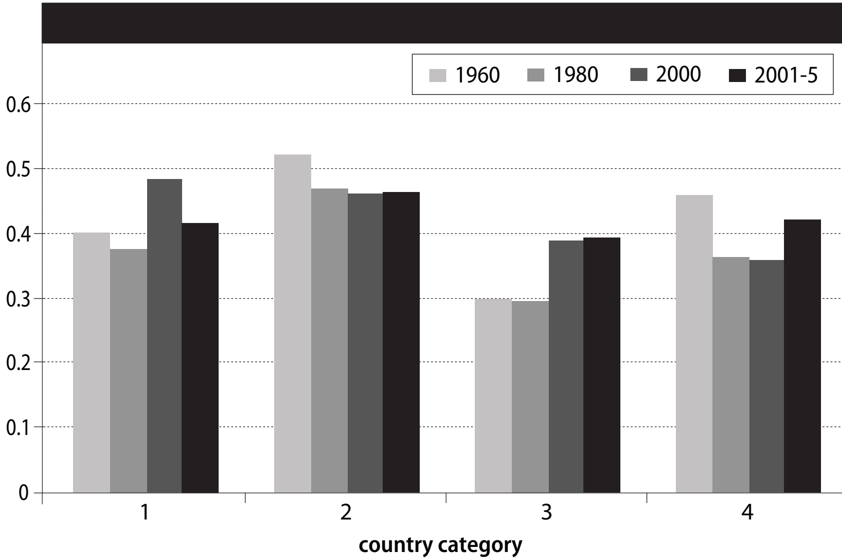
Source: World Development Indicators.

others are similar. On environmental criteria, the open economies do the worst. If we do a crude combined index (by averaging), selective liberalizers come out on top and non-liberalizers at the bottom.

The early liberalizers' poor showing on the environment and inequality suggests that we do need an alternative model; but the poor performance of the closed economies in terms of growth and improving life expectancy suggests that the closed-economy alternative is not satisfactory, and that *a selective liberalization combined with policies to protect the environment and limit inequality may be optimal*.

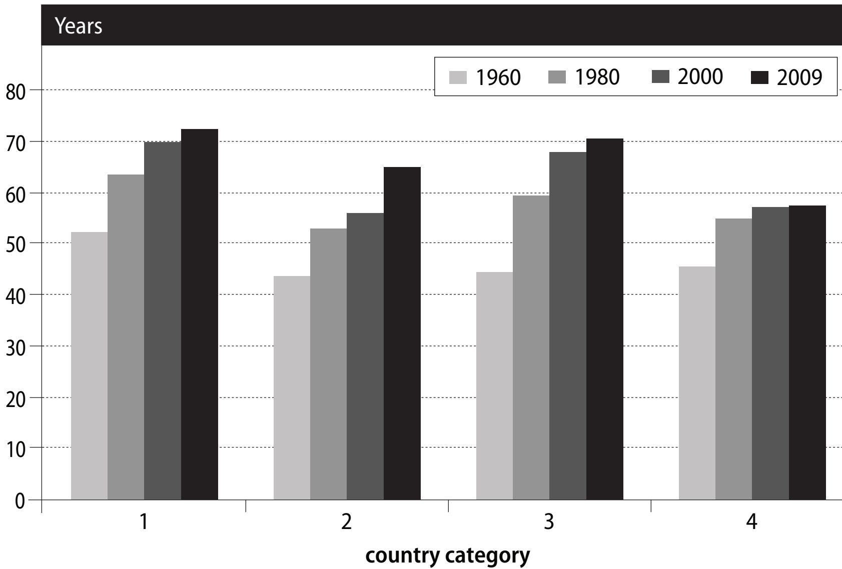
The comments above relate to the pre-liberalizing (1960-1980) and liberalizing (1980-2000) eras, and not to post-2000 developments, when conditions changed as the terms of trade improved for commodity exporters and policy stances changed in many developing countries. Nonetheless, post-2000 developments are of interest. Growth of output improved considerably in the period 2001-2007 compared with the previous two decades in each except for the early liberalizers where it fell (figure 3.7). The investment ratio also increased, but only marginally among the early liberalizers and by a small amount among the late and non-liberalizers (figure 3.8). Improved investment and growth is likely to have been due to a combination of the good external

Figure 3.10
Gini coefficient, 1960-2005



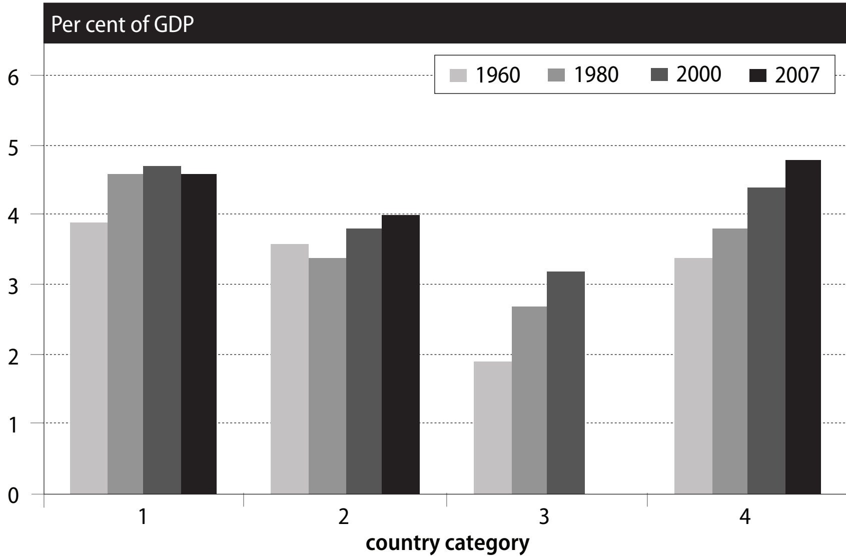
Source: WIDER.

Figure 3.11
Life expectancy at birth, 1960-2009



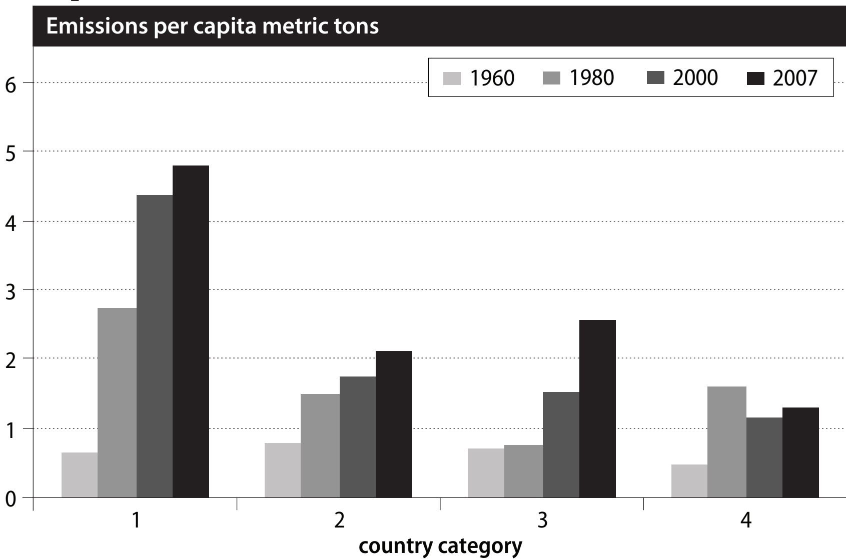
Source: World Development Indicators.

Figure 3.12
Education expenditure, 1960-2007



Source: World Development Indicators.

Figure 3.13
CO_2 emissions per capita, 1960-2007



Source: World Development Indicators.

Table 3.5
A summary of performance

	Ranks by category			
Category	***Early liberalisers***	***Forced liberalisers***	***Selective liberalisers***	***Non-liberalisers***
Economic				
Growth rate, 1981-2000	2	3	1	4
Employment growth, 1981-2000	3	1	2	4
Investment ratio, 2000	2	3	1	4
Diversification increase: industry value-added as % GDP	2	4	2	1
Social				
Inequality, 2000	4	3	2	1
Education expenditure, 2000	1	3	4	2
Life expectancy, 2000	1	4	2	3
Improvement in life expectancy, 1980-2000	2	2	1	4
Environmental				
CO_2 emissions, 2000	4	2	1	3
Change in CO_2 emissions, 1960-1980-1980-2000	4	2	3	1
Average rank	2.0	2.7	1.9	2.5

conditions and the policy combinations adopted. But it should be noted that the improved growth was not reflected in increased employment expansion, apart from among the late and non-liberalizing group. Diversification towards industry occurred in each group, reversing the small drop previously experienced by the forced liberalizers. However, primary product exports increased as a proportion of total exports in each category apart from the selective liberalizers, probably due to the improved prices received.

The data are rather partial for the Gini coefficient, but what there are suggest that inequality fell in the early liberalizer group, rose very slightly among the forced and selective liberalizers, and significantly among the late or non-liberalizers (figure 3.10). Improvements in life expectancy continued everywhere, but slowed down in all but the forced liberalizers, although

among this group life expectancy was still much lower than among the early and selective liberalizers (figure 3.11). Education expenditure continued to rise as a proportion of GDP in all countries apart from the early liberalizers, where it fell slightly 2000-2007 (figure 3.12). CO_2 emissions continued to rise, especially sharply among the selective liberalizers, but remained much the highest in the early liberalizer group. In terms of ranking, in the economic sphere, the selective liberalizers do best. In the social sphere, the early liberalizers continue to outperform the others with little difference among the other three categories. The non-liberalizers do best in terms of containing CO_2 emissions, while the early and selective liberalizers score the worst. The aggregate ranking remains the same as for the earlier period, with the selective liberalizers outperforming the rest and the forced liberalizers still ranked lowest.

We must emphasise that the exercise carried out in this section is very crude. Weaknesses include: arbitrary categorization of countries; the endogeneity of policy change to initial conditions, which may then influence what happens over time; variations in policy choice and performance within each category; and lack of (or inaccurate) data in quite a number of cases. Therefore, we now turn to summarizing some econometric approaches that have been adopted to assess the liberalizing reforms.

3.5 Assessment: findings from empirical studies

Section 3.3 presented some general arguments concerning defects of the neo-liberal model. But, as noted there, there were also defects in the pre-reform state-oriented model. To get a balanced assessment therefore one needs an empirical assessment of the neo-liberal model in comparison with the prior model. In this section, we review some studies that have made such a comparison, pre and post-reform, and with and without reform. However, the pre-reform situation is *not* the only, or, almost certainly, the most desirable alternative policy package, so in principal one should also consider whether the neo-liberal reform model compares positively or not with other potential alternatives. This, however, is clearly difficult to do, as there are many alternative possibilities, often with unknown effects.

The standard model and economic growth

Easterly sums up a dilemma for adherents of the neo-liberal model: "In 1960-79, the median per capita growth in developing countries was 2.5 per

cent. In 1980-98, the median per capita growth of developing countries was 0.0 per cent. In contrast, the standard determinants of growth in growth regressions like financial development, black market premiums, real overvaluation, educational attainment, life expectancy, fertility, and infrastructure got steadily more favorable for growth from the 60s through the 90s." (Easterly, 2001: 3). He concludes: "The fact remains that many, even stationary, country characteristics widely thought to be favorable for growth (or at least favorable for level of income) have improved, yet developing countries on average have stagnated. This in itself is a blow to the optimism surrounding the 'Washington Consensus' prior to the experience of the last two decades." (Ibid.: 21-22).

The conclusion that the model, as introduced by the IMF, did not speed up growth, and indeed may have reduced it, is confirmed by many assessments of IMF programmes, which examine the main elements of the reform programme. For example, a survey by Ul Haque and Khan (1998) of 18 evaluations undertaken between 1978 and 1997 showed mixed evaluations. The "before-after" evaluations produced three positive assessments and four zero ones; the with-without assessments gave one positive, one negative and two zeros; the "generalized evaluations" produced two negative, two positive and one negative in the short-term and positive in the longer term, while simulation exercises showed one negative, and one negative in the short term, positive in the longer term. The summary by Bird is broadly similar:

> *On economic growth, although many early studies found little connection, Goldstein and Montiel (1986) found IMF programs to have a significantly negative effect. Simulation tests by Khan and Knight (1982) also predicted that demand management programs similar to those supported by the IMF will have negative short-run effects on growth, although subsequent research by them suggests that these effects can be ameliorated by incorporating supply-side measures to protect investment (Khan and Knight, 1985). Conway (1994) finds significant differences between the short-run and long-run effects of IMF programs on economic growth and investment, as contemporary reductions are followed by lagged increases. Killick (1995) finds a largely neutral association with economic growth, although over a longer time-frame the association is positive (albeit of only limited statistical significance)…. While Hutchison (2001) discovers a significant adverse effect on output growth over one to two years, Przeworski and Vreeland (2000) claim that IMF programs have an enduring adverse effect on economic growth. (Bird 2001: 1851)*

More recent assessments have used instrumental variables in order to separate the impact of the programmes from the economic conditions of the country which led to the need for a programme. Barro and Lee (2005: 1245) conclude that "a higher IMF loan-participation rate reduces economic growth" and it also has a small negative impact on democracy and the rule of law, which may further impact negatively on growth. Dreher (2005), also allowing for endogeneity, comes to similar conclusions.

Beyond economic growth, studies of IMF programmes generally find that they have a negative impact on investment (Bird, 2001) while improving the current account and the fiscal balance (Atoyan and Conway, 2005). The effects on inflation appear to be small and ambiguous in direction (Bird, 2001).

The consequences of particular elements in the model

There have also been many studies of the effects of particular elements in the package. A major element is *import liberalization*. Here Sachs and Warner famously argue that more-open economies grew faster, based on cross-sectional evidence correlating degrees of openness, as defined above, with growth. Similar results have been produced by others (e.g. Dollar, 1992; Harrisson 1996; Edwards 1998). But as noted earlier, the way openness is measured may determine these results (Rodrik and Rodriguez 2000). Wacziarg and Welch (2003) argue that before-after studies of liberalization avoid this problem and show that import liberalization is associated with a speed up in growth. However, Slaughter (2001) compared before-after results of trade liberalizers with non-liberalizers among OECD countries, and found little difference in growth. Kneller (2002: non-technical summary) came to similar conclusions examining developing countries: "The increase in growth that took place in liberalizing countries also took place in non-liberalizing countries i.e. trade liberalisation did not cause growth rates to increase."

Moreover, adverse effects of trade liberalization have been noted. Shafaeddin (2005) argues that in 40 per cent of countries, trade liberalization had the effect of speeding up the growth of manufactures, but in many of the remainder, including many least developed countries, it led to deindustrialization. Mosley and others (1991) argue that in Africa, trade liberalization reduces growth.

Studies of the impact of trade liberalization on income distribution, which had been expected to be egalitarian for developing countries, again show ambiguous results with some liberalizing countries becoming more equal but in many cases trade appears to have been unequalizing.

Several studies point to the equalizing effect of free trade. In the nineteenth century, trade liberalization led to an increase in domestic inequality in rich New World countries, but reduced it in the poor Old World countries. Likewise, in an analysis of 35 small developing countries, Bourguignon and Morisson (1990) conclude that the removal of trade protection in manufacturing reduced the income share of the richest 20 per cent of the population and raised that of the bottom 60 per cent. While Wood (1994) arrives at a similar conclusion for East Asian exporters of labour-intensive manufactured goods, he has argued further that the unskilled to skilled age ratio improved in East Asia following liberalization but worsened in Latin America, and attributes this to the differing dates at which liberalization occurred, with Latin America facing severe competition from China in the 1980s and 1990s (Wood, 1997). Michaely and others (1991) present some cases of improving and others of worsening income distribution in a nineteen-country study of trade liberalization. According to Lindert and Williamson (2001) wage inequality was found to have increased in six out of seven Latin American countries that had liberalized trade, as well as in the Philippines and Eastern Europe. And an analysis of 38 developing countries for the years 1965-1992 found that trade liberalization benefited the richest 40 per cent, while negatively affecting the bottom 40 per cent, who were hurt by greater fluctuations in the terms of trade following the opening of the economy (Lundberg and Squire, 2000). Savvides (1999) showed that the most open developing countries experienced a rise in inequality between the 1980s and the early 1990s, and a positive correlation between trade protection and the income share of the poorest quintile (Cornia, 2005: 3-4).

In general, while the liberalizing era was accompanied by worsening income distribution in many countries, this did not occur everywhere (figure 3.10) and since there were many simultaneous changes, it is not possible to attribute this to any single measure.

Financial sector reforms do not consistently increase savings as assumed by its advocates, and can deter investment. Although Fry (1988) indicates that national savings increase with higher real interest rates brought about by financial sector reform, there is evidence of declining savings following liberalization in number of countries (Williamson and Mahar, 1998). Savings fell following liberalization episodes in Chile, Argentina, Colombia and the Philippines, Kenya and Malawi, but rose in Egypt, Lesotho and Uganda, according to a range of studies (Cobham, 2002). Warmana and Thirlwall (1994) show that in Mexico financial reforms did result in a rise in the real interest rates, but this did not lead to an increase in total savings and was a

deterrent to investment. Demetriades and Devereux (1992) find a negative impact on investment from higher real interest rates in a panel study of 63 developing countries from 1961 to 1990, while Günçavdıa and others (1998) show that in Turkey financial liberalization did not relax credit constraints. But Siddharthana and others (1998) found that in three industries in India, MNC behaviour changed, with market share post-reform being determined by factors related to innovation, as against the ability to secure licenses in the pre-reform era.

More broadly, financial sector liberalization has been attributed with encouraging speculation in future markets, which is likely to have contributed to high and volatile food prices, pushing many millions into poverty (Gilbert, 2008; United Nations, 2011; World Bank, 2011).

The evidence on *capital account liberalization* is also ambiguous. According to Cobham's survey: "It may be concluded on the basis of this literature survey that the growth-related benefits of capital account liberalisation for developing countries have not been established" (Cobham, 2002: 19). While Klein and Olivei (1999) find a positive impact on financial deepening and growth for developed countries, they do not find this for developing countries, which they attribute to a lack of appropriate institutions. Kraay (1998: 19) confirms "the absence of evidence of the growth benefits of capital account liberalization". Capital account liberalization can have negative effects – first, because some flows are highly volatile and can result in acute crises and, second, because high inflows of foreign capital can lead to an exchange rate appreciation. The volatility has been exhibited in the series of financial crises experienced by highly liberalized countries, such as Mexico; South East Asia in the late 1990s and a number of countries during the 2008-2009 global financial crisis, in which countries with limited private capital flows were relatively unaffected (Stewart, 2011).

These crises have had heavy economic and social costs. As Stiglitz writes:

> *One of the most controversial aspects of globalization is capital market liberalization; not so much the liberalization of rules governing foreign direct investment, but those affecting short-term capital flows, speculative hot capital that can come into and out of a country. In the 1980s and 1990s, the IMF and the US Treasury tried to push capital market liberalization around the world, encountering enormous opposition, not only from developing countries, but from economists who were less enamoured of the doctrines of free and unfettered markets, of market fundamentalism, that were at that time being preached by the international economic institutions. The economic crises of the late*

> *1990s and early years of the new millennium, which were partly, or even largely, attributable to capital-market liberalization, reinforced those reservations. (Stiglitz, 2004: 57).*

With respect to *privatization*, in a study of 63 countries, Cook and Uchida (2003) find that privatisation is robustly *negatively* related to economic growth, although Filipovic (2005) gets more ambiguous results when introducing a number of other policy variables simultaneously.

In summary, empirical assessments of the reform packages, and of individual elements, produce differing results, depending on methods and time period. On balance, the IMF packages seem to have a negative impact on economic growth and privatization has also been associated with negative growth impact. No systematic growth effects can be detected from import liberalization or financial liberalization, while capital account liberalization increases the risks of costly crises without necessarily raising savings and investment. Income distribution worsened in many countries during liberalization (Cornia, 2004), but no clear-cut relationships can be found between particular measures and distributional outcomes.

3.6 Conclusions

The review of the basic neo-liberal model showed that there were deep flaws in the theoretical foundations. The more pragmatic arguments for liberalizing were also shown to be inconclusive. But the proof of the pudding is in the outcomes. Here we find that the Washington Consensus model has not delivered its promised acceleration in growth. Indeed, on balance it seems to have been associated with reductions in growth and often with worsening income distribution. Financial liberalization does not seem to have raised investment, as predicted, nor has privatization been associated with increased growth. Capital account liberalization has shown very few benefits and high costs in terms of instability and exchange rate effects.

Yet this does not mean that all liberalizing policies should be reversed: indeed, the survey of outcomes of countries categorized according to the extent of liberalization found that the non-liberalizers did worst. Countries which liberalized selectively *and retained a strong role for the state* in steering the economy—in this review just a small subset, notably India, China and Vietnam—seemed to do best. The conclusion then is that we do need a new macroeconomic model, but this is not likely to consist of a total reversal of all liberalizing policies, but a careful selection and modification

of these policies, supported by complementary polices towards investment, human resources, taxation and social transfers. Moreover, the best policy mix is likely to differ across countries according to level of development and economic structure, while international conditions are also relevant.

Appendix

Table A3.1
Trends in the composition of taxation in developing countries

Country	*Year uninterrupted openness began*		*Category*
	Sachs &Warner	Wacziarg & Welch	
Barbados	1966	1966	1
Bolivia	1985	1985	1
Botswana	1979	1979	1
Chile	1976	1976	1
Hong Kong SAR, China	always open	always open	1
Indonesia	1970	1970	1
Jordan	1965	1965	1
Korea, Rep.	1968	1968	1
Malaysia	1963	1963	1
Singapore	1965	1965	1
Thailand	always open	always open	1
Yemen, Rep.	always open	always open	1
Argentina	1991	1991	2
Bangladesh	closed	1996	2
Benin	1990	1990	2
Brazil	1991	1991	2
Burkina Faso	closed	1998	2
Burundi	closed	1999	2
Cameroon	1993	1993	2
Cape Verde	n.a.	1991	2
Colombia	1986	1986	2
Costa Rica	1986	1986	2
Cote d'Ivoire	closed	1994	2
Dominican Republic	closed	1992	2
Ecuador	1991	1991	2
Egypt, Arab Rep.	closed	1995	2
El Salvador	1989	1989	2
Ethiopia	closed	1986	2

(cont'd)

Table A3.1 (cont'd)

Country	*Year uninterrupted openness began*		*Category*
	Sachs &Warner	Wacziarg & Welch	
Gambia, The	1985	1985	2
Ghana	1985	1985	2
Guatemala	1988	1988	2
Guinea	1986	1986	2
Guinea-Bissau	1987	1987	2
Guyana	1988	1988	2
Honduras	1991	1991	2
Jamaica	1989	1989	2
Kenya	1993	1993	2
Madagascar	closed	1996	2
Mali	1988	1988	2
Mauritania	1992	1995	2
Mexico	1986	1986	2
Morocco	1984	1984	2
Mozambique	closed	1995	2
Nepal	1991	1991	2
Nicaragua	1991	1991	2
Niger	closed	1994	2
Panama	n.a.	1996	2
Paraguay	1989	1989	2
Peru	1991	1991	2
Philippines	1988	1988	2
South Africa	1991	1991	2
Sri Lanka	1991	1991	2
Tanzania	closed	1995	2
Trinidad and Tobago	closed	1992	2
Tunisia	1989	1989	2
Turkey	1989	1989	2
Uganda	1988	1988	2
Uruguay	1990	1990	2
Venezuela, RB	closed	1996	2
Zambia	1993	1993	2

(cont'd)

Table A3.1 (cont'd)

Country	*Year uninterrupted openness began*		*Category*
	Sachs &Warner	Wacziarg & Welch	
China	closed	closed	3
India	1994	closed	3
Vietnam	n.a.	n.a.	3
Algeria	closed	closed	4
Angola	closed	closed	4
Central African Republic	closed	closed	4
Chad	closed	closed	4
Congo, Dem. Rep.	closed	closed	4
Congo, Rep.	closed	closed	4
Cuba	n.a.	n.a.	4
Gabon	closed	closed	4
Haiti	closed	closed	4
Iran, Islamic Rep.	closed	closed	4
Iraq	closed	closed	4
Korea, Dem. Rep.	n.a.	n.a.	4
Lesotho	n.a.	closed	4
Liberia	n.a.	closed	4
Malawi	closed	closed	4
Myanmar	closed	closed	4
Nigeria	closed	closed	4
Pakistan	closed	2001	4
Papua New Guinea	closed	closed	4
Rwanda	closed	closed	4
Senegal	closed	closed	4
Sierra Leone	closed	2001	4
Somalia	closed	closed	4
Swaziland	n.a.	closed	4
Syrian Arab Republic	closed	closed	4
Togo	closed	closed	4
Zimbabwe	closed	closed	4

Notes

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Chapter 4
Learning from the past: Which of the past/current development strategies are best suited to deal with the "quadruple crisis"?

Giovanni Andrea Cornia and Milica Uvalic[1]

4.1 Challenges posed by the quadruple crisis

The MDG development strategy has mainly been framed in terms of social and aid policies and has said little about the national development strategies and governance changes required for their achievement. Because of this omission, national strategies have, often by default, relied on an unfettered liberalization of domestic and external markets and weak food security and environmental policies. Such an approach has done little to prevent the emergence of a "quadruple crisis" which has severely affected the economies of many developing countries and delayed the achievement of the MDGs. The elements of the "quadruple crisis" are (i) a mounting macroeconomic instability which periodically erupts into costly financial crises; (ii) rising food prices, hunger and malnutrition; (iii) a worsening of income inequality; and (iv) long-term environmental problems which raise the costs of the mitigation and adaptation measures needed to prevent additional personal and environmental damages. In all these areas, the search for new development approaches is in order, to deal with the crises themselves and to support the drive to achieve the MDGs.

One way to shape a new development strategy which simultaneously reaches the usual targets (adequate growth and sustainable macroeconomic balances) and the new ones (financial stability, tolerable inequality, food security, and environmental sustainability) consists in evaluating the past development strategies, so as to find out what worked and what did not, while being aware that the current conditions often differ from those under which the past strategies were developed.

How can a development strategy be characterized? Until a decade or so ago, a strategy was basically characterized by a *driving idea* (such as import substitution, market liberalization, and so on), a *small set of key policy instruments* (trade protection, monetary policy, and so on), and a limited number of *performance indicators* (the twin deficits, inflation and GDP growth). Given the four crises mentioned above, this is no longer sufficient. Any development model now needs to make explicit its *objectives, policies and indicators* also in the fields of financial and macro regulation, short-term and long-term food security, income inequality and climate change, both adaptation and mitigation. This means also designing or selecting appropriate *performance criteria* in each of these four areas. In addition, it is important to consider the *political regimes* under which the development strategies have evolved. In the case of a democratic or authoritarian regime achieving the same economic, social, environmental and inequality objectives, the former should be valued more favourably, as democracy has an intrinsic value.

4.2 Past and recent development strategies considered

We focus on seven development strategies, paying particular attention to the political regimes under which they were developed, the policies applied, and their outcomes. The distinction between "past" and "recent" development strategies is relevant, as the new policy regimes have emerged under contextual conditions that constrain domestic policymaking but also offer new opportunities. The first recent major difference in relation to the past is a generalized spread of democracy, a trend which is desirable for its intrinsic and instrumental values but which may constrain the adoption of measures that are efficient but socially costly, or that produce benefits only over the very long term. On the positive side, democracy may lead to the election of governments more sensitive to distributive and environmental issues. Other contextual conditions that have changed markedly during the last two decades include the massive liberalization of international trade and finance,

as confirmed by the drop in import tariffs and the increase in the Kaopen Index of international financial integration (table 4.1). As a result, for many developing countries the achievement of financial stability, food security and a tolerable income inequality has become more complex due to their increased vulnerability to external shocks and contagion and to the legal and economic constraints imposed by participation in the WTO, TRIPS, Basel III, Kyoto and various regional trade agreements. At the same time, the globalization of trade and finance offers an opportunity to accelerate growth thanks to greater access to export markets, technology and world savings. In addition, the 1980s and 1990s witnessed a sharp reduction in chronic

Table 4.1
Policy stance in the field of domestic and external liberalization[a], 1982-2010

Regions	1982-1990	1991-1997	1998-2002	2002-2010
A. Average Import Tariff				
South America	40.0	19.0	12.2	10.6
Central America and Mexico	46.6	18.1	8.8	7.2
Sub-Saharan Africa	26.7	24.9	14.5	13.2
MENA	29.7	21.9	17.3	16.2
South Asia	62.9	52.9	20.8	14.9
East and South East Asia	20.3	16.7	7.6	6.9
Asian economies in transition[b]	44.5	38.9	15.5	12.5
EE-FSU[c]	..	11.0	9.0	6.0
Advanced economies	8.5	7.1	3.3	4.2
B. Kaopen Index of Capital Account Openness[d]				
South America	-0.78	-0.17	0.76	1.00
Central America and Mexico	-0.84	0.29	1.18	1.67
Sub-Saharan Africa	-0.91	-0.82	-0.59	-0.56
MENA	-0.64	-0.35	0.02	0.36
South Asia	-1.29	-0.74	-0.93	-0.90
East and South East Asia	0.85	0.96	0.50	0.57
Asian economies in transition[b]	-1.75	-1.31	-1.05	-0.58
EE-FSU[c]	-1.84	-0.53	0.01	0.65
Advanced economies	0.83	1.89	2.28	2.32

Source: Cornia and Uvalic (2012) on the basis of the sources indicated therein.

Notes: a Regional un-weighted averages; b China, Vietnam, Laos and Cambodia; c concerns the entire region and not only the 11 countries covered in tables 4.3 and 4.4; d the Kaopen index varies between -2.5 (complete closure) and 2.5 (complete liberalization).

Table 4.2
Indicators of macroeconomic balance in developing regions, 1982-2010

Regions	1982-1990	1991-1997	1998-2002	2002-2010
Budget balance/GDP (deficit<0)				
South America	-5.3	-3.7	-5.1	-0.5
Central America and Mexico	-2.4	-0.8	-2.8	-1.9
Sub-Saharan Africa	-5.1	-3.9	-3.5	-0.7
MENA	-1.8	-1.9	-1.8	0.1
South Asia	-6.9	-6.2	-6.0	-4.7
East and South East Asia	0.8	4.5	-0.7	-0.2
Asian economies in transition[a]	-1.6	-1.7	-3.3	-2.5
EE-FSU[b]	-10.1	-5.3	-3.2	-1.1
Inflation (annual average rate of change)				
South America	386.3	111.7	11.7	7.6
Central America and Mexico	361.5	15.8	7.0	7.4
Sub-Saharan Africa	20.1	165.5	35.0	8.2
MENA	29.4	20.4	7.6	6.0
South Asia	10.3	9.3	5.9	8.3
East and South East Asia	6.5	5.7	5.9	3.9
Asian economies in transition[a]	69.7	26.7	14.5	6.4
EE-FSU[b]	15.0	528.2	16.6	6.7
Public debt/GDP				
South America	56.8	47.7	52.5	44.4
Central America and Mexico	111.7	121.9	66.9	49.0
Sub-Saharan Africa	93.1	105.8	105.0	69.2
MENA	62.3	89.8	72.2	61.8
South Asia	92.1	80.4	76.9	76.9
East and South East Asia	46.6	39.8	52.6	46.4
Asian economies in transition[a]	4.6	11.9	40.3	42.3
EE-FSU[b]	32.1	72.7	45.1	31.9

Source: Cornia and Uvalic (2012) on the basis of the sources indicated therein.

Notes: a China, Vietnam, Laos and Cambodia; b concerns the entire region and not only the 11 countries covered in tables 4.3 and 4.4.

macroeconomic problems, that is high budget deficits, inflation, and public debt/GDP ratios (table 4.2), which allowed policymakers to focus on growth, structural transformation and equity under open economy conditions.

In closing this section, we would like to explain why no development model for sub-Saharan Africa is included in our analysis. After the mid-late 1990s, a few African countries recorded important improvements (Radelet, 2010). According to the Polity IV and Freedom House index, the number of

democracies rose from three in the early 1990s to 20 (out of 44 countries) in 2008. In turn, growth of GDP per capita—negative over 1980-1995 in two thirds of the countries—turned positive in nearly 80 per cent of them over 1995-2010. Finally, the distribution of income improved in 13 of the 21 countries with reliable information. Yet, the sources of these gains are highly heterogeneous and mostly exogenous, and may not be sustainable over the long term (as in the case of the recent increases in commodity prices). Indeed, the recent gains can be traced to an overall improvement in the global economic environment, that is: a rise of international prices and demand for the commodities exported by the region; greater Chinese FDI; slowly rising tourist receipts and migrant remittances; and a large increase in aid. More sustainably, growth also intensified due to domestic changes like the adoption of new technologies (such as cell phones), the policy-driven diversification of the economy and better technology policies and incentives to farmers, which helped the recovery of agriculture. However, poor governance, slow growth and political instability still grip half of the continent. Thus, while there are glimmers of hope, there is no clear evidence so far that a new sustainable economic policy model has yet emerged in sub-Saharan Africa.

4.3 An analysis of seven main development strategies

Hereafter we analyse in a standard format seven development strategies on the basis of a common methodology which focuses on: their *political regimes* (that is the extent and quality of democracy, proxied by the Polity 2 and Freedom House indexes); their *economic and social policies* in the field of trade, capital account, exchange rate, tax, fiscal and monetary policy, industrial and environmental policy, labour market, human capital formation, social assistance/insurance and food security; and 11 *performance indicators* including political criteria, GDP growth rate, income inequality, structural transformation (proxied by changes in the share of industry on GDP), human capital formation, twin deficits, foreign indebtedness, resilience to shocks, food security and environmental impact. As the development strategies considered cover periods of different duration, we measure performance in all these areas not only by means of regional period averages but also—and more importantly—in terms of their average yearly rate of change so as to remove level effects. As a final step we "rate" each of the seven development strategies by summing up in an ordinal fashion their 0 (negative) or 1 (positive) scores for each of the 11 performance indicators identified above. This allows to

determine which of them performed the best and whether any one of them can inspire, *in toto* or in part, a "new development strategy" capable of addressing the current financial-food-inequality-environmental crisis which threatens the achievement of the MDGs and of sustainable development in the future.

Latin America's import-substituting industrialization (LA-ISI) strategy of the 1960s-1970s

Political trends, dominant class and driving idea

The LA-ISI model was developed under semi-democratic or military regimes (table 4.3) in which a nationalistic bourgeoisie played a major role in coordinating with state institutions decisions in the fields of production, investment and industrial development, which was considered the only approach capable of generating simultaneously growth and the modernization of the economy.

Policy approach

Industrial development was to be reached through a trade policy protecting the infant industry through quotas and tariffs averaging 45 per cent for the region as a whole (table 4.3) but reaching in some cases 200-300 per cent. Tariffs on non-competing imports were much lower, especially for investment goods and inputs. As the strategy emphasized the role of the domestic market, exports were assigned a limited role in promoting growth, while the capital account was fairly closed (table 4.4). Only FDI and, after the 1973 crisis, sovereign borrowing were allowed during this period.

Monetary policy pivoted around low or negative real interest rates (so as to promote investments), rationed credit (benefitting the modern sector) and an accommodating money supply which—in the view of its advocates—had to offset the erosion of real money supply due to a high structural inflation. A fast-growing nominal money supply and the ensuing high inflation were not seen as a major problem as long as they facilitated capital accumulation, while the difficulties faced in tax collection meant that the state relied massively on a highly regressive "inflation tax". Most countries adopted fixed nominal exchange rates which often led to a real appreciation, a contraction of non-commodity exports and the weakening of the trade balance. Trade and corporate income taxes (characterized by many exemptions) and a myriad of *ad hoc* taxes and excises generated on

Table 4.3
Political and policy regimes of the seven models

Political–policy dimensions	Index	Metric	Latin America ISI 1950-1975	East Asian Miracle 1960s-1970s	Latin America WC 1981-2002	Eastern Europe 2000-2010	Chinese model 1990-2010	Indian model 1990-2010	Latin America OERG 2002-2010
Political regimes									
Extent of democracy	Political regime		Partly democratic	Authoritarian	Military technocracy	Technocratic democracy	One party system	Democratic	Mostly Social Democratic
	Polity 2	Period average	-0.99	-3.69	**5.51**	**9.02**	-7.00	**8.74**	**7.94**
	Freedom House	Period average	1.91	2.22	1.52	1.05	3.00	1.35	1.44
Dominant class			State and nationalist Bourgeoisie	State and nationalist Bourgeoisie	Financial technocracy	Liberal and populist parties	Communist Party and new elites	Alliances of political elites and private business	Broad class alliances
Policy regimes									
Trade openness	Type of regime		Fairly closed	X promotion slow M liberalization	Free trade	Free trade	X promotion slow M liberalization	Fairly closed, slow M liberalization	Free trade
	Tariff rate (%)	Period average	45.3	5.2	15.8	6.4	16.4	30.4	9.1
Capital account openness	Type of regime		Closed	Closed	Open	Open, big exter. debt	Selectively open	Selectively open	Open
	Kaopen index	Period average	0.04	-0.24	-0.18	1.24	-1.25	-1.15	1.33
Capital controls	Extent of controls		Complete	Complete	None	None	Important	Important	Limited
	Frazer Institute Index	Period average	3.08	5.00	4.51	5.88	3.36	2.83	6.19
Exchange rate	Type of exchange rate		Fixed nominal rate	Competitive	2 corners solution	Mainly fixed	Fixed till 2005, after competitive	Competitive	Intermediate
Fiscal policy	Type of fiscal stance		Expansive	Prudent	Prudent	Prudent	Prudent	Expansive	Prudent
Industrial policy			Active, not always efficient	Active and efficient	Absent	Absent	Very active	Active	Weak or absent
Taxation policy	Extent of tax effort		Limited	Moderate	Limited, falling	Falling, flat tax	Low but rising	Rising	Rising
Labour market			Segmented	Promoted lab. intensive sect.	Regressive	Regressive	Segmented	Very segmented	Progressive
Human capital formation policy			Limited	Strong	Falling	Falling from high level	Falling from high level	Gradually increasing	Growing

(cont'd)

Table 4.3 (cont'd)

Public social expenditure		Low	High (education)	Falling	Falling	Falling	Growing	Rising
Social insurance	Type of policy approach	Dualistic, regressive	Modest	Declining, regressive	Important, regressive	Declined	Low	Growing still dual
Social assistance	Type of policy approach	Absent or limited	Community based	Absent	Absent	Modest	Modest	Rapidly expanding

Source: Cornia and Uvalic (2012) on the basis of the sources indicated therein.

Notes: The Polity2 index ranges between +10 (strong democratic institutions) to -10 (strong autocratic institutions); the Freedom House index varies between 1 (free), 2 (partly free) and 3 (not free); for the Kaopen index see the notes to table 4.1; the index of controls on the international capital movements ranges from 0 (total controls) to 10 (no controls). A bold number indicates an acceptable degree of democracy. See note 2 for the countries in Eastern Europe.

average a low 10 per cent of GDP, as hardly any tax was levied on personal income and wealth. At the same time, industrial subsidies placed a large burden on the state budget and raised the deficit, which was financed by means of the seigniorage, "financial repression" or foreign borrowing at variable interest rates.

In addition to tariff and non-tariff barriers, industrial policy supported the infant industry by means of subsidized inputs and credit, the creation of infrastructure, an overvalued exchange rate, and low food prices so as to keep real industrial wages low. However, this approach entailed large budgetary outlays and affected allocative efficiency, which was further exacerbated by limited competition among domestic firms. As energy saving and environmental protection had not become a global priority, no policies were launched in these areas.

Workers in the modern sector were covered by collective bargaining and social insurance and enjoyed fairly high salaries relative to GDP/capita, while the workers in the informal and rural sectors had low earnings and no insurance coverage. With few exceptions (Chile, Costa Rica and Uruguay), welfare improvements were inferior to those achieved in other regions or obtainable on the basis of available resources. In addition, while in South-East Asia the anti-rural bias of the ISI approach was in part offset by a progressive land reform and rising rural school enrolments, such measures were conspicuously absent in the ISI-LA model.

Economic, social and environmental outcomes

It is beyond question that the ISI strategy led to 20-25 years of an almost uninterrupted GDP growth averaging 5 per cent a year, a diversification of production structure, technological upgrading, and an expansion of the

Table 4.4
Comparison between the economic, social and environmental outcomes of seven development strategies

Policy area	Index	Measure	Latin America ISI 1960s-1970s	EastAsian miracle 1960s-1970s	Latin America WC 1981-2002	Eastern Europe 2000-2010	Chinese model 1990-2010	Indian model 1990-2010	Latin America OERG 2002-2010
Fiscal performance	Budget deficit/GDP	Period average	**-2.00**[a]	**-0.20**[b]	-3.80	-3.10	**-2.00**	-7.60	**-1.10**
Current account balance	CA/GDP	Period average	**-1.60**[a]	..	-3.80	-5.50	**3.60**	-1.00	**-1.20**
Foreign Debt	Stock of foreign debt/GNI	Period average	32.30	40.00	76.50	70.50	13.60	23.10	44.40
		Yearly variation	2.00	1.22	0.55	5.22	**-0.31**	-0.52	**-4.85**
Growth performance	GDP growth[c]	Yearly % change	**5.00**	**9.10**	2.40	**4.00**	**9.90**	6.50	**4.50**
Income inequality	Gini Index	Period average	47.40	32.30	50.30	29.80	37.10	33.10	51.80
		Yearly variation	0.04	**-0.34**	0.22	0.19	0.87	0.26	**-0.57**
Human capital formation	Years of education (people 25+)	Period average	3.61	4.84	5.82	10.92	6.39	3.63	7.25
		Yearly variation	0.08	**0.11**	**0.10**	0.05	**0.13**	0.07	**0.10**
Structural transformation	Industry VA/ GDP	Period average	31.80	29.70	31.70	31.60	46.00	26.90	31.50
		Yearly Variation	**0.27**	**0.89**	-0.03	-0.44	**0.27**	-0.03	0.04
Resilience to shocks	Years of GDP growth <0 / n years	Ratio (%)	**7.10**	**3.50**	22.20	11.60	**0.00**	0.00	**8.70**
	Mean drop when GDP growth < 0	Period average	-4.56	-2.79	-3.79	-7.72	0.00	0.00	3.03
Environmental impact	C02 emissions/ GDP (Kg/1 million $)		**0.57**	**0.74**	**0.66**	2.10	3.58	2.49	**0.67**
Food security	Calories per capita/day	Period average	2,282	**2,660**	**2,469**	**3,140**	**2,834**	2,296	**2,599**
	Protein per capita/day	Period average	60.9	**70.4**	**65.1**	**91.7**	**80.9**	55.2	**70.7**

Source: Cornia and Uvalic (2012) on the basis of the sources indicated therein.

Notes: a refer only to Argentina, Brazil, Chile, Mexico and Venezuela; b refers to the Republic of Korea only; c the growth rates for the Taiwan Province of China are from ERS International Macroeconomic Dataset. Bold numbers indicate "positive" outcomes. See not 2 for the countries in Eastern Europe.

industrial base (table 4.4). Growth was also relatively stable, as only 7.1 per cent of the country/years recorded negative growth rates. While the tax, fiscal and monetary policies accommodated (or led to) high rates of inflation, the budget deficit averaged a modest two per cent of GDP (table 4.4) though the foreign debt grew by two GDP points a year. Finally, despite a widespread overvaluation of the exchange rate, the current account deficit remained manageable, while banking and currency crises were not allowed to come into the open due to a widespread "financial repression".

An important achievement of the ISI policy was a sizeable increase in the industry share in total output (table 4.4), though this objective was at times achieved at the cost of microeconomic efficiency. The results in the field of education were similarly unbalanced, as an increase in the level of education of industrial workers went hand in hand with a neglect of rural education and a narrow approach to secondary and higher education.

Income inequality stagnated at a high level, as the ISI strategy did not try to reduce the high concentration of land and human capital, "curse of natural resources" and urban bias of public policy affecting the region. Thus, despite a robust growth and a non-negligible structural transformation, inequality rose with the partial exception of Argentina, Costa Rica and Uruguay. Due to the ISI's urban bias, rural incomes stagnated while access to the land remained problematic for millions of landless peasants. Thus, food security remained precarious both because the average availability of calories and proteins rose slowly (table 4.4) and due to a persistently skewed distribution of income. Finally, given the low initial level of consumption per capita and industrial development, even a robust growth caused a modest environmental contamination and CO_2 emissions (table 4.4).

The development strategy of the East Asian Miracle (EAM)

Political trends and dominant class

The EAM evolved under authoritarian regimes which promoted a "shared growth" approach and so counted on the support of the middle class. Its success also depended on the competence of the bureaucracy and on the creation of institutions to ease the coordination problems among firms and with the state. Johnson (1982) argued that the EAM success was due to the combination of some of the best features of both the capitalist and socialist systems, and avoidance of the major weaknesses of each.

Policy approach

Trade policy in the region changed around the mid-1960s when governments devalued the national currency and targeted a competitive exchange rate, selective exports were subsidized, the protected firms were asked to export a quota of their output, and general trading companies were created to promote the exports of small firms (World Bank, 1993, table 1.5). Import tariffs were gradually reduced to an average 5 per cent (table 4.3) except for sectors facing a strong foreign competition. As a result, the share of the EAM countries in world manufacturing exports rose from 1.5 per cent in 1965 to 5.3 per cent in 1980. The capital account was broadly closed. In spite of this, capital accumulation was very rapid thanks to a high savings rate and a policy of "financial restraint" (Hellman, Murdock and Stiglitz, 1997).

Monetary policy targeted an inflation rate of 5-10 per cent, low positive real interest rates on deposits, deposits insurance and limits to the maximum interest rate on loans (World Bank, 1993). Governments maintained a tight control of the banking systems, actively mobilized domestic savings and channelled credit on a preferential basis to key industries. The fiscal and monetary stance aimed at ensuring macro stability and avoiding the accumulation of public debt. Budget deficits rarely exceeded 2 per cent and seigniorage 1-2 per cent of GDP. In the early years the governments imposed steep wealth taxes, but later avoided placing too heavy a tax burden on firms. A key feature of the EAM model was a selective industrial policy focusing on "picking the winners" (steel, shipbuilding, and so on) and supporting them by means of tariffs, preferential credit allocations, investments in research and infrastructure, imports of technology and pro-FDI incentives. While industrial policy can cause efficiency problems, the EAM countries limited the costs and duration of such interventions and withdrew support when the targets were not achieved (World Bank, 1993). As there were no major environmental concerns, public policy did not adopt specific measures in this area.

The Taiwan Province of China and the Republic of Korea enacted equalizing land reforms and promoted the development of rural infrastructure thus broadening the market for simple consumption goods. Labour policies emphasized the creation of new jobs rather than wage increases while social insurance remained undeveloped (in the Republic of Korea unemployment insurance was introduced only after the 1997 crisis). Social benefits were modest as families were given the role of being the main welfare providers. Meanwhile, full employment and fast and egalitarian GDP growth reduced

poverty and the need for anti-poverty transfers. All EAM countries allocated considerable resources to human capital formation, in particular secondary and higher education on science and technology. As a result, the number of scientists per 100,000 people reached levels 3-5 times higher than those of other countries with similar GDP/capita.

Economic, social and environmental outcomes

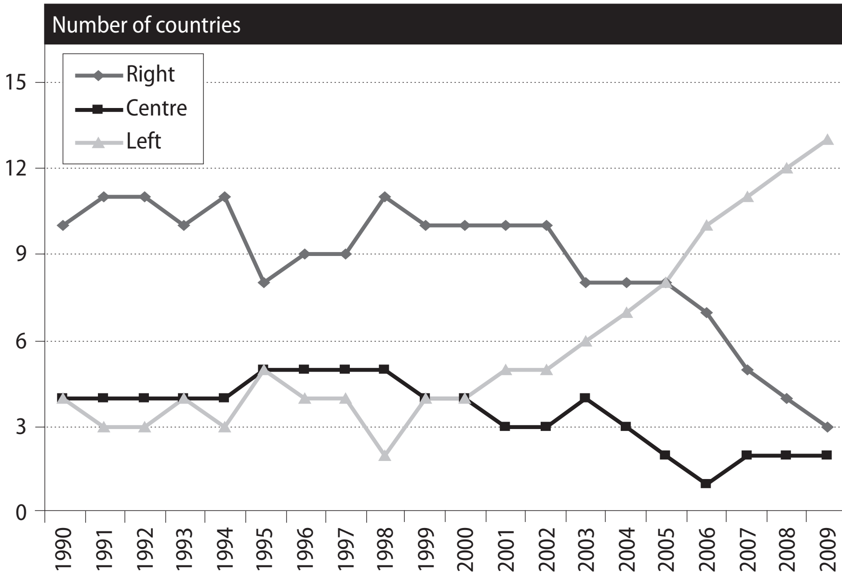
Though some economists have criticized the "extensive nature" of the EAM pattern of growth, most of them agree that it generated excellent results in many areas (Wade, 1992). Growth averaged over 9 per cent a year (table 4.4) while cyclical fluctuations were minimal (Wade, 1992). Inflation remained below 10 per cent, the average budget deficit was small, the current account balance was in most cases positive, and the public debt/GDP ratio rose by a tolerable 1.2 points a year (table 4.4). Banking and financial crises were rare. Fast growth was accompanied by an equally rapid change in the structure of output and exports and technological upgrading, as shown by 0.89 points average surge per year in the share of industry in GDP (table 4.4) which turned these economies into very efficient manufacturers in just two decades, also thanks to the 0.11 points annual increase in the average years of education of the labour force (table 4.4). Another important achievement was a decline of inequality from already low levels. In the Taiwan Province of China, for instance, the Gini coefficients fell from 0.32 to 0.28 between 1964 and 1980 thanks to a rapid expansion of employment for both low-skilled and well-educated workers. Meanwhile, rapid growth and supportive food prices and input policies reduced the urban bias of public policy. As a result, average food availability per person/day rose to 2660 calories and 70.4 grams of proteins, which, combined with reduced income inequality, ensured a broad-based access to food by most people. Though the attention to environmental issues was modest, the carbon emissions per one million US$ of value added remained low (table 4.4), signalling a fairly efficient energy use.

Latin America's Washington Consensus (LA-WC) of 1981-2002

Political trends and dominant class

During the 1980s and most of the 1990s, the political landscape in Latin America was dominated by authoritarian and military regimes, particularly in the Southern Cone and Central America. Even after the return to

Figure 4.1
Trend in the political inclination of the governments of 18 Latin American countries, 1990-2009



Source: Cornia (2011).

democracy, the traditional parties and the new élites retained control of political life (figure 4.1). Such a model differed from the prior LA-ISI, as it focused on macro stabilization and liberalization and neglected growth, structural change and inequality.

Policy approach

Trade liberalization reduced tariffs from 45 per cent during the two prior decades to 15 per cent over 1980-2002 while quantitative restrictions were reduced even more. A similar, if less marked, liberalization concerned the capital account, as suggested by the Kaopen and the Frazer indices (tables 4.1 and 4.3). The LA-WC strategy focused on reducing the budget deficits and high inflation inherited from the LA-ISI regime and on tackling the debt and fiscal crises of the early 1980s. Yet, the deficit was not reduced through a rise in low tax/GDP ratios but by means of cuts in public expenditure which depressed growth and revenue collection, leading in this way to an "illusory adjustment", as the deficit widened again in line with the adjustment-induced slowdown of GDP (Perry and others, 2008). Trade taxes were

replaced by VAT and other consumption taxes, while personal income tax was reduced or abolished (Cornia, 2012). Monetary policy remained pro-cyclical as inflation was controlled through changes in the money supply, rises in interest rates, constraints to credit expansion and the adoption of fixed nominal exchange rates. As a result, after peaking in the 1980s and early 1990s, during the rest of the decade inflation fell to 7-11 per cent (table 4.2). Though contributing to rapid disinflation, the fixed pegs unavoidably entailed an appreciation of the real exchange rate, a loss of competitiveness, rising unemployment, job informalization, wage compression, and rising current account deficits which were offset by FDI or portfolio inflows.

Particularly in the authoritarian Southern Cone regimes, public policy reduced the scope of collective bargaining, relaxed regulations on dismissals, suspended wage indexation, and reduced minimum wages. These measures severely affected jobs creation, unemployment, job informality, average wages (table 4.5), and the coverage of social insurance. The 1980s and 1990s also witnessed the launch of semi-autonomous Social Emergency Funds (SEF) aimed at compensating the "adjustment poor" by means of income-maintenance programmes. However, these programmes had a limited impact on the number of unemployed and "adjustment poor" (Cornia 2001). The LA-WC model did not adopt any industrial policy which was thought would distort resource allocation. As a result, tariffs were reduced sharply and state subsidies cancelled. Though problems due to climate change had been gradually accumulating, between 1980s and 2000 no high-profile environmental policies were launched in the vast majority of the countries of the region.

Table 4.5
Labour market trends for the Latin America region as a region, 1990-2009

	Activity rate (% of pop. of 15-64 years)	Unemployment rate (%)	% wage earners on total workers	% formal sector workers	Wage	
					Average monthly wage (constant 2000 US dollars)	Informal/ Formal sector
1990	61.0	6.2	62.6	55.0	384	0.54
2002	63.0	10.7	60.9[a]	52.8	397	0.43
2008	64.7	7.3	63.7	50.3	421	0.46
2009	64.3	8.2	63.2	50.7	434	0.47

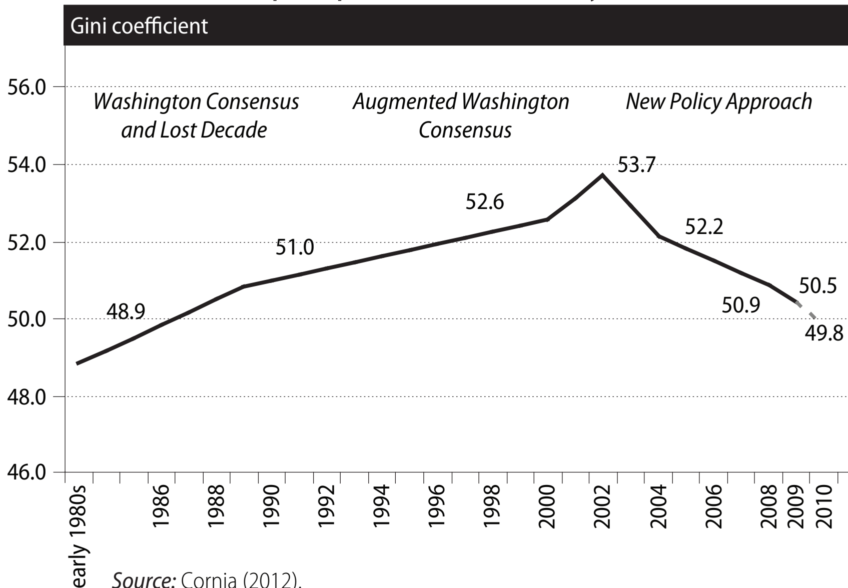
Source: Cornia (2012).
Note: a refers to 2000.

Economic, social and environmental outcomes

The LA-WC model generated a few positive results but worsened the situation in several areas. During the entire 1981-2002 period the regional GDP growth fell to 2.4 per cent per year (table 4.4), that is, below that achieved during the LA-ISI (5 per cent). In addition, the investment/GDP rate declined on average by 2-3 points. The region also experienced a high growth volatility and low resilience to crises, as 22 per cent of the country-years recorded negative growth. In addition, despite the strong emphasis placed on macroeconomic stabilization, the achievements in this area were modest (tables 4.2 and 4.4): the twin deficit hardly declined, the public debt/GDP ratio rose by 0.55 GDP points per year and so did the foreign debt/exports ratio. In addition, a botched domestic and international financial liberalization raised the number of banking, financial and stock market crises, which demanded huge and un-equalizing injections of state funds to prevent a collapse of the banking system. Indeed, the greatest failure of the LA-WC regime consisted in its poor results in re-establishing macroeconomic stability.

Unlike during the LA-ISI and EAM strategies, the share of industry in GDP declined, thus reversing earlier gains in terms of economic diversification

Figure 4.2
Trend in the average Gini coefficient of the distribution of household income per capita, Latin America, early 1980s to 2010



Source: Cornia (2012).

towards well-paid and higher-tech manufacturing jobs (table 4.4). In contrast, despite cuts in public expenditure on human capital formation, the number of years of education of the population of more than 25 years increased annually by 0.1 years, though this mainly reflected efforts carried out in prior decades. The 1980s and 1990s recorded also a drastic increase in already high levels of inequality (figure 4.2). On average, the Gini coefficient of the distribution of income rose by of 2.3 Gini points during the 1980s, and by 2.5 points between 1990 and 2002 (figure 4.2). The slow growth of these two decades, and a policy approach which focused almost exclusively on macro issues and neglected agriculture, did not increase a low average calories and protein supply per capita. In addition, stagnation in incomes per capita and a worsening of income distribution generated no improvement or an increase in the rate of malnutrition. Meanwhile, with slow growth of output and incomes, the carbon emissions per unit of GDP remained low.

The neo-liberal approach followed in Eastern Europe in 2000-2010

Political trends and dominant class

The last decade in Eastern Europe (EE)[2] saw a further consolidation of democracy. Populist and liberal parties dominated the scene, while social-democratic parties remained marginal. The region quickly moved from being highly egalitarian to being highly segmented, while the middle class was hollowed out and only the "new rich" enjoyed most benefits of liberalization and privatization.

Policy approach

During the 2000s, trade liberalization cut average import tariffs to 6.4 per cent while the exports/GDP ratio rose to over 50 per cent in most countries. Trade diversification was facilitated by the arrival of multinationals that restructured many firms and secured export markets. Financial liberalization was marked, as the capital account was liberalized for all types of inflows. The privatization of banks led to a dominance of foreign ownership which often exceeded 90 per cent of total assets. Increased cross-border borrowing contributed to a surge in foreign indebtedness which by October 2008 exceeded 90 per cent of GDP in Latvia, Estonia, Slovenia, Bulgaria and Hungary.

The priority given to macroeconomic stabilization kept inflation low by means of high interest rates and the use of the exchange rate as an anti-

inflation anchor. Although exchange rate regimes varied greatly[3], the exchange rate policy was seldom used for promoting exports, as a tight monetary policy in combination with increasing capital inflows often led to the appreciation of national currencies. Only the countries with more flexible exchange rates were able to adjust to external shocks, including the recent ones (Nuti, 2009). A cautious orthodox approach kept public deficits low until recently, while the public debt remained substantially lower than in other regions. Tax policy simplified tax regimes, lowered tax rates, and pivoted around fairly low VAT and flat-tax rates for both personal and corporate income (Cornia, 2011). None of these countries implemented a pro-active industrial policy, and enterprise restructuring and technological upgrading were carried out mainly when state enterprises were purchased by foreign investors (Kolodko and Nuti, 1997). The environmental problems inherited from the communist era were reduced in part, but CO_2 emissions per unit of GDP remained among the highest in the world.

After the sharp increase in unemployment recorded in the 1990s, some improvements took place during the last decade. Yet, labour market policies remained weak: only some categories of workers qualified for unemployment benefits, the minimum/average wage ratio stagnated in many countries (Cornia 2011), consultation with the unions remained sporadic, and the coverage of collective agreements and trade union membership declined (Giannetti and Nuti, 2008). Social differentiation grew further and inequality rose, though less than in the 1990s and in China or India (table 4.4). Privatization benefitted only a small group, while the introduction of user fees in formerly free public services and greatly reduced social transfers contributed further to social polarization.

Economic, social and environmental outcomes

These policies led to fast GDP growth and, until recently, low inflation and fiscal deficits, but fared poorly in most other areas. A pattern of growth based on strong FDI inflows, fast expansion of bank credit and increasing foreign borrowing raised the vulnerability of the EE economies to external shocks (Nuti, 2009) as already observed in Latin America in the 1980s. Furthermore, a rigid approach to macro policies reduced the space for fiscal, monetary and exchange rate adjustments to respond to external shocks, including on occasion of the sudden stop of capital inflows in 2009-2011.

Growth based on liberalization, privatization and FDI led to rapid deindustrialization and the fast expansion of services. In addition, the cuts in public expenditure caused a slowdown in human capital formation.

Though the average years of education remained by far the highest among the models considered, the average annual change indicates that the rate of improvement was the slowest of all analysed strategies. The liberal approach also had an impact on inequality, which, despite considerable GDP growth, continued to worsen during the 2000s, exacerbating popular dissatisfaction (EBRD, 2006). Meanwhile, the policy of real appreciation favoured massive food imports at the expense of local production, but food security was not a problem (indicators in this area remained the best among the seven models considered). Finally, the carbon emissions/GDP ratio remained the third highest among the seven strategies considered (table 4.4).

The Chinese export-led, mixed-economy approach between 1990-2010

Political trends and dominant class

Regional decentralization has limited the power of the central government, but the Communist Party still retains strong control over much of the economy, as power is in the hands of the communist elite in close alliance with a new bourgeoisie of "red-hat capitalists" (Bardhan, 2010). Decentralization has also led to the creation of local alliances between the bureaucracy and businesses, as about one third of private entrepreneurs are members of the Communist Party. Meanwhile, a few state-owned enterprises are controlled by powerful political families (Bardhan, 2010).

Policy approach

China substantially opened up its economy after joining the WTO in 2001, though average tariffs remained relatively high, at 16 per cent. Capital controls have remained important as China opened its capital account selectively, primarily to FDI (table 4.3). This approach has prevented the entry of short-term speculative inflows as well as free capital outflows, with the result that China recorded a surplus on both the current and capital account over much of the past two decades. However, such surpluses were not used to import capital goods, technology or managerial skills but to buy US treasury bonds, making China a capital-exporting country (Yongdin, 2006). A restrictive monetary policy kept inflation under control. Since 1995, China officially adopted a managed floating exchange rate, although the currency until 2005 was *de facto* pegged to the US dollar. Thereafter

the central bank allowed greater exchange rate fluctuations, which led to a strong currency appreciation. A prudent fiscal policy kept the average fiscal deficit at 2 per cent over the period considered. The tax burden has been relatively low, though rising after 2000. Since 1994, a marked reform of the tax system centralized revenue collection and allocation, but centre-local fiscal relations have not been effective in reducing income disparities across provinces.

China has applied a highly interventionist industrial policy. Though half of the GDP is generated by the private sector, the state still controls important industries (Wu, 2011). Export-led growth has been promoted through special economic zones, incentives to export-oriented firms, and incentives to FDI (low tax rates, tax rebates, long tax holidays, low or negative rents on use of land, and so on). The state-owned banks played a crucial role in industrial finance and have been at the service of a state-directed industrial policy. FDI traditionally concentrated in capital-intensive projects, large-scale infrastructure, high-tech and service industries, though recently policy has emphasized the promotion of research and development, high quality education and biotechnology. Energy-intensive industries still dominate the economy, presenting great challenges to decoupling CO_2 emissions from growth.

China has a dualistic economy and a segmented labour market. The new 2008 labour law partially secures the tenure of long-time workers. At the same time, the post-1994 tax reforms reduced the capacity of local bureaucracies to serve social needs. Schools and hospitals have been commercialized to such an extent that the poor are often priced out of social services (Bardhan, 2010). The decline of basic services, inadequate fiscal transfers and high fees reduced substantially access to social services, particularly for the poor. In a rather short period of time, China essentially moved from one of the most impressive and egalitarian social-service systems to an effectively privatized system (Bardhan, 2010: 106-9).

Economic, social and environmental outcomes

The Chinese model has produced a very high growth rate of GDP and considerable macroeconomic stability, but also rapidly increasing inequality and environmental degradation. Despite China's growth integration itno the world economy, high foreign reserves have protected it from external shocks. China has a low foreign debt which shrank over the last 20 years. Rapid structural transformation has taken place through fast industrialization and exports growth. Human capital formation has

been falling from medium-high levels, however, due to a drop in public expenditure, though there have been improvements in some areas, as for the years of education of people above 25 (table 4.4). As noted, China also experienced a very rapid increase in income inequality. China does not face a major food problem, as its food indicators have been better than in India and slightly better than in Latin America (table 4.4). Since China relies on coal to meet 70 per cent of its commercial energy needs (compared with 16 per cent in Europe), its CO2 emissions per unit of GDP are the highest of all models considered (table 4.4).

The Indian service-oriented approach over 1990-2010

Political trends and dominant class

India is one of the oldest democracies in the world, but it is also one of the most fragmented societies in terms of language, religion, caste, and ethnic divisions. The Congress Party used to coordinate negotiations among different political groups but with time has lost power. The old rent-sharing equilibrium has changed in favour of a capitalist class which operates in close cooperation with the political elites while local level democracy is inadequately developed and corruption remains widespread (Bardhan, 2010).

Policy approach

Trade liberalization was introduced following India's entry in the WTO in 1995, with the removal of quotas, a reduction in import tariffs and the abolishment of restrictions on FDI (except for financial services, the media and retail trade). Nevertheless, average tariffs remained at over 30 per cent (double those in China) over the 20-year period considered (table 4.3). India's trade/GDP ratio increased from 16 per cent in 1990-91 to 45 per cent in recent years, thanks also to fast-growing exports of information technology services which have attained a world reputation, though they employ less than half a per cent of the total labour force (Singh, 2009). The liberalization of capital outflows has been gradual and restrictions on foreign purchases of Indian bonds, resident outflows and corporate borrowing remain in place. Yet, the opening up has raised external dependence, leading to growing current account deficits.

A conservative monetary policy has kept inflation low, though after 2007 it rose to 12 per cent by 2010. The central bank has heavily managed the exchange rate and only recently has allowed some flexibility to absorb

pressures from capital inflows. The monetization of government deficits was frequent in the past, but it was discontinued after 2003. Since official lending rules have remained rigid, India has one of the highest costs of financial intermediation in the world and private firms pay interest rates twice as high those charged in China. Tax reforms undertaken in the 1990s have significantly lowered and restructured direct and indirect taxes. Expansionary fiscal policies have produced an average 7.6 per cent budget deficit/GDP ratio over the 20-year period and a public debt of 75 per cent of GDP (table 4.4).

India's industrial sector has traditionally been heavily regulated (Bardhan, 2010). Private firms have played a subsidiary role with respect to strategic state enterprises which were supported through regulated interest rates, preferential credit allocations and the licensing regime. Though many restrictions were abolished, the government still holds considerable power over new firms in getting land, water and electricity connections and environmental clearances. Important bottlenecks remain in infrastructure, with serious underpricing of water, electricity, fertilizers, and domestic fuels. Pollution, degradation and over-exhaustion of soils has led to declining quality of cultivable land and to crop failures. Measures to control environmental degradation so far have been modest.

Caste, religious and gender-based discrimination are behind a highly segmented labour market where employment opportunities and wages differ dramatically across social categories (Ghosh, 2010). Restrictive laws on hiring and firing labour limit employment in labour-intensive manufacturing, preventing a shift of the labour force out of agriculture (Singh, 2009). Only 15 per cent of the population has any health insurance and the share of out-of-pocket spending on health care exceeds 70 per cent (Bardhan, 2010). Social services remain of low quality, so people frequently turn to private providers. No major improvements have taken place in literacy, educational attainment and infant mortality (Ghosh, 2010).

Economic, social and environmental outcomes

India's development strategy has led to fast economic growth and considerable resilience to external shocks. However, the pre-2008 economic boom was dependent upon exports of services, capital inflows and the role these played in underpinning a domestic credit-fuelled consumption and investment boom (Ghosh and Chandrasekhar, 2009: 725). Since 2008, macroeconomic stability has been endangered by increasing inflation and rising fiscal deficits.

Despite important structural changes, there was no major reallocation of the labour force to higher productivity and better remunerated activities. Agriculture continues to account for well above half of the total workforce, even though its share of GDP is now less than 15 per cent (Ghosh 2010). Human capital formation has remained dismal while the delivery of essential social services has become highly non-egalitarian. India scores worst, among all policy regimes, regarding the years of education of people over 25 (table 4.4).

The impact of growth on poverty reduction has been weaker in India than in China, due to less favourable initial conditions, greater land, education and social polarization, and slower growth. The increase in wage inequality is also consistent with the mounting skill-intensity of India's growth pattern (Singh 2009). Malnutrition remains a serious problem; food indicators are the worst in comparison with the other models analysed (table 4.4). Coal still accounts for 53 per cent of commercial energy demand in India, so the CO_2 emissions per unit of GDP is the second highest among the policy models analysed while environmental degradation, particularly in agriculture, remains high (Bardhan, 2010: 16).

Latin America's "Open Economy Redistribution with Growth" (LA-OERG) model, 2002-2010

Political trends and dominant class

During the last fifteen years, Latin America witnessed a return to democracy, its consolidation and a shift towards left-of-centre regimes (figure 4.1) which placed growing attention on social justice while following a prudent approach to macroeconomics. In most cases, policy was consistent with the "Redistribution With Growth" model (Chenery and others, 1974) rather than with the more radical "Redistribution Before Growth".

Policy approach

The free trade measures adopted in the 1980s and 1990s were not overturned and any remaining anti-export bias was eliminated (tables 4.1 and 4.3). However, there was an increase of trade within the region and with East Asia. The region also sustained the openness of the capital account (though controls on portfolio flows were introduced in some countries), external indebtedness was reduced and currency reserves soared. Most

countries introduced stricter regulations of their banking system, while assigning to state banks a greater role in the financing of economic activity.

As for the macroeconomic policy, during periods of bonanza the authorities controlled the expansion of money supply through the accumulation of reserves and sterilization, while during the crisis of 2008-9 they adopted counter-cyclical monetary and fiscal policies. Most countries abandoned the fixed peg regimes and opted for a managed exchange rate (table 4.3). However, in spite of these measures, the extra-regional real exchange rate appreciated by 4.8 per cent for the period as a whole owing to export bonanzas, capital inflows and remittances. The last decade witnessed also an intensification of past efforts at reducing the budget deficit by raising progressive income taxes, taxing the informal economy, introducing a financial transaction tax and making excises less regressive.

The OERG model has generally lacked an explicit industrial policy. At the same time there was an increase in investments in human capital, focusing in particular on secondary education and on the children of the poor (Cornia, 2012). Despite an already significant impact of climate change (Vergara, 2007), the region has not yet developed a low-carbon development strategy, and sooner or later might face a trade-off between GDP growth and CO_2 emissions.

Public policy explicitly addressed the problems inherited from the LA-WC regime by strengthening wage bargaining, formalizing employment, expanding social security coverage and raising minimum wages (table 4.5). Social expenditure continued the upward trend initiated in the 1990s (table 4.3), while its incidence became more progressive. In addition, all countries introduced progressive social assistance programmes (social pension, cash transfers, employment schemes) costing 0.2-0.8 per cent of GDP (Cornia, 2012).

Economic, social and environmental outcomes

The OERG model appears to have generated positive results in all but one area. It produced a satisfactory GDP growth of 4.5 per cent a year (table 4.4) driven in part by higher world commodity prices and a rise in the investment/GDP ratio. Though the region avoided a financial crisis in 2009, GDP decelerated on average by 3 percentage points despite greater export diversification and improved financial regulation. Improvements in growth, investments and food security were achieved in a context of low inflation and twin deficits (table 4.4) and the near absence of banking crises, while the gross foreign debt declined on average by 4.45 points of GNI a

year. However, with the exception of Argentina and Mexico, the share of industry on GDP did not increase (table 4.4) owing to continued pressures on the real exchange rate and a weak industrial policy, fuelling fears about a possible re-primarization of production and exports (Ocampo 2012).

One of the key achievements of the OERG model was a 4-point decline in the Gini coefficient (figure 4.2) due to an improved distribution of human capital among workers, a rise in minimum wages and transfers, better macro policies and more progressive taxation (Cornia, 2012). Average calories and protein availability per person/day rose to acceptable levels (table 4.4). While still widespread in Central America, the incidence of malnutrition fell due to rising incomes, a better income distribution and the subsidies introduced to head off the food crises of 2007-8 and 2010. Carbon emissions per unit of GDP remained lower than in other continents (table 4.4). However, the region contributes 25 per cent of all carbon sink losses due to deforestation in Brazil and Mexico.

4.4 Comparing and ranking the seven development models

The above review shows that all development models analysed produced positive results in some areas but that as a whole the East Asian EAM and Latin America's OERG models generated a greater number of positive outcomes,[4] that is, ten out of eleven in the latter, and eight out of ten in the former (for which it was impossible to obtain current account data).[5] Obviously, both regions are heterogeneous, and approaches varied among subgroups within each of them. Yet, these results are broadly in line with the discourse of the literature about the development impact of the strategies analysed.

Be that as it may, both the OERG and (especially) EAM strategies generated a fast GDP growth, falling inequality, a rapid accumulation of human capital, current account equilibrium (less so in the EAM), resilience to external shocks, low fiscal deficits and public debt (in Latin America), limited carbon emissions per unit of GDP and an improvement in food security. However, the EAM model set into motion a deeper industrial transformation than in Latin America. Moreover, the EAM's exceptional results were achieved under conditions of limited import liberalization, closed capital account, and freedom to conduct an active industrial policy, options now precluded for the Latin American countries. Furthermore, while the EAM model produced

on the whole socially progressive results, its policies were designed under authoritarian regimes which suppressed individual and collective freedoms. If these two factors are taken into account, then the LA-OERG model appears marginally superior to the EAM. Yet, the OERG strategy has failed to promote an evolution of the industrial structure and it remains to be seen if it can do so in the years ahead.

The data in tables 4.3 and 4.4 show also that as a whole the LA-OERG model performed better than the LA-WC strategy which recorded positive results only in four areas out of eleven while doing poorly in terms of growth, inequality, macroeconomic balance, foreign debt, structural change and resilience to shocks. In addition, in several years of the LA-WC experiment, democracy was suppressed. The LA-OERG model also appears to have achieved better results than the LA-ISI which did reasonably well in the field of budget and current account balances, structural transformation, growth, resilience to shocks and carbon emissions, but failed in terms of inequality, human capital formation, food security, debt accumulation and, in part, democratic governance.

One of the interesting findings of the analysis is that both the EAM and LA-OERG strategies did better than the celebrated "Chinese export-led" and "Indian service-oriented" models. The remarkable achievements of these two large countries are no doubt some of the most positive news in recent economic history. However, both countries recorded a fast rise in income inequality (at 0.47 China's Gini coefficient is now higher than those of Uruguay and Argentina), small or no gains in the field of health and social assistance, and rising environmental contamination. In addition, in China such achievements were obtained under a non-democratic (if slowly evolving) political regime. Finally, both the LA-OERG and EAM strategies (as well as the Chinese and Indian development strategies) appear to have over-performed the neo-liberal model adopted by 11 countries of Eastern Europe (EE-11). This was particularly true in most macroeconomic areas, inequality, human capital formation, structural transformation, resilience to external shocks and environmental impact.

Summing up, this paper suggests the following ranking of the seven development strategies: (i) LA-OERG (10/11, or 91 per cent success rate), (ii) EAM (8/10, 80 per cent),[6] (iii) Chinese model (8/11, 73 per cent), (iv) LA-ISI (6/11, 55 per cent); (v) Indian model (5/11, 45 per cent), (vi) LA-WC (4/11, 36 per cent) and (vii) EE-11 (3/11, 27 per cent). Despite its many limitations,[7] our comparative approach provides some indications about the nature of the development strategies which could be followed to achieve the MDGs

in the post-2015 era, while avoiding being trapped in the food, financial, inequality and environmental crises. As noted, the most suitable option could be a reformulation and update under democratic and open economy conditions of the East Asian model, the Latin America OERG model and, to some extent, the Chinese model. Yet, each of them requires adjustments to respond to new challenges, particularly in the field of climate change.

Notes

1 The authors would like to thank José Antonio Alonso, Frances Stewart and a few members of the UN Committee for Development Policy for their insightful comments on a prior version of this paper, as well as Bruno Martorano for his comments and assistance in compiling the empirical material included in this paper. The usual caveats apply.

2 The 11 countries in Eastern Europe are Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia and Ukraine. Although Ukraine differs in many ways from the other countries, it was included because it faced similar external constraints in the 2000s as most countries in this group, particularly regarding the growing current account deficit/GDP ratio.

3 Slovenia, Slovakia and Estonia have introduced the euro; Latvia, Lithuania, and Bulgaria have a currency board, Ukraine has adopted a dollar peg, while the Czech Republic, Hungary, Poland and Romania have a managed float.

4 The criteria used to consider as "positive" a given outcome are the following: budget and current account deficit smaller than 2 per cent of GDP; growth rate of GDP greater than 4 per cent; income inequality: a negative yearly variation; structural transformation: a yearly variation greater than 0.1 per cent; resilience to shocks: number of years with negative growth smaller than 10 per cent; Kg of carbon emissions per 1 million US$ of value added smaller than 1; food security: calories and proteins availability respectively greater than 2450 and 65 grams.

5 The simple ordinal approach used to rank the seven development strategies in table 4 consists in assigning 0-1 scores to each of the 11 indicators (10 economic and social and one political) listed in tables 3 and 4, and in dividing the number of positive outcomes (on the basis of the thresholds described above) by 11. This implies that each outcome is assigned the same weight, a choice which may bias the ranking. In addition, this ordinal approach neglects "how positive" was the performance of each strategy. For instance, the 4.5 per cent GDP growth of the OERG model and the 9 per cent of the Chinese model are assigned the same "1" value, as both exceed the threshold of 4 per cent. However, while numerically feasible, the adoption of a cardinal approach (such as that used for calculating the HDI) would require the adoption of similarly arbitrary hypotheses about the scaling of the various performances (which requires setting a theoretical minimum and maximum for each of the performance indicators). Also any HDI-type approach faces a number of well-known problems. In view of all this, the results of our analysis have to be taken with a pinch of salt.

6 The current account criteria in this case is not considered because of the lack of data for the years considered.

7 A limitation of our evaluative approach is that we do not consider explicitly, as mentioned in the introduction, the impact of changes in world market conditions on the policies adopted and the outcomes achieved by the seven development models analyzed. A second problem is that it is unclear how sustainable would our three most successful models (OERG, EAM, China) be in the future. The weak points of each of them (lack of an industrial policy in the LA-OERG example, impossibility to use selective trade policies for the EAM, and the continued repression of domestic consumption in the case of China) were duly highlighted in the paper but may derail these entire policy approaches in the future.

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Chapter 5
Towards climate-compatible and resilient development

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5.1 Introduction

Among the environmental problems related to global socioeconomic development, climate change may well be the main challenge facing the world today. Unmitigated climate change may reverse established development gains and jeopardize development prospects for future generations, especially for those at the lower ends of the distributions of assets and income. These challenges are most effectively, equitably and efficiently addressed in a context of wider policy coherence including intra- and intergenerational fairness—in the perspective of sustainable development. In short, climate change is an issue for international cooperation, *and* for national and local development strategies.

This chapter is devoted to exploring the prospects in the next decades for "climate compatible development". It must be read in the context of the current interest in "greening" the economy, notably the United Nations Conference on Sustainable Development in 2012 (Rio+20). There are three dimensions of the concept of sustainable development: economic, ecological and sociocultural. Here we will focus is on interactions between the first two. The chapter deals with economic *processes* such as production, consumption, and investment, but also addresses elements of the economic *systems*, both nationally and internationally, in which these processes unfold.

5.2 Sustainable development and the green economy

Substantively, climate-compatible development, or CCD, is a key element in the wider framework of the search for equitable, inclusive and especially *sustainable* development and a green global economy. In terms of institutional features, climate change will be analysed as a "global public good" (GPG).

Environmental space, sustainable development and green growth

Since the 1960s it has become clear that ongoing unfettered economic growth along the trajectories as pursued since about 1945, characterized by an orientation on material consumption and driven by market forces insensitive to social and ecological challenges, would take the world outside what can be considered a safe biospheric or environmental utilization space (Opschoor, 2010). This is certainly the case with climate change; the "safe" boundaries of this space have been passed (Rockström and others, 2009). Similarly, pressures on environmental systems affect livelihoods at the sub-global level (UNEP, 2011a). The resulting unsustainability has distributional aspects, including *intra*generational elements: poor groups and countries depend relatively more on the use of natural resources to secure livelihoods and development; moreover, there are gendered asymmetries in environmental burden bearing.

These concerns have triggered attempts to identify pathways towards *sustainable development*, defined as a process of change in which: (i) the exploitation of resources; (ii) the direction of investments; (iii) the orientation of technological development; and (iv) institutional change are compatible with and enhance the current and future potential to meet human needs and aspirations (WCED, 1987). Socioeconomic and ecological processes are susceptible to external shocks and turbulence, which has prompted an approach to sustainability that is less interested in a system's final state than in its *resilience*, defined as its capacity to survive, adapt, and develop in the face of exogenous changes—it is the opposite of vulnerability. In this resilience perspective, policies for sustainable development aim at enhancing adaptive capacities and inducing behaviours that anticipate future events or trends. Sustainable development is to be guided by the Rio Principles of Sustainable Development (UNCED, 1992), which include poverty eradication as a priority (no. 5), recognize the special needs of developing countries (no. 6) and the different shares in responsibility for environmental degradation of developing and developed nations (the "common but differentiated responsibilities" of

no. 7), the "precautionary approach" (no. 15), and the inclusion in prices of environmental costs according to the "polluter pays" principle (no. 16).

Environmental pressure (including on natural resources) is driven by economic growth, population dynamics and technological change. This suggests three basic routes to reducing environmental pressures: (i) technological innovation and change; (ii) reduction of economic growth; and (iii) reductions in population size. Reducing population growth is evokes a range of ethical and cultural considerations. Curbing economic growth also is fraught with problems (see below). Changing technology is the simplest way of tackling unsustainability. So far, the rate of change in the environmental efficiency of technology has remained lower than average economic growth rates. Some infer from this that a new technological revolution or transition is needed (Banuri and Opschoor, 2007; UNDESA, 2011). Changing consumption patterns or lifestyles may also reduce environmental pressures.

Attempts to reconcile the urge for development with the search for sustainable economic activity have generated proposals for *green growth*, combining economic recovery, poverty reduction and environmental efficiency (UNEP, 2011b; OECD, 2011). In a green economy there may be economic growth if environmental limits considered to be of vital interest are adhered to. Developmental risks associated with its possible one dimensionality, one-size-fits-all reductionism, and new trade restrictions and conditionalities (Khor, 2011) are recognized and should be addressed through international negotiation during and beyond Rio+20.

A public goods perspective on sustainability and climate

Natural resources and environmental services vary in terms of degrees of rivalry in use and excludability of users, and hence show features of "public goods" and "common pool resources" (Kaul and others, 2003). Market mechanisms typically are inadequate as exclusive facilitators in the provision of such goods, or fail through their role in the generation of externalities in terms of social and ecological costs. Unsustainable development may result from an inherent orientation within market forces and market actors towards short-term aspects (like revenues and profits) as opposed to future needs, reinforced by inherent growth impulses. In the absence of standards and regulations that safeguard the continued delivery of the functions of nature, economic growth ignores the constraints inherent in the notion of environmental space. Global public goods such as climate often embody

"stock externalities" (Nordhaus, 1999), the impacts of which come after long-term accumulation. Moreover, irreversible effects may be associated with thresholds being surpassed as the levels of impacts rise, and long time lags may separate the (often costly) engagement in response measures from the benefits thereof. In relation to climate change, features such as these are further exacerbated by uncertainties. These considerations necessitate public involvement in assessing *and* addressing unsustainability and climate change. Several forms of institutional failure need to be addressed: *policy* failures in terms of adequacy and coherence, *instrumental* failure in terms of ensuring effectivity and compliance, and *architectural* failure in terms of structures and networks capable of implementing and coordinating policies and interventions. Mitigating market failures often demands regulatory approaches and structures capable of curbing, directing, *and* harnessing market forces. Internationally this entails issues to do with shared sovereignty or at least of "responsible sovereignty" (Kaul, 2010).

Common pool resources are governed by various management regimes—public as well as private ones, including "common property regimes" (CPRs), typically based on self-management by often local communities (Ostrom, 1990, 2003, 2010). Such collective regimes may, if their span of control is wide enough and in the absence of overriding power asymmetries, allow effective dealing with the associated externalities and thus potentially supporting a more sustainable use of these resources. CPRs can be very important alternatives where privatization of property or resources entails social and ecological risks. In cases of global environmental goods and in the absence of a single global authority, states may collaborate as if they operate a CPR.

5.3 Climate change in the sustainable development perspective

Climate change (CC) is a key developmental issue calling for international cooperation, as is recognized by the UN Framework Convention on Climate Change (UNCED, 1992). Depending on the intensity of future cooperation on CC, one may discern a variety of possible futures with different outcomes in terms of emissions, impacts, income levels, and response-related costs/investments. We will compare "business as usual" (BAU) development with two other scenarios, one in which warming is to stay below 2° C (in line with the current position under UNFCCC), and the other representing outcome(s) for 2020, 2030 and 2050 that fall somewhere in between UNFCCC's position and BAU.

The challenge of climate change

CC results from natural factors and societal ones. The latter contribute through emissions of "greenhouse gases" or GHGs, CO_2 being the major one of them. Energy use is the main source of $CO_{2,}$ followed by land use change (including deforestation). The impacts of CC affect livelihoods and societal welfare: they include sea level rise, changes in weather regimes, declining agricultural output, and health effects. Effects of CC are manifest already now; with more warming they will grow in number and severity (IPCC, 2007a). Developing countries will be confronted with 75 per cent or more of the global damages in relation to CC and have a relatively limited capacity to respond. Even global warming of 2°C (as is aimed for internationally) is likely to result in permanent reductions in GDP of 4 to 5 percent for Africa and South Asia (World Bank, 2010a). Warming at present is above 1900 levels by about .75-.8° C; in view of the proposals in the 2010 and 2011 climate negotiations, it appears that, by 2100, the world will have temperatures 3.5° above preindustrial levels (Ecofys, 2011). Biospheric tipping points may then come in sight, with consequences such as a possible dieback of the Amazon rainforest, irreversible loss of the Greenland ice sheets, and permafrost thawing.

Responses to CC include: (i) adaptation (when, given the effects of CC, people and societies avoid or curb the associated damages), and (ii) mitigation (when the emissions of GHGs are reduced). Given the challenges inherent in the long-term perspective, mitigation efforts, specifically carbon emissions, are a priority globally. Compared with "business as usual" emissions, in order to stay below the 2°C threshold, global emissions in 2100 would have to drop by about one quarter of what they were in 2005. Per person, the drop would have to be about 85 per cent (CDP, 2007), implying a dramatic, near-full, decarbonization of the global economy. Table 5.1 presents (in crude numbers) a review of several emissions estimates in various global development trajectories.

The first block is a compilation of GHG-related estimates showing that if the international targets on warming (including the < 1.5° variant) are to be achieved, drastic cuts must be realized by 2050, but must begin by 2020 (the "peak year"). Also shown are the expected impacts of the pledges made in the FCCC negotiations thus far. The second block shows scenario results from UNEP (2011b): a BAU scenario (rather more optimistic than the one in the first block) and what might be achieved in relation to climate by a "green" reinvestment at the level of 2 per cent of GNP. The third block provides estimates of warming in the different UNEP scenarios. Comparing

Table 5.1
GHG emissions and global warming in different mitigation scenarios,1990/2000-2050

	1990	2000	2010	2020	2030	2040	2050
GHG emissions (Gt CO_2-eq/yr)							
BAU	36	40	48	58	67	75	80
Warming < 1.5°	..	..	..	44	30	20	10
Warming < 2°	..	..	..	44	35	26	18
Cancun/Durbanpledges	..	..	..	55	58	60	60
CO_2 emissions (Gt/yr)							
BAU UNEP	20	..	..	34-36	40-44	< 48	50-57
2% scenario UNEP	..	..	30	30	30	..	20
Warming above 1890-1910 (°C), UNEP							
BAU	0.6	0.6	0.8	1.2	1.5	1.8	2.1
CO_2 measures	..	..	..	..	1.5	1.8	1.9
All GHG	..	..	..	..	1.2	1.4	1.5

Sources: compiled from Ecoequity (2010); IPCC (2007b); Ecofys (2011b); UNEP (2011a, 2011b, 2011c).

the 2030 or 2050 emissions in the BAU and 2° scenarios discloses a daunting emissions mitigation gap. Furthermore, warming will continue to take place at least up till 2050, whatever the scenario, to levels 2-2.5 times those of 2010. Currently pledged efforts in mitigation are too little and plans to redress that may well be too late. So, it is of the utmost importance for sustainable development, that negotiations proceed with the objective of bringing emissions below agreed caps. Meanwhile, *accelerated adaptation* is called for, till 2050 and beyond.

Dealing with the climate challenge

Unmitigated CC is incompatible with sustainable development, yet what this implies for future development pathways is not yet sufficiently explored (IPCC, 2007b). The World Bank (2010a) explores prospects of "climate-smart development" through enhancing development, reducing vulnerability, and financing the transition to low-carbon growth paths. Elsewhere in the development community (CDKN, 2011) the notion of "climate-compatible development" (CCD) is advanced, combining "low-carbon development" (as a pathway on the interface of development and mitigation) with "climate-resilient development" (as a blend of adaptation and development). We proceed in this perspective, by discussing adaptation,

mitigation and integrated approaches, to then suggest possible different roles in this for different groups of countries.

The climate resilience dimension (adaptation)

Adaptation is a response to impacts of CC; it is conditioned by contextual elements such as types of livelihood, level of development, cultural features. Adaptation may come in the form of public efforts (for example larger scale dike and dam construction) or of private activity (households or communities acting on their own strength). A further distinction is between "soft" and "hard" adaptation options (World Bank, 2010b), the former relating to policies and institutional/social capital development, the latter involving more tangible, often financial capital intensive interventions. On the "hard" side, a wide array of technology and knowledge based systems is available, focusing on different types of vulnerability (floods, droughts, sea level rise, heat waves, storms, generic) and strategies (infrastructure, regulation, management). Soft adaptation options, while of crucial importance in local development processes, are underemphasized in national adaptation strategies.

One main point is that adaptation be embedded in development pathways; mainstreaming adaptation into sustainable development may make it align better with other development processes and policy concerns in resource related fields (water, land, forests) and sectors.

The "adaptive capacity" of societies needs enhancement. This entails the development of new capabilities and appropriate institutions, but often CC aggravates risks already known so that communities have an existing portfolio of response options and capabilities. Yet, if adaptation strategies are developed with future threats in mind, then these established options risk being too path-dependent. Thus, local experience may present assets as well as setbacks. Adaptive capacity is related to "social capacity", so the development of social capacities in general would also enhance resilience to CC (World Bank, 2010a).

Sustainable adaptation (Eriksen and Brown, 2011) is about building and strengthening social resilience. It is more generic in terms of vulnerabilities addressed, *and* it flexibilizes societal organization by developing adaptive governance systems and common pool resource management schemes well embedded in the societal and ecological context (Dietz, Ostrom and Stern, 2003). New models of "inclusive and sustainable adaptation" focus on economic diversification, employment and social security, universal access to education and health, and sustainable agriculture, as well as on appropriate low-carbon growth strategies.

Pro-poor adaptation should build on strengthened local institutions, more options in terms of finance and insurance, enhanced protection from natural disaster and climate/weather variability; it should deal with problems related to poverty in a sustainable and climate compatible way. Community-based institutional adaptation initiatives are already gaining importance (Reid, Huq and Murray, 2010). Women should be given a more prominent place in institutional mechanisms for common-pool management (Agarwal, 2009a-b).

The low-carbon dimension (mitigation)

Land use change and forestry development account for some 12-15 per cent of overall carbon emissions. The climate side of forest-related land use change is addressed by REDD+ (Reducing Emissions from Deforestation and forest Degradation), discussed further below.

For curbing-energy related emissions, many options exist (IPCC, 2007b; IEA, 2010). One set aims at efficiency improvements in processes and/ or end use devices. Secondly, there are fuel shift options, from one fossil source to another (coal, oil, gas, nuclear), or to nonfossil, and renewable sources (wind, solar, hydro, tidal, geothermal, biofuels) or agrofuels. Some of these options are not generally accepted (nuclear, biomass). For instance, first generation biofuels claim land presently under forests and/or usable for food production; given the emerging problems of food supply this competing use is heavily loaded with negative tradeoffs.

Beyond these now traditional alternatives there are new, more Prometheusian options in the domain of "geoengineering": solar radiation management and CO_2 removal. Safety repercussions, including as yet unknown risks of these often large-scale interventions, and accessibility aspects related to the development and use of such technologies cast doubts on the desirability of these options (Williamson, 2011).

Thus, currently available technology may not go far enough to keep the world within safe limits to warming, it may have serious side effects and/ or high costs. Innovation may help resolve these problems. United Nations (2011) outlines a "Great green technological transformation" based on National Innovation Systems to realize the envisaged innovations.

Integrated, climate compatible approaches

Integrated perspectives may raise the probability that unnecessary side effects are prevented or tradeoffs eased, and even that "win-win" situations are found.

At the sectoral level, land use and agriculture provide an example. "Climate-compatible" or "smart" agriculture develops systems and practices that are sustainable even in a warming world. It limits soil destruction and improves cropping systems, develops new crops (in food, fibres and fuels), and grows these ecologically efficiently. Where appropriate, practices of common pool management regimes can be stimulated or enhanced.

REDD+ promotes sustainable forest management, the use of forests as carbon sinks and low-carbon paths to development, including food and natural resource-based production. It provides incentives in which the conservation of forests and their sustainable use generates more revenues than clearing them; it may also create significant financial flows towards the South. Linking REDD+ with credits for the preservation of biodiversity might even boost these further (Dooley and others, 2011). Sustainable development implies bringing in social, poverty and distribution-related considerations. Doubts exist as to whether current REDD proposals do that adequately. Adverse distributional impacts due to the commoditization of environmental services through REDD+ must be curbed by ensuring effective benefit sharing if not by seeking options for noncommercialized use. Also, rights of indigenous resource users need to be addressed.

Lastly, "commercial pressures" on land (sometimes labelled "land grabs") can pose threats to sustainable development (OXFAM, 2011): globally some 227 million hectares of land have been sold or leased, mostly to commercial entities. Governments must develop policies and instruments to protect the rights of small-scale producers to their land, and where state land is concerned, governments should consider the risks of irreversibly opening up land to commercial and transboundary forces.

The approach can be broadened to become economywide. "Investment-led" green and climate-compatible innovation strategies have been proposed (CDP, 2007; United Nations, 2011) with "national innovation systems" (United Nations, 2011) to stimulate and direct innovation and investment to structurally push economies on to more sustainable and climate-compatible patterns of production and consumption. To make these strategies effective, human and financial resources will need to be brought together well beyond the point of critical mass, and they need to be anchored in well-mandated organizations. A "great green technological transformation" is to achieve a green(er) economy within a time frame of three to four decades (United Nations, 2011). The latter strategy covers energy/climate, food security and natural hazards. The further development of green technologies should

receive public sector support and (at least in developing countries) infant industry treatment.

In its Green Economy Report, UNEP (2011b) addresses natural resources, biodiversity, agriculture and fishery, rural development, energy and climate, building, transport, and tourism, in a search for sustainable economies that creates employment and enhances social security.

Costs of dealing with the climate challenge

Estimates of average per annum *mitigation costs* over the next decades range rather widely—from about 1.5 per cent of GDP (to achieve concentrations of ~450 ppm) to 2.4 per cent (aiming at 400 ppm) (Edenhofer and Stern, 2009). UNEP estimates that an adequate reorientation of economic activities can be achieved by redirecting investments at the level of 2 per cent of global GDP; McKinsey (2009) shows high investment levels (some $700 billion) in developing countries and $450 billion in industrialized countries (in 2030, 2° C cap). The regional breakdown for outlays in developing countries amounts to: China, 45 per cent; India, 13 per cent; rest of developing Asia, 15 per cent; Africa, 7 per cent; and Latin America, 11 per cent. The trajectory for the average total investments shows an increase with a factor of 2.5 between 2011-15 and 2026-30. These trajectories differ much from region to region; for China this factor is calculated at 3.7; for Africa it is 2.9. In economic terms, mitigation may be accompanied by drastic shifts in sectoral levels of activity. The associated price changes would generate further repercussions including distributional consequences. There also are intertemporal impacts. For instance, UNEP's "2%" scenario generates a calculated drop in real per capita GDP with 1 per cent in 2015/2020, but shows a rise of 2 per cent above BAU in 2030, moving up to as much as 14 per cent in 2050. Thus, initial socioeconomic costs might be compensated by benefits later.

Adaptation costs in developing countries (with warming not exceeding 2° C) are calculated at $80 billion - $100 billion per year, or about 0.1 per cent of projection world GDP in 2030 (World Bank, 2010b). Adaptation costs in East Asia and the Pacific are estimated to be about 25 per cent of the total in developing countries, 21.5 per cent in Latin America and the Caribbean, 20 per cent in South Asia and Sub-Saharan Africa (almost 20 per cent). Total annual cost towards 2050 would be about 20 per cent above the 2030 average, starting from a 2015 level estimated at about 20 per cent below the average; the pattern differs from region to region. When warming goes up to 3° C, adaptation costs might double, especially in South Asia and Africa.

Residual damage (or economic losses related to effects where adaptation would not be cost-effective) would still occur; they are very hard to estimate, but may far exceed adaptation and mitigation costs (Ecofys, 2011a).

Estimates given above include figures per region or country where the costs may occur. However, much of the current climate negotiations are about sharing this burden, in line with the principle of "common but differentiated responsibilities and capabilities" (UNFCCC art. 3). Attempts are ongoing to find $30 billion for 2010-2012 for adaptation and mitigation and to raise $100 billion per year by 2020. The latter amounts to one seventh of the needs as calculated by McKinsey (2010), for adaptation costs coverage from international finance cannot even be estimated but most certainly is far from adequate as well. The upshot of this is that the world will most likely not see the financial means for adequate levels of mitigation emerge on time, so that, again, warming beyond 2° C is likely to become a reality, and abatement needs and associated costs will rise.

The climate challenge and policy responses

Rationales for responsive actions: a global perspective

The responses to climate change have been presented above with reference to a 2° cap on global warming. In a precautionary approach, this appears justified *per se*. The question arises whether there would be justification also in political and economic terms.

Another approach is to regard the costs of mitigative measures to stay below this cap as a premium to safeguard the world against further damage and adaptation costs, and to consider whether such a premium appears warranted by the damage avoided (see UNDP, 2007, for an affirmative answer). A third approach is asking whether such responses are justifiable in a cost/benefit perspective. In the context of global issues involving serious irreversible changes, the appropriateness of this approach is not unchallenged (Spash, 2007). Yet, it is of interest that one attempt to apply it finds that, by investing about 1 per cent of global GDP per annum, warming beyond 3° could be prevented with a benefit in terms of damages avoided in the range of 5-20 percent, if a time horizon of up to 200 years were taken and a low discount rate applied (Stern, 2006). This again suggests that efforts to stay below the currently agreed cap may be justified.

However, national costs and benefits deviate from global averages. This may be exacerbated by a higher time preference. Moreover, as

warming trends can reverse only beyond 2040 or 2050, decision makers may be reluctant to engage in strategies with high "up-front" costs and uncertain future benefits. It does take a long-term perspective, and an acknowledgement of the interest of stakeholders that may not have a voice as yet, to push for early mitigation.

Policy responses contextualized

Environmental issues vary with setting; so do levels and patterns of development. Lastly, policy responses are likely to reflect "contextual" differences among countries.

There are clear associations between GDP (in total and per capita) and CO_2 emissions for countries in different income groups (low, middle and high-income countries, or LICs, MICs and HICs, with 2008 CO_2 emissions per capita ranging from 0.5 to 3.3 and 12.5 mt respectively). Adaptation efforts (notably the domestic ones) are likely to be associated more with vulnerability. The World Bank (2008) has analysed countries' vulnerabilities in relation to six climate change-related threats. Many LICs and MICs feature in these six rankings. UNFCCC has recognized the special vulnerability to climate change effects of least developed countries (LDCs), other (non-LDC) African countries, and small island developing States (SIDS, most of which are MICs, some even HICs), by proposing a category of "Most Vulnerable Countries" (MVC). There are some 100 MVCs with a combined population of over 1 billion; in terms of emissions per capita, they average slightly below the lower MICs. Strategies in LDC /LICs, MICs, and HICs may differ in terms of the relative significance of the components of mitigation, adaptation and contributions to sharing financial burdens and knowledge. Where their efforts in mitigation and (international) burden sharing are concerned, countries could be considered to ideally determine their policies in relation to the principle of Common but Differentiated Responsibilities and Capabilities.

High-income countries are typically among the major energy-related emitters, in terms of per capita domestic emissions of GHGs and even more so of accumulated emissions. They vary in terms of exposure and vulnerability—with some countries even benefitting from warming in terms of specific sectoral impacts (for example agricultural productivity). HICs have higher capabilities and means (financial, technological) than those in the other groups. They are to take a lead in developing mitigation, and in facilitating mitigation and adaptation-oriented activities in developing countries. In 2012-2030, HICs are to realize a profound and complex

energy-related transition and reduce their emissions per capita. Caps could be set for primary energy use or emissions per capita, or for total emissions (with some allocation of quota underneath), or reductions could be aimed at by applying financial/economic incentives (taxes, charges, and so on; see next section). Such caps would provide strong incentives for innovation in the direction of energy efficiency, shifts to renewables, and cleaner technologies. The introduction and tightening of financial incentives will also trigger changes in consumption patterns and the infrastructural facilities to support these (like alternative transportation systems and urban forms). Frictional effects are likely to arise in the early phases of these transitions. In the longer run, economic effects may be positive (UNEP, 2011; OECD, 2011). A fairly modest shift to a low(er)-carbon development path in Europe may eventually generate more prosperity and employment compared to a BAU scenario, if adequately supported by policy and society (Jaeger and others, 2011; EC, 2011). Farther-reaching policies (for example zero net emissions by 2030) are more demanding in terms of public support (Kemp and Wexler, 2010).

Many *middle-income countries* are vulnerable to climate change impacts. Yet, as three quarters of the world's poor live in MICs, they are assumed to continue on an economic growth path that may turn them into more serious sources of emissions. Some MICs are already contributing so much that curbing warming globally necessitates serious action in these countries as well as in HICs. MICs may develop away from more fossil fuel-based futures, by leapfrogging towards cleaner and leaner technologies, potentially even boosting their export positions in these domains. This will also generate significant co-benefits in domains such as health and energy security. The benefits of embarking on a green technological transition-oriented trajectory may easily overtake possible frictional welfare costs associated with some more usual but also dirtier types of economic growth. MICs may also benefit from technology or innovation sharing arrangements with countries in the HIC category, or in setting up programmes for South-South technology development. Many opportunities exist in MICs to engage in more sustainable agriculture and rural development. A number of MICs will face increasing climate change-related impacts on their livelihoods and levels of development, calling for adaptation strategies. "Hard" adaptation strategies can be more readily deployed here than in LIC/LDCs, and may offer prospects of growth and employment as well as livelihood protection.

Low-income countries and least-developed countries will be pushed by inescapable warming trends to engage more deeply in adaptation, as

livelihoods are increasingly affected. LDCs need to accelerate efforts to reduce risks in an effort to achieve sustainable development. Climate change-related risks are part of their special vulnerability but should not be separated from broader social and economic vulnerabilities. Adaptation is to be based on domestic needs in a longer time frame than was usual thus far, taking into account more likely climate scenarios over this longer time horizon. Resource management and the wise and sustainable exploitation of natural resources will offer opportunities for innovation and development. Opportunities may also be found in relation to agricultural innovation. Sectoral development programmes may be sought that reduce emissions of GHGs; these may be combined in plans for National Appropriate Mitigation Action that can be offered for internationally provided sectoral credits. LICs could invest in developing and diversifying their rural areas, and seek ways forward in developing micro-level renewable energy production.

5.4 Institutions and instruments for climate policies

The climate challenge is an issue of global public goods (GPGs). The global economic system needs to move away from its current configuration, dominated by almost unfettered market forces and ill-conceived growth drives, in order to make the economy more responsive to the call for sustainable and climate compatible development. In the absence of established global governance systems, international coordination of strategies and policies is necessary. This section first addresses some systemic elements, then it reviews instruments and mechanisms, and ends with some observations on financing and global financial architecture.

Institution, governance and the climate challenge

The 2002 World Summit on Sustainable Development established the need for an "institutional framework for sustainable development" (IFSD). It should include: (i) a strengthened and broadened system of international environmental treaties; (ii) conflict management among multilateral agreements towards a sustainable global economy; (iii) a reinforced multilateral environmental organization; and (iv) enhanced integration of sustainable development within the UN system. An effective and comprehensive IFSD needs to go beyond environmental domains and also ensure coherence with economic elements of global development: international finance, aid and trade. A strong mechanism is desirable for

global economic coordination to establish coherence across all areas of global economic governance (Ocampo, 2010). In the field of trade regimes, it needs to be made clear where and how objectives and mechanisms agreed in the setting of Multilateral Environmental Agreements trump traditional notions laid down in current WTO regulations and practices. This holds for arrangements to protect industries and regulation of processes and products, as well as for arrangements regarding intellectual property in relation to environmental goods and services and technology development (see also Vos, this volume). As we saw, land policies and large-scale commercial land deals relate to climate change; internationally, new codes must be developed and applied (such as the 2009 Framework and Guidelines on Land Policy in Africa as endorsed by the African Union).

The current global protocol for climate change is to be elaborated and updated (ideally with binding commitments on emissions reduction by the largest sources); it will take inspired governance to shift the global economy towards a CCD track and to distribute the costs and gains of such a transition fairly. Setting quantitative limits on emissions is a potentially effective way of keeping economic growth within safe environmental boundaries—more so than open ended and voluntary agreements. Investment-led green and climate-compatible innovation strategies need sectoral policies and overarching structural or industrial policies to encourage market development where this is appropriate and necessary.

International agreements could encourage and facilitate self-governance systems in relation to natural resources and environmental goods (for example in relation to REDD+). Such arrangements can be based on local/individual entitlements or communal use rights, and develop collective systems of rewards, incentives and penalties in relation to the use of collectively used resources such as land, water systems, forests—which are significant in the face of the climate challenge either because of mitigation or in view of adaptation options (Ostrom, 1990). In order to make these common pool systems work, states would have to protect the rights of small-scale producers to their resources.

Climate policy instruments

Environmental (including climate-oriented) policy instruments have been used to either *directly* promote and facilitate desirable changes in activities or discourage and prohibit undesirable activities (or features thereof), or to *indirectly* induce such activity change by altering the settings in which

decisions about such activities are made. Direct interventions include (i) *public programmes* (for reforestation and technological innovation) and (ii) *regulatory measures* such as the setting of targets or caps on GHG emissions, zoning, standards (on emissions, products and technology). In the indirect approach, activities that better achieve societal targets are made more rewarding, for instance through: (i) altering price signals; (ii) the creation of markets where they do not yet exist; (iii) fostering *voluntary compliance* with climate policy objectives, for example through private-public partnerships, certification and labelling of products.

Instruments can be compared in terms of their (i) environmental (climate) effectiveness; (ii) cost effectiveness; (iii) distributional impacts, and (iv) political feasibility (Opschoor and Turner, 1994). For instance, emissions (permit) trading under caps is expected to be relatively predictable; energy use might be insufficiently responsive to a tax when the price elasticity is less than necessary. In practice, trading schemes have not been very effective, though that may be due to weakness on the side of policymaking when the instrument was operationalized, rather than to inherent flaws. In fact, taxation may have much to offer and even be a more desirable instrument than trading.

New types of instruments may help countries in shaping CCD. Examples are: "feed in" tariff systems to stimulate decentralized power generation; insurance or guarantee systems to cover policy and economic risks; social impact bonds related to climate and agriculture; tax credits (on investment, production); sectoral crediting mechanisms for reductions beyond a certain baseline; credits related to NAMAs (nationally appropriate mitigation action); "suppressed demand" and "blue carbon storage" extensions of clean development mechanisms (CDMs).

Instrument portfolios may differ among countries and groups of countries. Countries may find certain types of instruments to be more or less compatible with prevailing political and/or sociocultural conditions; new instruments sometimes aggravate power asymmetries in relation to resource use. In developing countries it can be expected that direct interventions (through regulation and intervention based on sectoral policies, subsidization, and monetary and fiscal policies) are relatively more suited.

Pricing carbon?

"Pricing" of carbon is one possibility of effectuating emissions reduction in a relatively efficient way. A uniform price would give an effective and efficient signal to reduce emissions, in line with the "polluter pays" principle

(Stiglitz, 2009). One approach towards this is carbon taxation. The impacts of carbon pricing on emissions have been estimated by IPCC (2007b): roughly, in developed economies, prices up to \$50/tCO_2 would generate reductions of some 20 per cent on average (35 per cent in developing countries), prices between \$50 and 100 would lead to reductions of about 35 per cent (40 per cent), and prices up to \$150 to reductions of over 40 per cent (close to 60 per cent in developing countries). UNIDO (2010) expects that in the long run a carbon price at the level of \$50 would be necessary to obtain a sizable market for renewable energy and feedstocks. Also, through its revenue raising features, carbon pricing could be used to reduce other taxes (thus "greening" taxation).

Pricing may have negative consequences as well. It may induce sectoral or even macro-level contraction; it may have short run regressive distributional effects (outweighing at least in perception the progressive longer run outcomes of emissions reduction); it imposes burdens on people who did not contribute to warming. Regressive effects will have to be addressed through offsetting mechanisms (such as: pro-poor price differentiation or subsidized provision to low income groups, or a "carbon dividend" from tax or auction revenues to poor households). In order to embed low-carbon orientations institutionally, *and* to raise the means for funding the investments in innovation and structural transition, internationally agreed carbon pricing—if flanked with measures correcting serious social side effects, and if shaped in contextually sensitive ways—seems to have more promise than the alternatives.

Financing and related mechanisms and architectures

Meeting the climate challenge through mitigation and adaptation will require huge amounts of finance. Comparisons of needs in developing countries with available means and with fundraising in the international climate negotiations indicated a gap of hundreds of billions of United States dollars per year. Thus, the levels of finance for addressing CC need to be raised. Fairness suggests that finance be mobilized in proportion to responsibilities and capabilities. The basis for this is the 1992 Rio Principles of Sustainable Development and the UN Framework Convention on Climate Change, especially the principles of "equity" and of "common-but-differentiated responsibilities and capabilities". A third basis for action is the Rio Principle that environmental costs be internalized and "economic instruments" used, to make the polluter/user bear the ecological costs. A

range of burden-sharing mechanisms has been proposed including moving towards equal per capita emissions rights, and greenhouse development rights (Baer and others, 2008). Developmental considerations could come in by exempting countries below certain thresholds of per capita income and/or emissions (as proposed by Baehr and associates in their work on "Greenhouse Development Rights"). There, obligations are estimated based on shares in above threshold incomes and emissions.

Finance may come from domestic sources, international economic sources, and international cooperation. Domestic sources include national taxation and savings. Many proposals for increasing financial resources have been made (Stiglitz, 2006; UNEP, 2011; UNDESA, 2011). Many of the incentive-related instruments may help raising financial resources, but other, additional, mechanisms have to be identified. National authorities could collect taxes on the basis of national legislation, to feed either national or international funds. Taxes could also be levied internationally, on the basis of agreements.

Proposals relating to GHGs and energy include: (i) tapping carbon-related market flows like revenues from sale or auctioning of emission permits; (ii) levies and taxes for example on fossil fuels, carbon content of fuels, emissions of greenhouse gases, and air travel marine transport; (iv) auctioning allowances for international aviation and marine emissions; (v) stopping fossil fuel subsidies; (vi) leveraging private investment flows; and so on. Several of the economic instruments, like energy taxes, have fund raising properties the revenues of which could be channelled back or "recycled" into funds for climate-related activities.

Non-climate related new funding sources may include: (i) a Currency Transaction Tax; (ii) FOREX reserves or monetized SDRs; (iii) funding from state budgets; (iv) GDP-related predictable transfers. Regarding the latter, national governments could decide to voluntarily make available funds in relation to their own GDP (a voluntary "GDP tax"), or there could be GDP-related transfers based on an internationally agreed rate (analogous to ODA commitments), or there could be a multilateral collection of such "GDP taxes". In terms of intertemporal reallocation, a dedicated international financing facility could stimulate front-loaded investments in mitigation.

In order to enhance predictability, contributions must, as much as possible, not be voluntary but structural, for example based on *pro rata* mechanisms (such as levied percentages of financial flows and mandatory contributions in relation to income or emissions).

An important question is whether to consider international financial support of climate action in developing countries to be part of ODA or a separate category. Clearly, mitigative activity would stimulate economic growth and hence have developmental "co-benefits" (or joint products); likewise, adaptation projects also contribute to the realization of traditional development objectives. Yet, the primary motives of these activities are not those of traditional ODA. Considering support for climate action to fall under ODA might put pressure on, and risk crowding out, developmental action concerned with poverty eradication, economic diversification and other goals. It is to be remembered that international cooperation on climate in developing countries might easily call for funding at levels beyond the current levels of financing through ODA (in 2007, for instance, bilateral aid for mitigation in developing countries was at the level of 4 per cent of ODA (OECD, 2009)). For reasons of transparency, international financial flows for mitigation and adaptation in developing countries should not be seen, or counted, as ODA; yet, for reasons of coherence, the activities these flows are to stimulate should be considered in the context of sustainable development planning.

A financial *architecture* is needed that can mobilize and disburse new and additional means efficiently, effectively and equitably. By "financial architecture" I mean a set of financial mechanisms and operating entities able to broaden the scope and scale of activities, the arrangements to govern these, and provisions for coordinating them. Elements of such architecture exist and function; international negotiations are establishing other multilateral funds (notably the Green Climate Fund). Yet there are many others, such as the Adaptation Fund and the LDC Funds operated by the World Bank or the Global Environmental Facility; in addition there are various bilateral initiatives. An architecture is to be developed that is effective, transparent and fair, and not more complex than is absolutely necessary. It is important they eventually operate under the guidance of multilateral entities such as UNFCCC and be open to considerations related to overall policy coherence through guidance from ECOSOC or any new body on Sustainable Development are concerned. For systems of mandatory contributions and/ or global tax regimes, a new international financial institution (or a World Development Fund as suggested by the Brandt Commission in 1983) might be envisaged to levy these taxes and allocate their revenues, under a treaty body, UNGA, or—when this route were taken for climate issues alone—as part of the climate finance architecture under UNFCCC.

Climate related investment and economic crisis

Finding funds during periods of economic crisis may evoke difficulties to do with competing claims on resources for easing recession-related volatilities and risks. Yet, meaningful anticyclical spending options generating economic growth may be necessary to find ways out of the financial crises. Safeguarding development in the face of global warming provides such options. "Green New Deals" (GND) were proposed as a response to the range of crises the world faced in 2008, combining stabilization in the short run and a reorientation of long-term processes and systems. Both the degradation of the environment and measures to mitigate and avoid that have effects on aggregate supply and demand, with potential positive effects on livelihoods, welfare and employment. In this chapter a case was made to also involve industrial (or production structure-related) policies and institutions or mechanisms to implement these reforms in agriculture and land use, pricing of resource use and pollution, the development of sustainability-oriented systems of property rights (collective and individual) and management regimes.

The case for switching to CCD- and greening-oriented strategies in counter-cyclical endeavours is a strong one and the needs in terms of finance are considerable but far from impossible (UNSG AGCCF, 2010; UNEP, 2011b; United Nations, 2011).

5.5 Concluding observations and next steps

Reflections on CC support the view that the current model of economic development is unsustainable and inequitable. A new model of development is to be oriented towards quality of life, equity and social safety, inclusiveness, and ecological sustainability. It should not denounce economic growth; nor should it embrace growth without qualification. Economic processes should remain within safe limits for GHG emissions, incentives should be put in place drawing economic and technological forces towards sustainability and the realization of low-carbon resilient societies; social and ecological costs of economic activity should be internalized by pricing (and/or taxing) emissions or their driving forces.

Such a model of development should be guided by future-oriented systems of valuation of resources and of life and life support systems, without irresponsibly discounting away future events, costs and benefits. The inherent logic of it needs to be made concrete in Sustainable Development

Indicators or Goals, to be combined with other internationally agreed goals. Examples are statistics on overall sustainability and quality of life (such as net savings and footprints) next to traditional measures of human development (Stiglitz, Sen and Fitoussi, 2009; UNDP, 2011).

It is in the urgent interest of most LICs/LDCs and many MICs that an effective, fair and ambitious global climate deal is achieved soonest, with binding commitments for *all* major emitters (mitigation), primarily the developed countries, and with adequate assistance to vulnerable countries for dealing with harmful and unavoidable CC impacts (adaptation). Meanwhile, vulnerable countries should explore, develop and deploy resilience-enhancing strategies for adaptation and associated capacity development. This has governance and institutional implications, not only at the international level but also at lower levels; the overall architecture should be capable of effectively embedding and curbing economic processes and forces, where CC is at stake and of engendering adequate action in the field of climate smart technological innovation.

Strategically, important next steps at the international level should be to: (i) elaborate new inclusive paradigms of sustainable development and transitions towards green economies; (ii) deliver a fair, equitable and effective international agreement on CC; (iii) if this agreement cannot include country level targets, then it must pursue programmes of action (for innovation, sectoral development) to be periodically reviewed and scrutinized on their capability of achieving global development consistent with the 2° goal (or other agreed-upon cap); (iv) organize international investment in adaptation and mitigation, and technology development and dissemination; (v) establish coordinated efforts towards carbon pricing; (vi) achieve coherence with international economic agreements; (vii) complete the system of multilateral environmental agreements and implement new ISFD architecture.

At the national level, a strategic approach might take the following path: (i) development of a clear vision of sustainable development and CCD, and a view on national transition towards it; (ii) mobilize broad public interest in, and support for this vision; (iii) ensure sustained support through equity and inclusion oriented next steps both in direction of adaptation and of mitigation; (iv) develop innovative funding mechanisms by linking and greening domestic fiscal systems and policies, and for public investment in CCD-oriented innovations in technology and resource management; (v) rebalance the economy (market versus state, consumption versus quality of life); (vi) actively engage in international renegotiations on climate and other multilateral arenas on economy and environmental resources.

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Chapter 6
Aiming for food and nutrition security in a changed global context: strategy to end hunger

Joachim von Braun[1]

6.1 The problem and the goal

The most relevant price for the poor is the price of grain—especially wheat, maize, and rice. Maize prices increased by 105 per cent between March 2010 and March 2011 on international markets; wheat by 102 per cent; rice increased less in the 2011 crisis, but more than wheat and maize in 2008. The price increase implies that a kilo of wheat in many developing countries typically costs about $0.30 instead of $0.15—a critical difference for a person who lives on $1 a day, as do more than 1 billion people. This kind of price increase requires poor people to cut back on other food and non-food expenditures to maintain food energy consumption. Consequently, quality of diet and of livelihood suffers.

The absolute number of undernourished people in developing countries decreased from an estimated 980 million in 1990/92 to about 850 million in 2010/12 according to FAO estimates (FAO 2012). This is a decline of the percentage of under-nourished in the developing countries from 23 to 15 percent. If these trends continue, the MDG indicator related to under-nutrition would be just about one percentage point above the target of

cutting the percentage of undernourished in half, i.e. 12.5 percent instead of the target of 11.6 percent (FAO 2012). Most of this noteworthy progress since 1990/92 seems to have been achieved before the setting in of the food crisis of 2008. While there is a risk of declining progress in reducing hunger, which needs to be addressed, ending hunger in the coming decade would be realistic yet ambitious goal.

The food crisis has shed light on the highly deficient data about the scale and change of food and nutrition problems. The numbers about undernourished people are rough estimates at best, and even less well known is the increase in diet deficiency and related long-term—indeed lifelong—health effects that impair physical and mental capacities. The FAO above mentioned estimates do only capture trends and not annual change. They are based on aggregate data, not actual people (household) level food deficiencies. Other relevant indicators of nutrition, such as child underweight and stunting show less progress. It is roughly estimated that 2 billion people suffer from micronutrient deficiencies. Moreover, the prices of non-staple foods, such as vegetables and pulses, have risen even more than grains, further adding to these deficiencies, especially in South Asia. Part of an appropriate response to the global food crisis needs to be an overhaul of the system of monitoring information on food and nutrition.

Food and nutrition security depend upon the availability of food (through production and trade), access to food due to purchasing power, and the utilization of that food by people who transform availability and access into more or less satisfactory nutrition, and on stability of the food system, especially of related markets. These concepts, however, need to be viewed in a dynamic context, where food and nutrition insecurity undermines the resilience of poor people and low-income countries and thus further exacerbates the insecurity, eroding both societal cohesion and the natural resource base of countries. Therefore, food and nutrition security goals need to be addressed with comprehensive strategies, adapted to the regional circumstances.

Strategies for food and nutrition security need to take note of two fundamental changes that re-position food and nutrition in the global and national economies: food and agriculture are now embraced by a larger bioeconomy, and food markets are embraced by financial markets. Each of these interlinkages poses challenges to the aspects of availability, access and utilization of food by the poor and will be discussed in relation to post 2015 MDG implications.

6.2 Food and agriculture increasingly embedded in the bioeconomy

Producing more food to achieve food security is confronted with new challenges arising from the fact that agriculture and the food economy are part of the larger bioeconomy—the emerging sector that produces, transforms, and uses biomass. Food security partly depends on the availability of food, which is part of biomass production and increasingly determined by new competitive uses of biomass for energy and industrial raw materials. This puts biomass and the bioeconomy at the centre of sustainable economic development and any Green Growth strategy.

The bioeconomy intends to use a bigger part of what we are able to sustainably grow on soils, with seeds, sun and water, and use it a lot more efficiently. It is the aggregate of all industrial and economic sectors and their associated services that produce, process or in other ways use biological resources (plants, animals, micro-organisms). Langeveld and others (2010) define a bio-based economy as the "(…) technological development that leads to a significant replacement of fossil fuels by biomass in the production of pharmaceuticals, chemicals, materials, transportation fuels, electricity and heat. (…)". Defined as such, the bioeconomy is interconnected with a large cluster of economic sectors in the wider economy; even in some industrial economies it constitutes the largest sector in terms of GDP and employment, while in many low-income economies it tends to be the largest employer. New technology intervenes in all of the above sectors, to different degrees. The largest sector of the bioeconomy, in terms of total output, employment and so on, is typically food and feed production.

Achieving sustainable development will have to rely on alternative sustainable sources of energy and raw materials, mostly away from fossils, and in that context, biomass is likely to play a key role. The key challenge will be to frame this increased reliance on biomass without undermining the long-term productivity of agriculture and other ecosystems. Addressing the challenge will require a systemic approach identifying:

- the consequences of substituting the consumption of finite resources by using biomass and other renewable resources;
- what is needed in order to move towards production systems that rely more on recycling, on more efficient use of limited resources and on an increased employment of renewable resources.

The fast growth in the world ethanol production indicates a bioeconomy in the making. This particular sector, however, has so far not dealt with

its negative externalities, but innovations might change that even in the foreseeable future. In low-income countries, the challenge is different. For instance in Ethiopia, biomass is still by far the dominant energy source, providing about 90 per cent of primary energy. Here the challenge is to make better use of biomass with new technologies, that is to say, a leapfrogging into a knowledge-based bioeconomy can be explored.

World food consumption is demanding more products that are rather biomass intensive, for example, animal products. A comprehensive integration of animal production into efficient value chains is an essential part of the bioeconomy. Climate change provides powerful incentives for investment in the bioeconomy in three ways: first, there is the need to establish a different energy base, including Biomass; second, there exists the threat of declining crop productivity and production risks; and third, the emerging GHG mitigation markets or related taxation policies are increasing the incentives for biomass production (sequestration).

The new value chain system of knowledge-based bioeconomy is much more a system than a chain; actually, it is a set of interlinked chains, i.e. a "value web". For the bioeconomy to make significant progress there needs to be increased efficiency in the whole value web. Until now the technological options have for the most part been pursued in a traditional manner, and hence in isolation: that is to say, by enhancing outputs per unit of individual inputs in production, say yield per hectare or per animal.

Bioeconomy demands new biomass types, optimized for several applications. Crops must improve to ensure this optimization. Plant breeding is necessary to meet these challenges:

- Biofuels: sugar-ethanol will not be enough to achieve energy/climate goals; dedicated lingo-cellulosic crops to be converted into ethanol, or others, with higher energy input/output ratio, are required. Plant breeding in this context is crucial in terms of lignin content and composition (amount of lignin present in cell walls) and conversion technology with chemical innovations, such as catalytic conversion.
- Fibres: They are especially useful in the textile industry, superior to artificial fibres. Cotton is most common, but there is now a need to spread the value chains covering fibres from flax and hemp. These fibres are also a means to decrease water and fertilizer use (compared to cotton). Breeding targets should aim to improve fibre quality by optimizing cell wall properties in relation to specific applications of fibres users.
- Oil crops: plant breeding to enhance use of vegetable oils in industrial applications, by introducing different fatty acid profiles in plants, in

order to simplify the refining or chemical modification of the oil, or by developing plants with new specialty fatty acids, not normally present in food oil crops. Usually breeding is traditional, but as knowledge grows modern biotechnology is increasingly employed to achieve the following targets: reduce costs through higher seed yield, improve disease resistance and use of by-products, decrease transport costs, ensue better quality of oil and oil content of seeds.

- Challenges to be met in the biorefinery sectors, i.e. the processes of transforming biomass into a wide range of value-added products (chemicals, materials, food and feed) or energy (biofuels, heat or power), which has been much less studied so far than the sector of primary biomass production, will include recycling too. For instance, precycling from microbial fermentation (biofuels).

The amount of land that is presently used for agricultural purposes cannot be substantially increased, as either cultivation makes no economic sense due to low potential yields, or expansion would negatively impact the environment and climate. The preferred way of increasing productivity is, therefore, to intensify farming sustainably on the land that is already used for agriculture. There must also be further advances in crop varieties by breeding techniques. Viewed globally, soil may be one of the most important terrestrial resources for carbon storage. Research should focus on maintaining or improving the quantity and quality of productive soils. To achieve this, new national and international concepts of land use need to be devised and a global initiative for the assessment of costs of inaction on land and soil degradation is called for (Nkonya and others, 2011).

By means of innovative research into locally adapted crop cultivation, alternative farming scenarios must be developed which allow priorities to be set for land use. The rapid expansion of foreign direct investment in land acquisition—to grow food and biofuels abroad to secure domestic supply—reflects the strong demand for biomass that has become an international issue (von Braun and Meinzen-Dick, 2009). The often unregulated land markets in which power rather than efficiency and price rule, the investment ventures need more policy attention to protect rights of poor land users, especially small farmers and pastoralists.

In sum, the emerging bioeconomy is changing the competition for food, land and water. Food security strategies must take a trans-sector perspective, beyond food and agriculture. The governance of the food system needs to pay renewed attention to property rights, especially land, including communal lands. The emerging market for biomass and its

agricultural underpinnings need sound institutional arrangements and codes of conduct beyond voluntary guidelines. A resilient and sustainably growing agricultural production sector remains essential for food security of the poor.

6.3 Food markets became part of financial markets

Food and nutrition insecurity have increased in the context of the interlinked food and economic crises of 2007-2011. The food crisis actually came first while overlapping with the onset of the economic recession, and may actually have had some role in the onset of the latter due to the inflationary forces of food and energy prices to which macro policies reacted. Not only food and energy markets but also food and financial markets have become closely linked and these links pose new and added risks for the poor, increasing their vulnerability. Therefore a renewed attention to food and nutrition security needs a perspective that mirrors the increasingly closer nexus among food, water, energy and financial markets.

The chronic food and nutrition crisis is deepening, as high and volatile food prices and global recession further undermine the food and nutrition security of the poor and threaten their livelihoods. The food price crisis was mainly the consequence of neglected investment in agriculture and infrastructure in developing countries, inappropriate agriculture energy subsidization policies in industrialized countries and then triggered by adverse weather events and exasperated further by inappropriate policies, such as export restrictions, lack of appropriate regulation of commodity trade and speculation (von Braun and Tadesse 2012).

The adverse effects of increasing and volatile food prices are reflected in a number of ways. A comprehensive assessment of food price volatility needs to include attention to four major cost components of volatility, namely, increased hunger and disease, reduction in investment, fiscal and macro-economic effects (government spending, increased inflation), and growing political insecurity. The hunger "costs" of food price volatility is to be seen within the perspective of its relative impact on poor consumers and producers. Rapidly rising food prices hurt poor consumers more than they benefit poor producers.

Estimates suggest that the 2011 food price hike has pushed 68 million people into poverty and pulled 24 million people out of poverty, a net increase of 44 million poor people (Ivanic, Martin and Zaman, 2011). Food prices can result in any of the following outcomes: 1) raised level

of malnutrition, 2) persisting malnutrition at its previous level, 3) and a lower rate of reduction in malnutrition. In order to further investigate the impact of rising food prices on child malnutrition, the average malnutrition percentage for three periods from 1999-2002, 2003-2006 and 2007-2010 were calculated for a sample of developing countries that have related data. Of the 11 countries for which data are available, malnutrition increased or coincided with decrease in the reduction rate of malnutrition in eight countries. Thus, in the majority of countries for which data are available, an adverse trend in child nutrition or a break in the trends toward improvement is observed. Any economic assessment of the costs of volatility that neglects the human capital effects is a flawed assessment. Further analysis is called for to determine the size of these effects and to identify why some countries are affected but others not.

Market fundamentals, that is to say, the usual demand and supply factors, are not adequately explaining the high and volatile food price in 2007-08 and 2011, let alone their extreme spikes. Factors such as exchange rates, general inflation, money supply and real interest rate could explain only a small part of the volatility. Food price volatility (i.e. monthly price changes) since 1970 suggests the following stylized facts:

- Strong correlation among the volatility of different commodities. This may suggest that common factors explain more than factors specific to individual markets.
- For the last 40 years, food price volatility exhibits a non-linear trend. Volatility has been declining since 1970 and remained stable for much of the 1990s. However, it has started to increase since early 2000s resulting in the extreme spikes in 2008 and 2001.
- The 40 years volatility trend shows two major food crises in the 1970s and late 2000s.

Probable sources of such structural change are 1) the variation in grain stocks that change the effect of demand and supply shocks, 2) energy price volatility associated with the demand and supply of biofuels, 3) the speculative behaviour in more de-regulated futures markets, and 4) spillover effects to the food markets from financial crisis.

The world has become "small" as shocks can easily be transmitted around the globe. Such transmission not only affects the performance of macroeconomies, but also the global food economy. Reinhart and Rogoff (2009) studied bank, currency, default and inflationary crises that happened worldwide during the last 100 years. Their index shows an increase in financial crises between 1920 and the end of World War II. After that, the

world economy remained stable for about 30 years. Following the end of the cold war in 1990, when many economies were liberalized, the financial sector started to experience difficulties in various regions of the world. Comparing this index with food (wheat) prices indicates changing linkages among financial and food commodity markets. Weak correlations before the 1990s turned into strong positive correlations when the world economy became more integrated after the 1990s. The 2008 food price hikes might have been partly caused by the cumulative effects of financial crises since 2004, and speculative engagement in commodity markets, including food, also played a role.

To distinguish the relative importance of the variables mentioned above, regression models were estimated using short time period panels for food commodities (for details see: von Braun and Tadesse, 2012). The three major variables such as supply shocks, energy price volatility, and financial market crisis were found to be statistically significant and robust across all alternative specifications. Food price volatility response (elasticity of 0.6 at mean values) to financial crisis is higher than the response to supply shocks (0.22) and oil price volatility (0.32). This implies that the three markets such as food, energy and financial markets are increasingly linked to each other. The linkage can happen in different ways. Biofuel demand, stock-to-use ratio, production cost and speculations can connect energy and the financial markets with the food market.

Since speculation has remained a prime suspect to link both energy and financial markets with the food market, a speculation index is included to control the side effects. However, controlling the effect does not change the result. The significance of speculation should be interpreted contextually. Speculation effects should be captured only in a non-linear analysis at higher and lower prices. Thus, the negative and positive effects may cancel each other out and become insignificant on average. Related analysis by Algieri (2012) also shows, that speculation has significantly boosted price spikes.

6.4 Development strategy and MDG implications for food and nutrition security

In 2000, the member states of the United Nations committed themselves to creating a "more peaceful, prosperous and just world," to "free(ing) our fellow men, women and children from the abject and dehumanizing conditions of extreme poverty," to making "the right to development a reality for everyone," and to ridding "the entire human race from want." Obviously,

ending hunger would be an essential component of the Millennium Development Goals, and MDG 1 actually calls for halving hunger and poverty by 2015 in relation to 1990. In pursuing the MDGs, we should seek the elimination of hunger on a realistic but ambitious time schedule. Cutting maternal and child malnutrition is to be part of the hunger goal, as these nutrition issues reduce cognitive ability, and robs nations of healthy and productive adults. Micronutrient malnutrition is a part of these larger, devastating "hunger" problems.

It is now well recognized that pursuing each of the eight MDGs separately without acknowledging their interlinkages will reduce the complex process of human and economic development to a series of fragmented, conflicting, and unsustainable interventions (von Braun, Swaminathan and Rosegrant, 2005). A comprehensive development strategy that addresses the whole set of goals is required for the efforts to be successful. These strategies differ by country due to resources and institutional conditions, so strategies must be tailored to the specific needs and circumstances of a given situation. The political and economic climate must be taken into account, along with historical, cultural, and geographic characteristics. At the same time, each of the goals needs to be reached and that requires specific action in the overall context. Policy actions that improve agricultural productivity and food and nutrition security are essential components of a successful MDG strategy that focuses on the poor, as there are strong, direct relationships between agricultural productivity, hunger and poverty. Two thirds of the world's poor live in rural areas and make their living from agriculture. Hunger and child malnutrition are more widespread in these areas than in urban areas.

The response to the food crisis should be multifaceted. It requires a strategic approach (development strategy), sector-relevant actions in production, consumption and trade policy. Moreover, under-nutrition should be addressed directly with new and strong actions. The world must also reduce waste in consumption and food processing. However, the often stated idea that the world food problem is mainly a problem of "distribution", that is to say, that there is enough food in the world for all and that it just needs to be shared more fairly and equally, is a gross simplification. The root cause of the food crisis was lack of agricultural productivity, and acute policy failures. But a broader set of risks needs to be comprehensively addressed. These include:

- The risk of *high and volatile food prices,* which limit poor people's food consumption, diet quality, and spending on health and general welfare, is likely to increase in the future.

- *Financial and economic shocks*, which lead to job loss, expensive and scarce credit, and decreased demand for agricultural commodities, are also likely to persist in some parts of the developing world.
- The impacts of *climate change*, including an increase in the incidence of extreme weather events such as droughts and floods and a decrease in yields in developing countries, will further exacerbate food insecurity. These impacts will be severe because the majority of the poor depend on agriculture as a source of food and income.
- The risks that *political disruptions and failed political systems* pose for people and economies. This includes the risk of structural failures of policy change, such as lack of property rights and of traditional land and water rights leading to erosion of assets of the poor, as can happen under increased land grabbing. In addition, societal and political risks—such as food riots, destabilization of governments and domestic and trans-border conflicts—can result from these food system risks.

These complex system risks can assume a variety of patterns, and can become catastrophic "perfect storms". In order to be comprehensive, the action agenda should include the following three packages:

Resilient agricultural production systems: linking end hunger with end land degradation goals

A sustainable and resilient agriculture in both small and large farm sectors, requires not only technological innovations, but sound institutional arrangements for well functioning markets that offer a conducive investment climate, access to infrastructure, and information and extension systems that serve men and women farmers. An essential component of resilient agriculture is an end of land and soil degradation, as the natural resource base needs to serve future food security. The end hunger goal must be combined with related environmental sustainability goals in an inseparable package. The costs of inaction to reduce land degradation are partly borne out by the costs of food insecurity.

The future of food security to a considerable extent relates to the transformation of small farms for two reasons: about half of the world's hungry poor live on small farms, and second, the small farms of the developing world have considerable potential for contributing to rural and economy-wide growth. In emerging economies, these two features of small farms connect development strategy with agriculture and food and

nutrition security strategy. Thus, attention to agriculture and rural change remains important for many regions of the developing world and the above-mentioned tasks require public and private investments at scale.

Besides the strategic structural change and investment priorities just mentioned above, technological breakthroughs, and their adoption on a large scale, are critical in preventing food insecurity. Numerous studies have shown that spending on agricultural research and development (R&D) is among the most effective types of investment for promoting growth and reducing poverty. Advances in plant breeding have increased staple crops' nutritional value, their suitability to subtropical and tropical weather conditions, and their resistance to diseases and pests. Plant breeding and genetic modifications (GM) have created beneficial traits such as disease resistance, environmental improvement, higher nutritional value, and increased yields—traits that are difficult to achieve rapidly through traditional breeding techniques. Disseminating new technology in agriculture requires substantial upfront investments in the foundations of effective technology utilization—that is, rural education, infrastructure, and extension services. However, public R&D investments have been stagnating since the mid-1990s, and the gap between rich and poor countries in generating new technology remains large, except in a few countries such as Brazil and China. At the global level, a science and technology initiative is needed to prevent further increases in agricultural prices, reduce competition for natural resources, and adapt to and mitigate the effects of climate change. That global initiative should focus on increasing agricultural productivity, making agricultural practices more sustainable, enhancing food quality and health, and improving natural resources management. The initiative can also address nutrition insecurity directly by breeding new varieties of staple crops that are rich in micronutrients. This approach would allow the poor to receive necessary amounts of vitamin A, zinc and iron through their regular staple diets. This "bio-fortification" provides a means of reaching malnourished populations in relatively remote rural areas and delivering naturally fortified foods to people with limited access to commercially marketed fortified foods or supplements.

Policies to prevent extreme price volatility

Staple foods can be viewed from different perspectives given different actors' roles in production, trading, and consumption. For farmers, they are an income source; for food processors they are an input; for traders

and financial investors they are part of an asset in portfolios; and for poor consumers they are implicitly "currency," as they spend a large share of their income on them. The latter is the most neglected role. For the poor, grain price spikes mean hyperinflation in their currency, and they have no central bank that guards their currency. Food price volatility unpredictable large swings in prices affects the poor the most and undermines their health and nutrition. Extreme price volatility also hinders investment and leads to misallocation of resources. It increases the incentive to construct commodity asset portfolios, which foster speculative trading, further boosting price spikes.

In view of the adverse role of biofuels subsidy policies for food insecurity in times of tight grain supplies, these policies need to take food-security consequences explicitly into account, which they currently ignore. When food prices are high, subsidies for biofuel production should be frozen, reduced, or subjected to a temporary moratorium on biofuels from grains and oilseeds until extreme prices subside. Second-generation biofuel technologies are in the making but are still far from reality. If they are "smart", these technologies may partly overcome the food–fuel competition and lessen the negative effects on the poor.

Extreme price volatility is an international issue that requires international action. Together, national actions such as increasing grain stocks or restricting trade are inefficient and make global matters worse. These policy decisions—such as export restrictions which many countries have applied in the food crisis—often appear to be panic responses that give little attention to potential global market consequences. Food markets must not be excluded from the appropriate regulation of the banking and financial system, as the staple food and feed markets (grain and oilseeds) are closely connected to speculative activities in financial markets. There is growing evidence that the price formation at the main international commodity markets was significantly influenced by speculation that drove spot prices upward beyond market fundamentals (Robles, Torero, and von Braun, 2009; Algieri, 2012). To prevent extreme volatility, it is essential to ensure open trade, and transparent, appropriately regulated market institutions. Closing down futures trading in commodity exchanges is not an appropriate answer when price crises occur. But there is an institutional vacuum at the international level to address these matters. One set of actions calls for coordinated regulation, which does not require an organization. Another set of actions would require a new organization to fill the institutional vacuum—in other words, to act as the equivalent of the (missing) central

bank that protects the currency of the poor (grains). Two sets of measures are proposed here:

Better regulation. The deregulation of commodity markets in the past decade went too far and contributed to the high economic costs of volatility mentioned earlier. Regulation should curb excessive speculation in food commodities—that is, futures trading needs to be more transparent (providing information on actors and transactions), and costs of speculation should increase when prices do spike (through, for example, capital deposit regulations that increase at times of spikes for non-commercial and index trading but can be insignificant under normal market situations). Simply excluding food from speculative futures markets would be wrong, because these activities also play a useful intelligence role in identifying prices and signalling scarcity to investors.

Institutional innovation. Global collective action for grain policy that enhances food security is needed to overcome the collective action failures in grain markets. The instruments should be composed of two elements: First, an independent grain reserve (that may include other healthy foods) should be established exclusively for emergency response and humanitarian assistance. Such a reserve could be handled in a decentralized way and backed by an international agreement that assures free movement of grains to address food emergencies at all times. Second, an "International Grain Reserves Bank" should be established and tasked specifically with protecting the currency of the poor—grain prices—from crisis-type spikes. It would be governed like an independent central bank and equipped with resources similar to those of a central bank: it would have a modest reserve shared by nations at the regional or global level and a financial fund that positions it as a potentially active market player. It would advise on market-oriented regulatory regimes. This reserve bank concept is not a price stabilization fund, but it is an institutional tool for reducing risk and preventing large spikes that cause hunger and trade disruptions. Any cost–benefit assessment of these proposed regime-changing institutional actions need to consider the cost of action versus costs of inaction in three domains—the costs of human resources and suffering from the food crisis, the costs of losses from trade and the political disruptions as trade would remain more open under such a regime, and the costs from higher national grain stocks and excessive self-sufficiency investments.

Regional policy bodies, such as the Association of Southeast Asian Nations (ASEAN), South Asian Association for Regional Cooperation (SARC), and African regional and sub-regional bodies have partly

implemented joint reserve policies, which could be one step in the proposed direction if they become meaningful in terms of scale and reliability. A regional set of arrangements, however, is suboptimal and may run into trust problems in regions with one or two dominating regional powers. A key role could be played by more open trade and stock release policies by India and China, who both sit on large grain stocks. More trade liberalization in general and especially by these two nations could improve the global food security situation (Kumar, Roy and Gulati, 2010).

Social protection and nutrition policies

Actions related to agricultural production, trade, and reserves are necessary but not sufficient for overcoming the food and nutrition security crisis, which is not just an acute problem, but a chronic global one. Another set of public policies is required to address health and nutrition risks through social transfers and health services. Most of these actions are carried out by national governments, but international support for these investments is also needed, especially in the least developed countries. Setting priorities in this area requires a sound metric for targeting actions and measuring progress. First, a focus should be put on lives saved and livelihoods improved (measured by reduced mortality and morbidity), criteria of success that might also be considered in any future MDG framework. Second, priority should be given to enhanced economic productivity, growth, and returns to investment (measured by human productivity and lifetime earnings). A framework that includes both of these very different concepts may be helpful for stimulating an informed policy discourse on priority setting. With that in mind, policy actions in three priority areas are called for: (1) expand social protection and child nutrition action to protect the basic nutrition of the most vulnerable; (2) take protective actions to mitigate short-term risks (such actions would include cash transfers, pension systems, and employment programs); and (3) adopt preventive health and nutrition interventions to avoid long-term negative consequences. Social safety nets not only ease poverty in the short term, but also enable growth by allowing poor households to create assets, protect their assets, and allocate resources to more risky but highly remunerative production activities. Since good nutrition is crucial for children's physical and cognitive development, as well as their productivity and earnings as adults, early childhood nutrition and school feeding programs should be strengthened and expanded to ensure universal coverage (Hoddinott and others, 2008). Interventions need to be developed and include the following options:

Transfer actions. Programs transferring income to the poor in response to food crises have a long tradition, in particular as food price subsidies and rationing schemes. Often, however, they are ineffective and fail to reach the most food insecure. Of relevance are also employment-related transfer programs, such as the Indian rural employment scheme, scaled up to the national level in the past decade. Cash transfer programs are increasingly common. These programs—which transfer cash to households partly on the condition that they meet certain requirements such as sending children to school and using preventive health services—have proven successful in reducing poverty in the short run (through cash transfers) and in the long run (through the human capital formation that they encourage). They work particularly well in countries with low school attendance and adequate schooling infrastructure. They are not magic, however—they do not work in every country, can have adverse fiscal and labour market effects, and alone they are not sufficient for reducing poverty sustainably. Early childhood nutrition actions should be connected to them where needed.

Nutrition and health actions. Lack of energy is generally an issue only in highly food-insecure areas, but micronutrient malnutrition is much more widespread and pervasive. The core problems of low birth weight and early childhood under-nutrition need primary attention in nutrition and health actions. One promising way to start is to identify gaps where existing programs are insufficient to reach needed coverage and impact. Communities with the highest concentration of poor and vulnerable can guide priority setting. While problems of insufficient and poor-quality food persist, changes in the global environment are creating new nutritional issues such as the "nutrition transition"—a process by which globalization, urbanization, and changes in lifestyle are linked to excess caloric intake, poor-quality diets, and low physical activity, which together lead to rapid rises in obesity and chronic diseases even among the poor in developing countries. The main challenge for agriculture, health, and nutrition is thus to adapt to the changing environment and address the double burden of under- and over-nutrition by maintaining adequate food supply while increasing the production of low-cost, high-quality foods to improve diet quality among the poor. There is still too little private sector engagement in food fortification and in child nutrition in developing countries, in such areas as the delivery of low-cost and healthy baby foods. New alliances among the private and public sectors and nongovernmental organizations (NGOs) are needed in this field of action.

6.5 Conclusions

Six statements summarize this chapter's main points to be considered in achieving global food and nutrition security in the years ahead:

- The current and future MDGs should have a strong focus on the poverty and hunger goals. The hunger target that accompanies the poverty target brings attention to the food and nutrition security of the extreme poor—those far below the poverty line—and that should be maintained and further strengthened.
- A next set of MDGs should actually include an "End Hunger"-goal over an ambitious but realistic time schedule, where hunger is defined as under-nourishment, and where the progress toward the goal is well monitored based on people-level (household) data, not just broad trend estimates, as currently the case.
- The actions for achieving future MDGs require stronger prioritization, sequencing, transparency, and accountability for successful implementation. Related governance practices in many developing countries must be strengthened, as well as global governance of food, which does not currently deliver the necessary public goods to achieve food and nutrition security for the poor.
- The global context has changed in two important ways: agriculture and food are now part of an emerging bioeconomy, and food markets operate within the context of financial markets and macro-economic forces. Thus, food security in the future is to a less extent just a matter of agricultural development, as important as that remains. The emerging bioeconomy does offer opportunities for the rural poor and is not mainly a risk.
- Strategic elements of the required policy and program actions include nexus-oriented approaches to overcoming supply constraints through enhanced food sector productivity. An essential component of resilient agriculture is an end of land and soil degradation. The end hunger goal must be combined with related environmental sustainability goals in an inseparable package.
- Actions to address the new causes of food price volatility driven by financialization of food commodity markets are called for. Volatility also requires even more attention to social protection actions, including their connection to health investments, remain an essential element of food and nutrition security policies in the future.

Notes

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Chapter 7
Demographic dynamics and the international development strategy beyond 2015

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7.1 Introduction

The repercussions of demographic dynamics for development are considerable. Whereas countries find themselves at different stages of their demographic transition, the world population as a whole is ageing and becoming increasingly urban. Demographic trends cannot be easily reversed as they have built-in momentum, but they can be largely anticipated. The topic is obviously complex and vast, and cannot possibly be covered by a single chapter. Thus, this chapter will discuss some of the major impacts of demographic change on economic growth through its implications for labour supply, consumption, saving and investment patterns. But while demographic dynamics affect growth, economic growth has implications for the support of dependent populations as well. Economic growth is needed to support an appropriate distribution of consumption between active and inactive populations in order to avoid a high incidence of poverty among the inactive population. The question of support of dependent populations is relevant to the fulfillment of both the current and future international development agenda and related goals. Both the old and the very young represent a considerable share of the poor, even though not all of those in their working years are productively engaged and rewarded accordingly.

The chapter is organized as follows. Section two provides a brief overview of anticipated demographic trends for the period 2010-2050. The subsequent sections analyze the implications of demographic changes for economic growth. Challenges confronting countries with growing populations and labour force are addressed in section three, while those of countries with declining working populations are taken in section four. Issues of distribution and the provision of support for dependent populations are taken in section five and section six concludes.

7.2 Demographic trends

The global population reached the 7 billion mark in 2011, and is projected to grow to about 9.3 billion by 2050. Overall, fertility will continue to decline, from about 2.5 children per woman presently to 2.17 children per woman, closely approaching the "replacement level" of fertility (2.1 children per woman) in 2050. The increase in world population is taking place in developing countries (see table 7.1), particularly in low-income and some middle-income countries. In sharp contrast, in many developed countries but also in some developing countries population numbers are stable or in some cases even declining. The development implications, especially in a horizon to 2050, are consequently diverse.

The size of world population is also influenced by trends in longevity. Worldwide, life expectancy at birth is expected to continue to rise, from about 68 years presently to nearly 76 years by 2050. However, many developing countries continue to have very high rates of morbidity and mortality, especially among children. With persistent communicable diseases and a growing burden of non-communicable diseases and injuries, most developing countries are facing a double burden of disease which is hindering development efforts.

Changes in demographic dynamics have led to a major transformation of the age structure of the world population. The world is getting older. Worldwide, the share of children (ages 0 to 14) is expected to decline from 26.8 per cent in 2010 to 20.5 per cent in 2050. However, many developing countries still have young populations, owing to their relatively high fertility. Meanwhile, the share of persons aged 65 and above will jump from 7.6 per cent to 16.2 per cent from 2010 to 2050, respectively (see table 7.1). While population ageing is more advanced in the developed economies, most of the increase in older populations will take place in developing

Table 7.1
Population by broad age group, 1970 -2050

	Population (thousands)				Percentages			
Age group	1970	2010	2025	2050	1970	2010	2025	2050
World								
0-14	1 384 365	1 846 675	1 914 241	1 907 753	37.5	26.8	23.9	20.5
15-64	2 114 175	4 524 850	5 248 599	5 887 808	57.2	65.6	65.6	63.3
65+	197 646	524 364	840 138	1 510 567	5.3	7.6	10.5	16.2
total	3 696 186	6 895 889	8 002 978	9 306 128	100.0	100.0	100.0	100.0
Developed countries								
0-14	261 713	203 946	213 449	218 179	26.0	16.5	16.6	16.6
15-64	645 084	834 910	806 671	756 340	64.1	67.6	62.7	57.7
65+	99 625	197 044	266 619	337 213	9.9	15.9	20.7	25.7
total	1 006 421	1 235 900	1 286 739	1 311 731	100.0	100.0	100.0	100.0
Developing countries								
0-14	1 122 653	1 642 729	1 700 792	1 689 574	41.7	29.0	25.3	21.1
15-64	1 469 092	3 689 940	4 441 928	5 131 468	54.6	65.2	66.1	64.2
65+	98 021	327 321	573 519	1 173 355	3.6	5.8	8.5	14.7
total	2 689 765	5 659 989	6 716 239	7 994 397	100.0	100.0	100.0	100.0
Least developed countries								
0-14	137 763	334 007	409 641	504 276	44.2	40.1	35.8	29.2
15-64	164 869	469 955	688 653	1 100 620	52.8	56.5	60.2	63.7
65+	9 398	28 368	46 051	121 572	3.0	3.4	4.0	7.0
total	312 030	832 330	1 144 344	1 726 468	100.0	100.0	100.0	100.0

Source: UN/DESA, World Population Prospects. The 2010 Revision.

countries. Already some 63 per cent of the world's older population lives in developing countries. The process of population ageing in these countries—in particular the middle-income countries—is taking place at a much faster rate and at lower levels of income when compared with past trends in developed countries. Developing countries are getting older before getting richer. Moreover, the old population is getting increasingly older. In 2010, there were some 72 million people aged 80 and above, or 17 per cent of the world population aged 65 and above. By 2050 their numbers will reach 402 million, or 27 per cent of the older population.

At the global level, the population of working age (ages 15 to 64) is expected to grow from the current 4.6 billion to 5.9 billion in 2050, but in relative terms, its share will decline from the current 65.6 per cent to 63.3 per cent. This age group encompasses the majority of workers and

the evolution of the working-age population (WAP) gives an indication of the dynamics underlying the future supply of labour and the potential for economic growth. The increase in the global labour force will take place in the developing countries, and it will be particularly high in the least developed countries (LDCs). In general, the population of working age is expected to decline for the developed countries as a whole during the period 2010-2050, particularly in Europe and Japan. Additionally, at the global level, the working age population itself has begun to age in recent years. By 2025, the number of older working-age people (aged 50-64) will outpace the young working-age population (aged 15 to 24) and reach 25 per cent of the WAP by 2050. Older persons in the WAP will gradually become more predominant in the labour force of the future, which may bring implications for productivity growth.

Diverging demographic dynamics and persisting economic inequalities imply that pressures for international migration will continue (see chapter 11). Since 1960s, the developed regions have been net gainers of emigrants from the developing regions. Annual net migratory flows to developed countries reached 3.4 million migrants during the period 2000-2010 but are anticipated to decline to 1.9 million per year by 2040-2050 (United Nations, 2011). Thus, while the projections presented here already take international migration into account, the feasibility of increasing migratory flows to offset anticipated demographic trends comes to the fore. However, as discussed below, international migration cannot provide a definitive solution to the challenges of shrinking and ageing populations and of unemployment in poor countries.

Demographic dynamics and dependency ratios: key challenges ahead

The age structure of the population is reflected in dependency ratios, defined as the ratio of the dependent populations (children aged 0 to 14 and older people, at 65 and above) to the working age population (ages 15 to 64). Trends in total dependency vary across countries, conditional on the changes in child dependency (reflecting different stages in the fertility transition) and on longevity.

The demographic transition starts with a reduction of mortality, in particular for children. Population growth accelerates and the proportion of children in the population increases, leading to an increase in total dependency ratio. Eventually, longer survival rates among children contribute to a reduction in fertility and to a slowdown in population growth.

Thus, the proportion of the working age group in the population increases, while the long-term increase of the old-age population has not yet started. During this period, dependency ratios decline and may provide a potential boost for income growth, a demographic dividend, if the larger labour force is productively employed. In time, sustained fertility declines, accompanied by increased longevity, lead not only to a lower proportion of children but also to a shrinking share of adults of working age in total population and to higher dependency rates—this time due to old age factors.

At the global level, dependency ratios are still falling, reflecting the decline in the child dependency ratio in developing countries. But the global total dependency ratio is projected to reach a plateau very soon, around 2025. It will then begin a gradual but persistent rise. The old age dependency ratio is expected to increase everywhere (see table 7.2). For the majority of the developed countries, such an increase will be accompanied by rising child dependency ratios as well. But trends are also somewhat different within these two main groups of countries.

Table 7.2
Dependency ratios, 1970-2050

	1970	2010	2025	2050
World				
Child dependency	65	41	36	32
Old Age dependency	9	12	16	26
Total dependency	75	52	52	58
Developed countries				
Child dependency	41	24	26	29
Old Age dependency	15	24	33	45
Total dependency	56	48	60	73
Developing countries				
Child dependency	76	45	38	33
Old Age dependency	7	9	13	23
Total dependency	83	53	51	56
Least developed countries				
Child dependency	84	71	59	46
Old Age dependency	6	6	7	11
Total dependency	89	77	66	57

Source: UN/DESA, World Population Prospects. The 2010 Revision.

Note: The ratios presented in this table are multiplied by 10. Based on medium variant projections after 2010.

Among developing countries, in one group of countries—largely in sub-Saharan Africa, Central America, South Asian and parts of Western Asia (see table 7.3)—the total dependency ratio will continue to drop during the period 2010-2050 as the decline in child dependency more than offsets the increase in old age dependency. The population of working age in this group of countries is increasing both in numbers and as a share of the total population. This situation can provide a significant boost for the growth of income per capita as resources previously employed in the support of dependent children can be released for investment and growth once enabling policies are in place. At the same time, these are low and lower-middle income countries, some of which are challenged by structural and financial constraints and confront low and/or stagnant productivity growth, severely under-developed human resources, youth unemployment and under employment and economic activities which are predominantly informal. They may not be able to benefit from the demographic dividend if policies are not adjusted accordingly, in line with what will be suggested in the sections below.

Other developing countries (mostly middle-income countries in South America, parts of Western Asia and North Africa) and also some developed countries (largely the Anglophone countries) will experience an increase in their overall dependency ratios due to the increased old-age dependency while their labour force is still growing (albeit at declining and slower rates). This group of countries will have to continue to expand productive employment opportunities and, at the same time to provide for their larger and increasing dependent, older population, by introducing or reforming existing formal support systems and reinforcing informal support mechanisms. However, a growing labour force—ceteris paribus—should facilitate this adjustment process.

Finally, most developed countries but also a few developing countries will confront higher a dependency ratio with a shrinking labour force. For these countries, sustaining and increasing productivity levels by a graying and smaller labour force is a major challenge ahead. Nonetheless, the challenge is less pressing for developed than for developing countries. Given the level of resources at their disposal, developed economies are better placed to address the task at hand. In fact, what matters most is not the number of workers, but total output, which is determined by the number of workers and their productivity (Lee and Mason, 2011). Currently, societies with low fertility spend much more on health and education per child than countries with higher fertility, which means that the developed economies are also

Table 7.3
Trends in Dependency Ratio, 2010-250

A. Countries with a decline in dependency ratios (child effects)	
Afghanistan	Madagascar
Angola	Malaysia
Bangladesh	Malawi
Belize	Mali
Benin	Mauritania
Bhutan	Micronesia (Fed. States of)
Bolivia (Plurinational State of)	Mozambique
Botswana	Namibia
Burkina Faso	Nepal
Burundi	Nicaragua
Cambodia	Niger
Cameroon	Nigeria
Cape Verde	Occupied Palestinian Territory
Central African Republic	Pakistan
Chad	Papua New Guinea
Comoros	Paraguay
Congo	Peru
Côte d'Ivoire	Philippines
Democratic Republic of the Congo	Rwanda
Djibouti	Samoa
Dominican Republic	Sao Tome and Principe
Ecuador	Saudi Arabia
Egypt	Senegal
El Salvador	Sierra Leone
Equatorial Guinea	Solomon Islands
Eritrea	Somalia
Ethiopia	South Africa
French Guiana	Sudan
Gabon	Suriname
Gambia	Swaziland
Ghana	Syrian Arab Republic
Guatemala	Tajikistan
Guinea	Timor-Leste
Guinea-Bissau	Togo
Guyana	Tonga
Haiti	Turkmenistan

(cont'd)

Table 7.3 (cont'd)	
Honduras	Uganda
India	United Republic of Tanzania
Iraq	Uzbekistan
Jordan	Vanuatu
Kenya	Venezuela
Lao People's Democratic Republic	Yemen
Lesotho	Zambia
Liberia	Zimbabwe
B. Increase in dependency ratio (old age effects)	
B1. Countries with growing WAP	
Developing countries	
Algeria	Lebanon
Argentina	Libya
Azerbaijan	Macedonia
Brazil	Maldives
Brunei	Mexico
Chile	Mongolia
Colombia	Morocco
Costa Rica	Myanmar
Korea, PDR	Oman
Fiji	Panama
Georgia	Qatar
Grenada	St Lucia
Guadaloupe	St Vincent and the Granadines
Indonesia	Sri Lanka
Iran	Tunisia
Israel	Turkey
Kuwait	Uruguay
Kyrgyzstan	VietNam
Developed countries	
Australia	New Zealand
Canada	Norway
Iceland	Sweden
Ireland	United Kingdom
Luxembourg	United States
B.2 Countries with shrinking WAP	
Developing countries	
Armenia	Jamaica
Aruba	Korea, Rep

(cont'd)

Table 7.3 (cont'd)	
Barbados	Mauritius
China	Singapore
Cuba	Thailand
Hong Kong, SAR	Trinidad and Tobago
Developed countries	
Albania	Latvia
Austria	Lithuania
Belgium	Malta
Belarus	Poland
Croatia	Montenegro
Bosnia	Portugal
Bulgaria	Romania
Denmark	Russian Federation
Estonia	Serbia
France	Slovakia
Germany	Slovenia
Greece	Spain
Hungary	Switzerland
Italy	Ukraine
Japan	

Source: UN/DESA, World Popualtion Prospects. The 2010 Revision
Note: Countries in italics are LDCs

those with the highest levels of human capital, and consequently are better equipped to sustain and expand productivity.

7.3 Addressing the challenges in countries with young and growing populations

Changes in the size and in age structure of the population present a challenge for output growth and its distribution between the economically active and the dependent populations. The WAP in the first group of developing countries mentioned above amounted to some 1.7 billion people in 2010. It will grow to 3.3 billion by 2050. Based on current trends, at least 70 per cent of them will participate in the labour market. This implies that some 1.1 billion new jobs will need to be created from now to 2050 just to accommodate the increase in the labour force. And if poverty is to be reduced, the nature of jobs created needs to change.

Currently, a large proportion of the labour force of these countries is engaged in the informal sector and in low-productivity agriculture. Nearly 75 per cent of those employed in South Asia and sub-Saharan Africa—two of the regions that comprise many of the countries in this group—were own account workers and contributing family workers, often earning low incomes and comprising a disproportionately large share of the working poor (less than $1.25 per day). In fact, the share of the working poor in total employment was 43.5 per cent in South Asia and 58.5 per cent in Sub-Saharan Africa in 2009 (ILO, 2011). Thus, the quality of employment needs to be urgently improved, which requires continuous increase in levels of productivity. Relying on subsistence agriculture and the urban informal sector as the employers of last resort for an increasing labour force will simply not do for these countries.

Economic growth is a pre-requisite for employment generation, but growth per se does not guarantee that jobs are created rapidly enough to absorb the new entrants to the labour force and reduce existing level of unemployment and underemployment. Most of these countries experienced fast rates of growth in the first decade of the 2000s and yet the labour intensity of GDP growth was clearly not enough. The pattern of growth must be labour absorptive, which largely depends on productive specialization and on the quality of labour resources available in the economy (United Nations, 1997).

As further discussed in chapter 8, the neglect of agriculture—the largest employer in many poor countries—in the past decades has to be reversed. Moreover, with the ongoing feminization of agriculture, increased agricultural productivity also depends on removing specific constraints that women encounter as producers. Reducing the productivity gap between male and female farmers would significantly contribute to higher agricultural output (Agarwal, 2011).

A growing farm sector can increase the demand for the non-agricultural sector (often micro and small enterprises, which are important sources of employment in rural areas) and provide inputs to other sectors of the economy therefore reducing demand constraints and promoting dynamic linkages. But the challenges are great here as well. Although offering an important potential for job creation, these firms face large structural challenges, including lack of access to electricity, finance and transportation infrastructure, which require structural solutions (ADB/OECD/UNDP/UNECA, 2012). They usually cater to the low-income sectors, supplying goods and services produced using simple or outdated technologies; many

fail to forge productive linkages with the more dynamic sectors of the economy; most remain confined to one single entrepreneur, not an optimal size in many instances, and frequently have a very short life span (United Nations, 1997).

Strategies to increase productivity in agriculture and strengthen the rural non-agricultural sector need to include measures that enhance the quality of the human capital in a way that is consistent with the needs of these economies (see chapter 8). Three main challenges are noteworthy. First is the supply of basic education to a large, if not growing, number of children. As can be seen in table 7.1, there will be 504 million children (0 to 14) in the LDCs by 2050, compared to the current 334 million. Yet, increasing enrolment is not enough; the quality of the education needs to be urgently improved. Moreover, barriers to secondary education need to be removed as primary education does not equip the individual with the skills needed to tap the opportunities of the labour market, especially if agro-processing and manufacturing activities are to be pursued and eventually upgraded. Second, post-primary education, particularly of technical and vocational type, is often missing or insufficiently developed (CDP, 2011). In this regard, the particular needs of the rural economy and of the informal sector should not be neglected (ADB/OECD/UNDP/UNECA, 2012). Third, skills mismatches need to be avoided and the education system needs to be geared to produce graduates with the range and levels of skills the market needs. At the same time, poor countries experiencing rapid population growth are constrained in their capacity to expand public services that are fundamental for increased labour productivity and growth and therefore, improved welfare. The international cooperation has an important role to play in supporting these countries efforts while innovative forms of partnerships between the public and private sector need to be explored to remove these constraints.

While the increase in the older population cannot be avoided, some of the long-term pressures coming from population growth can. Young workers (15-24) anticipated to join labour markets in 2050 will only be born by 2025-2035. The already significant increase in children and young people projected for the next 40 years in the LDCs, for instance, assumes a drop in fertility from 4.41 children per woman in 2005-2010 to 2.76 in 2045-2050. Lower fertility rates are associated with greater human capital investment per capita, with positive implications for productivity growth and development. But extending primary and secondary education does not guarantee, by itself, a reduction of fertility. It needs to be complemented

by interventions in the area of family planning, reproductive health and by the promotion of the necessary adjustments in cultural and societal practices.

In a number of developing countries women marry very young, a significant proportion of them before age 15, including in countries where the minimum legal age at marriage with parental consent is 16 to 18 years (United Nations, 2012). Adolescent birth rates are high and increase with the percentage of women married at young age, with ensuing negative consequences for the completion of education and better integration of young women and men into the labour market. A substantial proportion of young women have expressed unmet need for family planning, particularly in the marginalized segments of the population. As a result, more than 6 million unwanted pregnancies take place in developing countries annually (United Nations, 2012). Access to family planning services for young men and women should be promoted, and reproductive health should be included in primary care and with universal access.

Increasing the legal age of marriage and better enforcement of existing laws may help but are not sufficient to counter early marriage in societies where it is seen as beneficial or an accepted and encouraged practice. Thus, there is also need for culturally sensitive programmes that promote marriage at later ages and discourage dowry practices.

Early marriage is also associated with low levels of education. The higher the level of illiteracy among women aged 15-24, the higher the propensity to marry young (United Nations, 2012). The propensity is also higher among those with no education and primary education in comparison with women with secondary education. In this regard, removing barriers of access to education by girls and increasing family incentives to send them to school are crucial.

7.4 Countries with smaller labour forces: enlarging the pool of workers

The rate of growth of GDP per capita can be expressed in terms of the growth of employment (often proxied by the growth of the population of working age) plus the growth in labour productivity. Thus, a contracting population of working age (or one that grows at declining rates) would lead to lower output growth, if labour productivity cannot be raised sufficiently to offset that contraction (or decline).

A number of policy options can be explored. Enhanced labour force participation, migration, outsourcing, and, as suggested above, increased labour productivity are among the possible responses. Despite some recovery in a few developed countries (Belgium, Denmark, Italy, Spain and Sweden, among others), it is highly unlikely that fertility will recover to replacement levels in the near future.

Turning to migration, the impact of international migration on volume of workers and on fertility rate although positive in the short-term, it is unsustainable in the long-term. It has been estimated that to offset the projected decline of population in Europe, annual net migratory inflows (1.8 million) would need to be twice as high as what was observed in 1995-2000 for the next 40 years. Levels of migration would need to be even higher to offset the projected decline in working age population for Japan and several European countries. For Europe, the total number of immigrants needed for the period 1995-2050 would amount to 235 million people, four times the migration experienced in the last 50 years. If such flows were to occur, post-1995 immigrants and their descendants would come to represent (an implausibly) large share of the total population in 2050; between 30 and 39 per cent in the case of Japan, Germany and Italy (United Nations, 2000). It is far from clear whether social, political and cultural conditions in these countries can accommodate such a large influx of migrants. Naturally, migration will help to offset some of the pressure and will continue to respond to trends in both developing and developed countries. There is already a noticeable rise in the number of female migrants as new jobs are created in the "care economy" (Alonso 2012), while the need for increased participation of females in labour markets discussed below will contribute to add pressures to female migratory flows. But international migration even if it helps to ease the adjustment in the short term will not solve for the problem of shrinking labour force in these economies in the long term.

Increasing participation rates

Output is generated by those who are de facto working; participation rates matter. Thus, relatively low participation rates among certain groups offer a potential to be explored. Overall, participation rates are higher in developing than in developed countries. This is probably due to the higher participation rates at relatively younger ages (aged 15-24) in developing countries, particularly in low-income countries, as well as to the relatively lower participation rates among older workers (aged 55-64) in developed

countries owing to early retirement. Among those aged 65 and older, participation rates are, on average, twice as high in developing than in developed countries owing to the limited old-age pension coverage and lack of alternative earnings options. Male participation rates are higher than female across the regions. In some instances, the gender gap in participation rate can be quite substantial (see tables 7.4a and 7.4b). For a few countries, projected increases in participation rates among those aged 15 to 64 years will not be enough to ensure a growing labour for the period 2010-2020. Increasing participation rates among women, older workers as well as among those aged 65 and above can partially offset declining labour force trends.

Female participation rates

The gender gap continues to be significant in the labour market. In the developed countries, it reaches a peak at around 24 percentage points for the 30-39 age group, which reflects the decline in female participation rates as they temporarily withdraw from the labour market probably owing to childbearing and child-rearing. As in United Nations (2007) a decomposition exercise was conducted to assess the possible implications of increased female participation on the size of the labour force and on the rate of growth of the developed economies. The exercise was based on the accounting identity discussed in the introduction to this section, with the growth rate of labour productivity assumed to be constant at 2 per cent per year over the period 2010-2050. Female participation rates were assumed to converge to male participation rates by 2020 and remain at that level for the remainder of the period. Results were compared with a baseline where female participation rates in the more advanced economies retained their anticipated trajectory, that is to say, they would increase from 65.9 per cent in 2010 to 67.5 per cent in 2020, and remain at that level after 2020. Results are presented on table 7.5 below.

The sharp rise in female participation rates (independently of its actual feasibility in such a relatively short period of time) would more than offset the anticipated decline in labour force during the period 2010-2020. Moreover, it would lead to an increase in the annual rate of growth of per capita GDP by 0.74 percentage points over the baseline. With no additional surges in the female participation rate during the subsequent period (2020-2050), the increased female labour force boosts the annual rate of growth of per capita GDP by 0.25 per cent over the baseline—a much smaller but not a negligible effect. It is also interesting to note that where the shock to the

Table 7.4a
Labour force participation rates at ages 15-64, 2000-2020

Percentage									
	Labour force participation rates of population at ages 15-64 (%)								
	Total			Male			Female		
Major area, region or country	2000	2010	2020	2000	2010	2020	2000	2010	2020
World (total)	70.3	69.9	69.8	83.6	82.6	82.7	56.7	56.8	56.6
Africa	67.7	68.8	70.0	81.5	81.6	81.8	54.1	56.2	58.2
Eastern Africa	83.3	84.1	84.5	88.6	87.9	88.0	78.1	80.3	81.1
Middle Africa	73.2	73.3	74.2	86.4	85.4	85.2	60.3	61.4	63.3
Northern Africa	53.6	54.4	54.7	78.8	79.5	79.6	28.2	29.3	29.8
Southern Africa	56.4	60.2	62.1	64.5	67.9	70.1	48.6	52.7	54.0
Western Africa	64.1	64.7	65.5	78.8	78.1	77.5	49.6	51.3	53.4
Asia	71.1	69.5	69.0	85.6	83.9	83.9	55.8	54.5	53.2
Eastern Asia	81.4	78.6	78.1	87.6	84.4	84.4	74.8	72.5	71.4
South-Central Asia	61.4	61.9	62.5	84.6	84.2	84.7	36.7	38.3	39.1
South-Eastern Asia	72.6	72.1	72.2	85.3	84.4	84.3	60.1	59.9	60.1
Western Asia	53.8	53.2	52.3	77.5	76.3	75.1	28.1	28.1	27.7
Europe	68.7	70.9	71.9	76.1	76.9	77.2	61.5	65.0	66.6
Eastern Europe	68.0	68.6	69.8	73.1	73.4	74.1	63.1	64.1	65.8
NorthernEurope	75.2	76.1	77.2	81.5	81.5	82.1	68.9	70.8	72.1
SouthernEurope	63.4	67.8	67.7	75.7	77.3	76.4	51.1	58.1	58.7
WesternEurope	70.9	74.7	75.7	78.5	80.0	79.9	63.1	69.4	71.4
Latin America and the Caribbean	66.7	69.2	70.0	83.6	82.8	82.3	50.2	55.9	58.0
Caribbean	64.8	66.3	67.4	79.7	79.0	79.3	50.2	53.8	55.6
CentralAmerica	63.4	65.2	66.7	85.6	83.9	83.7	41.9	47.3	50.5
South America	68.1	70.9	71.5	83.3	82.9	82.0	53.3	59.3	61.1
North America	76.8	74.6	74.8	83.3	80.3	79.9	70.4	68.8	69.6
Oceania	73.1	75.3	75.9	80.8	81.2	81.1	65.3	69.3	70.6
Memo items:									
Moredeveloped regions	71.3	72.3	73.1	79.1	78.7	78.8	63.7	65.9	67.5
Less developed regions	70.1	69.3	69.2	84.8	83.4	83.4	54.8	54.7	54.4
Leastdeveloped countries	74.8	75.1	75.7	86.5	85.0	84.6	63.3	65.4	66.9

Source: ILO, LABORSTA. Economically Active Population Estimates and Projections: 1980-2020 (EAPEP), table E5 (http://laborsta.ilo.org/applv8/data/EAPEP/eapep_E.html).

Table 7.4b
Labour force participation rates at ages 65+, 2000-2020

Percentage									
	Labour force participation rates of population at ages 65+ (%)								
	Total			Male			Female		
Major area, region or country	2000	2010	2020	2000	2010	2020	2000	2010	2020
World (total)	19.0	19.5	19.9	30.0	29.2	28.6	10.5	11.8	12.8
Africa	40.5	39.7	38.7	54.1	53.0	50.8	29.3	28.9	29.0
Eastern Africa	59.2	61.3	61.4	73.7	76.3	76.4	47.3	49.1	49.7
Middle Africa	51.3	50.4	50.1	63.0	62.3	61.7	42.1	40.9	40.8
Northern Africa	20.3	18.1	16.8	35.8	32.1	28.4	6.8	6.2	6.8
Southern Africa	14.2	7.2	5.7	20.7	10.5	7.2	10.0	5.2	4.7
Western Africa	45.0	44.6	44.3	57.6	57.4	56.1	34.2	33.6	34.3
Asia	23.0	21.3	20.4	36.7	32.8	30.2	11.2	11.4	11.9
Eastern Asia	20.2	19.7	19.1	32.2	30.0	27.6	10.1	10.8	11.7
South-Central Asia	23.0	17.3	15.5	40.1	31.7	28.0	6.7	4.6	4.6
South-Eastern Asia	36.3	39.7	39.8	49.3	51.2	50.0	26.0	30.7	31.7
Western Asia	20.8	14.6	13.9	33.2	24.0	22.5	10.8	7.2	6.8
Europe	6.7	6.8	7.1	9.4	9.1	9.3	5.0	5.3	5.7
Eastern Europe	11.4	10.6	10.6	15.9	13.5	13.2	9.0	9.1	9.1
NorthernEurope	5.9	8.5	9.8	8.8	12.2	13.3	3.8	5.7	7.1
SouthernEurope	4.8	4.6	4.5	7.5	7.2	6.8	2.9	2.7	2.7
WesternEurope	2.3	3.5	4.1	3.7	5.1	5.7	1.3	2.3	2.8
Latin America and the Caribbean	25.7	30.7	32.2	41.1	45.3	46.6	13.6	19.2	20.8
Caribbean	19.3	18.3	17.4	28.3	25.9	23.5	11.6	12.0	12.4
CentralAmerica	30.5	28.6	26.4	50.1	44.5	38.8	14.7	15.1	15.8
South America	25.0	33.0	36.0	39.9	48.2	52.3	13.5	21.4	23.5
North America	12.2	16.9	19.0	16.9	21.5	23.5	8.8	13.3	15.4
Oceania	8.8	13.0	15.1	13.3	18.2	20.0	5.1	8.7	10.9
Memo items:									
Moredeveloped regions	10.0	11.0	11.9	14.6	15.1	15.7	7.0	8.2	9.1
Less developed regions	25.3	24.7	23.9	39.2	36.8	34.6	13.2	14.3	14.9
Leastdeveloped countries	49.2	46.2	45.7	65.3	61.0	60.3	35.3	33.9	33.7

Source: ILO, LABORSTA. Economically Active Population Estimates and Projections: 1980-2020 (EAPEP), table E5 (http://laborsta.ilo.org/applv8/data/EAPEP/eapep_E.html).

Table 7.5
Developed economies: increased female participation rates and growth of per capita GDP, 2010-2050

Average annual rate of growth, percentage change				
Baseline	GDP per capita	Employment	Productivity	Population
2010-2020	1.66	-0.10	2.00	0.24
2020-2050	1.78	-0.25	2.00	-0.03
Simulation	GDP per capita	Employment	Productivity	Population
2010-2020	2.40	0.64	2.00	0.24
2020-2050	2.02	-0.01	2.00	-0.03

Source: Author's calculations based on UN/DESA, World Population Prospects Database (2010 Revision).

Note: Annual rate of growth of per capita GDP = Employment growth + Labour productivity – Population Growth. Baseline: Male and female participation rates projected as in table 7.4a and remain at 2020 level until 2050; Simulation.

female participation rate imposed over a much longer period of time—for example, if female participation rates converged to the male ones only by the end of the period (2050), the impact of such increase would be almost negligible at 0.08 per cent per year during the period 2010-2050, compared to the baseline. This is not only because the increase in female participation would have been slower, but it would also relate to a smaller population, given expected population decline. This suggests some urgency in boosting female participation rates: the benefits (in terms of faster rates of output growth) would be greater the sooner the increase.

Naturally, these are very crude results, based on a simple accounting identity. They say nothing about whether there will be jobs available for these additional workers. Moreover, both population and labour policies would need to be better coordinated and supplemented by other interventions to facilitate and support parents in reconciling their family and their workplace obligations. Additionally, gender wage gaps need to be closed and women need to have greater access to decent employment opportunities.

In developing countries, women are overrepresented in vulnerable employment. They work as unpaid family workers and own-account workers, usually in the informal sector and in low productivity activities. Furthermore, unemployment is higher among females than males in several developing regions (ILO, 2011a). Besides removing cultural and societal constraints to women's effective participation in the labour market, increasing women's access to education and enhancing female's educational attainment have been correlated with increased female participation and higher productivity outcomes.

Older workers and working beyond retirement age

Projected declines of the labour force can also be partially offset by increasing the participation of older workers (United Nations, 2007). But to sustain current rates of GDP growth, increased participation of older workers will not be enough; productivity also needs to be maintained at older ages (see below). Increased participation rates among older persons are facilitated by structural changes taking place in the economy. It is far easier to remain active in older age in the services sector than, say, in mining or agriculture. Additionally, there has been progress in closing loopholes in the legislation that unintentionally encouraged early retirement, the statutory retirement age was raised in many countries, while the overall health status of the older population has improved over the past years thus enabling longer participation in the labour market.

Nonetheless, the effective retirement age continues to be below the statutory pensionable age for the average of the OECD countries, which calls for further reforms in this area.[2] Yet, fine tuning access to pensions and solving problems related to the design of pension schemes addresses only part of the problem. Other factors (besides individual preferences) underline decisions to retire. The overall tax policy (if heavily tilted towards labour earnings), poor working conditions, cultural norms and negative attitudes towards older workers, ill health, and low job satisfaction are also relevant factors. Another important factor is access to training and updating of skills—often less among older than younger workers (United Nations, 2007). As skills become obsolete, employability is reduced, which calls for constant upgrading and investment in human capital. Additionally, changes in working environment are necessary to retain such older workers. Such changes should encompass both possible reallocation of older workers to positions that are compatible with their age and skills and also the introduction of technologies and processes that facilitate their work.

7.5 The changes in the age structure of the population: implications for growth

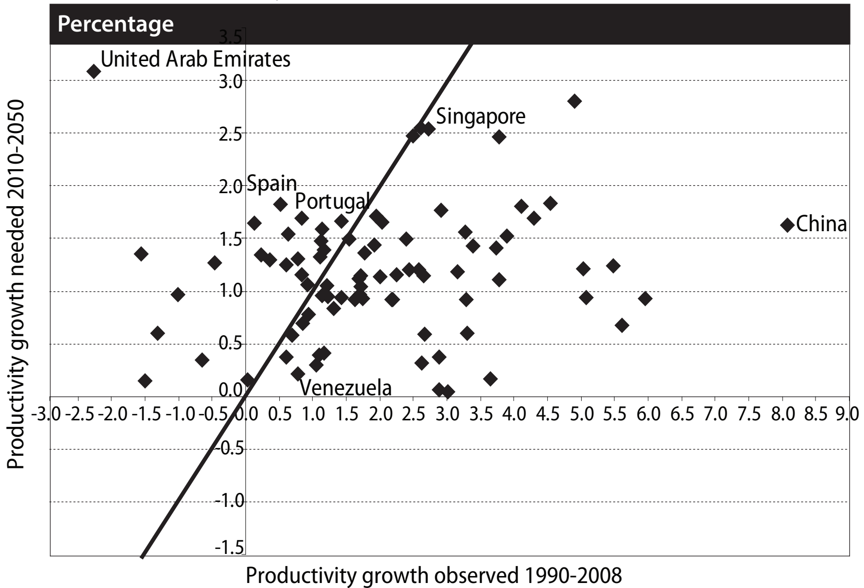
Ageing and productivity growth

In view of the anticipated demographic changes, it is important to have a rough idea of the scale of productivity increases that will be required to offset the increase in the dependent populations (both children and the

aged). Figure 7.1 plots the projected annual rate of change in the potential dependency ratio (defined as the ratio of the population of working age population to the dependent population) for the period 2010-2050 to the observed annual rate of growth of labour productivity in the period 1990-2008 (GDP per person engaged, calculated at constant 1990 PPP exchange rates).[3] The idea behind this exercise is that the increase in dependents per worker needs to be compensated by a comparable increase in labour productivity to maintain the status quo level of consumption per capita.

The good news is that among the 83 countries—largely middle-income developing countries and developed countries—considered in figure 7.1, only 23 countries—those located above the diagonal line on the graph—would need to accelerate productivity growth. Additionally, the increase in productivity seems to be reasonable at 1.5 per cent or below for the majority of the countries in the sample, with several of them already performing above that level. Naturally, for some countries 1.5 per cent implies achieving higher productivity growth than in the past, which can be challenging.

Figure 7.1
Selected coutnries: observed and required average annual rate of growth of labour productivity, 1990-2008 and 2010-2050



Source: Author's calculations based on ILO, Key Indicators of the Labour Market (KILM) database; and, UN-DESA, Population Prospects: 2010 Revision on-line database.

The not-so-good news is that these levels would only allow for the maintenance of the status quo; higher rates of growth of labour productivity are required if the level of welfare is to increase. Moreover, it is not clear whether countries can maintain such levels of productivity growth for extended periods, particularly in view of the potential impacts the change in the age structure of their labour force may have for the growth of productivity.

Freyer (2007) shows that changes in the workforce demographics have a strong significant correlation with the growth rate of productivity. He argues that an increase in the proportion of workers aged 40 to 49 seem to be positively associated with productivity growth: a 5 per cent increase in the size of this cohort over a ten-year period is associated with a 1 to 2 per cent higher productivity growth per year during the decade. Werding (2007) confirms the presence of an inverted U-shaped relationship between the share of workers in different age groups and productivity which works through the total factor productivity (TFP) channel. Age-related contributions peak for workers aged 40-49. However, as younger workers are still in the process of accumulating human capital and skills while older workers have lower final educational attainment than their successors, cohort effects in human capital accumulation may contribute to this pattern.

The relationship between age and productivity is a complex one. Sharpe (2011) argues that the impact of ageing on productivity depends on the particular combination of cognitive and non-cognitive abilities required to perform a given task. Moreover, changes in organizational structure, more effective use of ICT in specific occupations and better access to knowledge, education and training throughout work have also been identified as ways to maintain and improve productivity life (ECE, 2006; Black and Lynch, 2004). Garibaldi and others (2010) quoted in Sharp (2011, p.87) argue that "The net effect of age-specific productivity determinants depends on how individual skills are used in the work process, how the work is organized, and how the individual interacts with other workers and firm-level factors such as technology and capital levels." Moreover, age productivity profiles may change over time based on technological advancements and structural changes within an economy (ECE, 2006 and Nishimura and others, 2002) rendering some skills relevant to specific occupations more or less obsolete in the domestic labour market. Thus, the importance of investment in human capital is central and cannot be overemphasized. This also holds true for developing countries, with younger and supposedly more

creative working population and thus facing greater potential for faster productivity growth.

Overall, concerns that an aged and relatively smaller working population will lead to marked declines in economic growth seem to be exaggerated. While productivity growth remains central, levels required seem to be compatible with past experience as indicated in figure 7.1. The challenge is thus to maintain such productivity growth for prolonged periods through constant updating of skills and necessary adjustments in the work environment, including in organizational approaches.

Consumption, savings and investment

Changes in the age structure of the population have implications for economic growth beyond the labour market channel. Economic growth is affected by consumption, investment and saving decisions. Not only *what* one consumes changes according to age, reflecting evolving tastes and preferences over the life cycle but *how much* one consumes may change as well thus affecting economic growth.

Insights from the economic theory on consumption (and saving patterns) and its relationship with ageing is derived from the life-cycle model and based on the consumption smoothing hypothesis. The model indicates a constant trajectory of consumption and a hump-shaped saving pattern. During their working years, individuals produce more than they consume, and save. This surplus is used to provide for their dependent children or to finance retirement. Outside their working years, individuals tend to dissave. However, available evidence is not conclusive. Consumption does not necessarily follow a relatively constant trajectory across the life cycle, and savings do not necessarily fall as one ages.

Looking at consumption, results from National Transfer Account (NTA) project indicates there is a great deal of variation of in the level of aggregate consumption across ages. In some economies, aggregate consumption peaks at relatively young ages, while in other economies the peak takes place at much older ages (after 65).[4] Cross-country differences in part reflect diversity in the relevance of public consumption for aggregate consumption. The distributive or the consumption equalization role of public consumption is quite evident, particularly in the developed economies. These economies tend to have a higher share of public consumption in total consumption than the developing economies. Public consumption is the highest for the children in all countries (largely due to education), the smallest for

the average individual of working age but increases at older ages in some countries (Tung, 2011).

Turning to private consumption, average child (aged 0 to 19) consumption is the lowest among the three age groups considered (the other two groups are aged 20-64 and 65+) in all 23 economies, while an average older person consumes the most in only 8 out of the 23 economies. Private consumption declines for those aged 65+ in 15 countries. In general, the age profile of private consumption shows a great deal of heterogeneity. Overall, the level of consumption patterns seem to be country rather than age-driven, reflecting societal preferences, level the overall rate of income growth, the investment effort/drive in the economy and distributive or transfer mechanisms.

Age influences consumption patterns. However, several structural factors besides age— such as income, price movements, preferences, societal and technological change— underline these patterns. But if there are no strong cohort effects, it can be argued that spending on basic goods (such as food or clothing) will decline as societies age (and income rises). In particular, consumption of (non-tradable) services such as housing-related services, energy and health may increase. Health-care expenditures will likely rise as a result of increased prevalence of illness and disabilities that tend to occur more often later in life. But little can be anticipated in terms of how fast the demand for health services will increase.

At the global level, changes in the structure of production in economies with an ageing population will spill over to the rest of the world via trade. The implications for export-led growth in developing countries will depend not only on the magnitude of the change in the demand for tradable goods but also on the changes in production patterns taking place in developed economies. This global structural shift however is guided by the skill structure employed in different industrial sectors (Fehr and others, 2010). As production of tradable goods is transferred from developed to developing countries, the latter may see faster economic growth and a boost to the rise of income with positive feedback for the emergence of their own domestic market and continued growth in the future. This seems to have been the case in the last two decades, in particular for the developing economies in Asia. A structural shift in consumption towards services, i.e. non-tradable goods, in the developed countries could translate in a lower external demand for tradable goods. At the same time, many services are increasingly becoming tradable. The presence of India in the global information technology sector is a case in point.

Turning to savings, the life cycle model anticipates that countries with high child or old-age dependency ratios would have relatively low savings rates, while countries whose age structure is dominated by those in their working years would exhibit higher savings ratios. Nonetheless, not always do countries with the highest old age dependency ratios have the lowest saving ratios. Overall, cross-national differences in savings and investment seem to reflect differences in a wide range of factors.

Other factors influence savings besides demographics, particularly in the short term. In the long term, however, it is not possible rule out that demographic features influence savings. On the basis of information on 85 developing and developed countries during the period 1960-2004, Bosworth (2006) finds a strong correlation of demographic structure with both saving and investment; reductions in child and old-age dependency increase savings and investment, but changes in old-age dependency have larger effects. In sum, the significance of demographic effects varies across regions and is overall empirically small.

Savings patterns are also influenced by the design of pension schemes whose sustainability has been increasingly questioned owing to changing demographics (and poor design). Pension deficits impact on the public deficit with its potential negative consequences on macroeconomic stability and growth. Reforms have been advocated to restore the financial sustainability of such schemes and to increase the overall level of savings in the economy. Yet, while the need for reforms is recognized, pension reforms per se do not solve the demographic problem.

Pension schemes are essentially a tool for redistributing present output between those who are working and those who are not working. Whether fully funded, pay as you go, privately or publicly managed or a combination of these elements, and whether one, two or multiple pillars, the essence remains that consumption of workers and retirees must first be produced. And any pension-related "asset" acquired by today's working population is in the end a claim on future output. Hence, *output growth* is central in the discussion on sustainability of pension schemes. In this regard, a pension reform can only increase savings if consumption decreases—either of the current working through increased taxations or the retired populations through reduced benefits or both. And savings may only increase economic growth if properly and effectively invested.

Everything being equal, however, one may expect that savings will decline in those economies where an increasing share of income needs to

be transferred to those who are inactive (and whose share in the population is increasing) so that their consumption needs can be met. The impact is anticipated to take place gradually and be small (United Nations, 2007), while financial markets have an important role to play in accommodating the change. In this sense, "the kind of policies that are appropriate to reduce frictions and instability is a highly policy-relevant research area for global population aging." (Borsch-Supan, 2008: 75). In a world currently plagued by a deep financial crisis, these observations could not have been timelier.

7.6 Avoiding poverty among the dependent populations

The eradication of poverty will remain a major objective of the international development strategy beyond 2015. Poverty has a strong correlation with income security, the individual's ability to generate income and the capacity of the economy to employ productively and remunerate that individual accordingly. The risk of poverty is often higher among children and the old than it is among the working-age population. As seen above, the individual's earning capacity changes over the life cycle which makes him/her more vulnerable to poverty. The very young cannot and should not work. They need to be provided for while developing the skills necessary to be used later when they will join the labour force. Living standards often deteriorate for people at older ages due to reduced employment opportunities and deteriorating health status.

The provision of long-term care is a source of concern in view of the specific demands related to the care of persons with irreversible health conditions and the ongoing changes in the traditional family structure and the role of women in modern societies. But improvements in the overall health status of older populations can work as mitigating factor and should guide policy action. In developing countries, addressing the high prevalence of infectious diseases is still necessary while attention is also required to be given to preventive care and education to ensure increased longevity is accompanied by a healthy life expectancy. For instance, the use of tobacco and the excessive consumption of alcohol, which result in poor health in later life, are still prevalent, particularly in developing countries. In fact, few developing countries have implemented prevention programmes to encourage healthy lifestyle choices that would mitigate chronic diseases or delay their onset.

Currently older persons comprise 20 per cent of the dependent populations in developing countries; by 2050 they will represent 47 per cent. For the non-working, dependent populations, income security is provided through intergenerational transfers using both formal (public pensions and other sorts of public transfers, occupational pensions, family allowances, private pension schemes etc.) and informal mechanisms (through the family and the community). In developed countries, income security in old age is largely provided by formal pension systems and former accumulation of assets. In many developing countries, pension coverage is limited (largely due to employment in informal sector) and income security still depends on one's own work and/or informal transfer mechanisms. Worldwide, nearly 40 per cent of the population of working age is legally covered by contributory old-age schemes. Differences across countries remain considerable, largely reflecting differences in resource constraints. In Africa less than one third of the working age population is covered by legislation; effective coverage is even much lower at 5 per cent of the working age population.

In view of the strong correlation between income per capita and pension coverage, it was expected that with faster economic growth, coverage would increase in developing countries. This has not been the case. The economic growth in the recent decades has been accompanied by limited generation of wage employment in the formal sector. Additionally, pension reforms introduced in the late 1980s and early 1990s did not deliver expected results in terms of greater coverage.

The impact of old-age pensions on poverty reduction can be considerable; poverty among older people would be more common and with larger gaps in the absence of pensions. For instance, the U.S. Bureau of Census (2010) indicates that the (absolute) poverty rate among the aged (9 per cent) is below the national average (15.1 per cent) and significantly lower than among children (22 per cent). There is, however, wide variety of incidence of poverty among the old in the industrialized countries, which is largely explained by the level at which safety net retirement benefits are set. Among pensioners, poverty has a strong gender connotation: it tends to be higher among women than among men. This is due to women's shorter, intermittent participation or even lack of participation in labour markets, lower earnings and longer longevity. The share of older women living alone is higher than men's, which does not allow them to benefit from economies of scale in consumption, or shared incomes, as those living in extended households (United Nations, 2007). Increased female participation in the labour markets should offset some of the risks of poverty in old age for

women, but as long as women have shorter working lives and lower salaries, the risk of poverty in old age is greater for women than for men.

Pension reforms: ensuring sustainability, avoiding poverty in old age

The reform of pension systems has been the focus of intense debate. While financial sustainability is indeed an important consideration, it should not be the only objective to be pursued. There would be little use for a transfer scheme that is financially sustainable but fails to deliver a minimum amount of benefits and does not ensure economic security. Burtless (2005) argues that pension reforms adopted in some developed countries in recent years will lead to much smaller wage replacement ratios in the future which can make poverty a larger problem for the elderly in these countries. Similarly, the privatization of pension schemes—which still requires a great deal of public involvement in guaranteeing and supervising the system—in some developing countries has shifted economic risks to the pensioner, do not offer sufficient social insurance for idiosyncratic risks (such unemployment or disease) and may imply insufficient income during retirement.

Pension reforms also need to ensure accessibility, affordability and equity, offer the appropriate incentives and not intensify existing inequalities. There is no one-size-fits-all. Pension systems and their reforms largely depend on country contexts and reflect societal preferences in terms of redistribution of resources within and among generations. In this regard, pension systems could be approached as composite of several modules or pillars, each addressing specific needs and characteristics of different segments of the labour market. In countries with large formal labour markets, income security can be provided by a single basic public pillar, financed by earnings-related contributions. A solidarity mechanism should be built in to provide workers with unstable or insufficient earnings with minimum benefits. In countries with large informal markets or dual-labour markets, two public pillars could be considered: one non-contributory, offering a minimum floor, and the other earnings related. In all cases, individuals with capacity to make provisions for their own old-age income security to complement income to be received from the public schemes should be encouraged to do so (United Nations, 2007).

Additional challenges for developing countries

Informal mechanisms, while playing an important role in certain contexts, have been under increasing pressure due to repeated adverse shocks,

the reduced size of families, migration and changes in attitudes. More importantly, such mechanisms operate on a small scale, cannot diversify risks efficiently and are often unreliable. Therefore, for developing countries, where informal mechanisms are more frequent, the challenge is not only to ensure the sustainability of existing old-age pension systems but also to increase coverage.

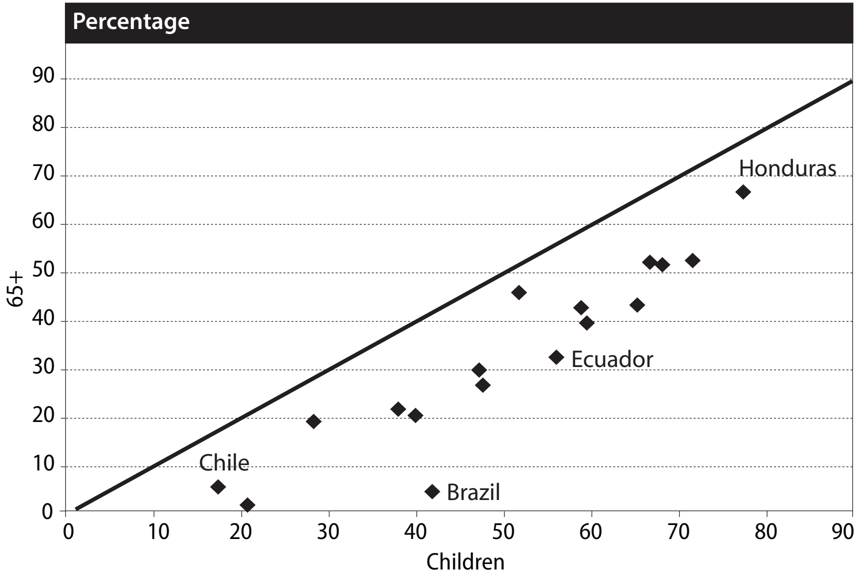
Even when benefits are modest, old-age pensions can contribute to reducing the intensity of poverty and strengthening livelihood strategies (United Nations, 2007). Accordingly, in view of the difficulties in expanding employment-related old-age pensions, a few developing countries have introduced universal non-contributory old-age pensions (e.g. Botswana, Mauritius, Namibia, Nepal and Samoa). There is wide variety in these arrangements; qualifying age ranges from 60 in Namibia and Mauritius to 75 in Nepal, while pension benefits range from 10 to 26 per cent of per capita GDP (Willmore, 2006). In these countries, the introduction of non-contributory programmes providing minimum support has helped to reduce disparities of access to old-age benefits.

But, as far as the dependent populations are concerned, the challenge confronting developing countries under the demographic point of view is not confined to the aged. Poverty among children is a severe problem in developing countries. For instance, in Latin America, the incidence of poverty is higher among children than among the aged in all 17 countries for which there is information available (see figure 7.2). On the other hand, the evidence seems to be less conclusive in Africa. In only 6 out of 15 African economies, the poverty head count for children is higher than for older persons, while the incidence of poverty in households where older persons were living with children (usually their grandchildren) is higher than the national average (Kakwani and Subbarao, 2005).

With their populations aged 0-14 still growing or remaining relatively stable in several developing regions during the next 15 years, children remain the most numerous vulnerable age group in all developing regions during the period 2010-2025. Addressing poverty among children should receive renewed attention by policymakers. There is urgent need to develop additional mechanisms and interventions to address children poverty—which is probably highly correlated with female poverty—while, at the same time, to introduce sustainable income support mechanisms for older persons.

Not excluding the preceding need, there are a number of synergies between providing income security for older persons and outcomes for children as well as for other family members. In Brazil and South Africa, for

Figure 7.2
Latin America: Poverty rate among children (0-14) and older people (65+), 2007-2009



Source: ECLAC.

instance, earnings from pensions and work from older persons are important sources of income in households that include them (Lloyd-Sherlock, 2006). Hermalin and others (2005) indicate that the levels of childcare provided by grandparents to co-resident and non-co-resident grandchildren are significant sources of support in Thailand, Taiwan Province of China, and the Philippines. In this regard, over the past years a new generation of social assistance schemes have emerge providing minimum income support not only to older persons but also working age individuals, children and their families. These cash transfer systems follow a wide variety of approaches: some are means tested, others are not; some are conditional. What is interesting to note is the fact that these programmes seem to be quite affordable. Often these programmes cover a rather large number of people (as in the case of Brazil and Pakistan) but cost just a small fraction of the GDP: between 0.3 and 0.5 per cent (ILO, 2010). The experiences of these (and other) countries demonstrate that countries at relatively lower levels of income[5] can afford to offer some form of social protection to their populations once there is political willingness to create the necessary fiscal space.

7.7 Concluding remarks

Economic growth is central for improving the welfare of populations worldwide. But population dynamics affect growth as well. However, these can be fully anticipated and policies—such as those discussed in this chapter and elsewhere in this volume—can be adopted to offset negative effects and harness potential positive impacts. But, however important—and without minimizing its importance for the design of future development strategies—demographics is one of the many factors affecting growth and its overall impact is more nuanced than implied by some analyses.

While the world population is ageing everywhere and will continue to grow on average, trends are diverse across countries. Some countries, largely the developed economies and also some developing countries, will experience a decline in their working-age population, while in other countries, mostly developing countries, the labour force is still increasing. Given the magnitude of projected trends, international migration, while offsetting some of the pressures, offers no solution to the demographic challenge in the long term. Thus, the former group of countries needs to adopt strategies to sustain and/or raise the productivity of their declining and graying labour forces; the latter needs to embark in growth patterns that are labour intensive, but that offer possibilities for dynamic structural change and productivity increases in view of the significant welfare gaps their populations suffer. Structural impediments confronting these economies need to be addressed and the international cooperation has an important role to play in this direction.

Both approaches require significant investments in education, skill formation and updating; for the former group of developed economies so as to increase productivity and avoid the obsolescence of skills of an older labour force. It is not efficient to increase labour force participation at older ages without addressing the potential decline in productivity of older workers. Interventions must also be accompanied by the necessary adjustments in the institutional framework (to support longer labour force participation), in the work environment and how work is organized. While higher participation rates at older ages can offset some of the decline of the labour force and contribute to the sustainability of transfer systems, there are obvious limits to the feasibility of this alternative. For developing countries, investment in human capital is needed to enlarge people's choices and to prepare the vast numbers of unskilled and uneducated workers for the needs of labour market. The correlation between higher levels of education and lower fertility is also noted.

Similarly, in both groups of countries there is need to recognize the important contribution women can make to overcome the demographic challenge. In the case of countries with fast-growing populations, further declines in fertility are contingent on increased access to family planning and modern contraceptives as well as on changes of attitudes towards early marriage. Increased female labour force participation can offset the anticipated decline in labour force if promoted fast enough, but it requires additional measures to facilitate the reconciliation of parents' family and work obligations. Addressing the severe gender gap in the labour markets in terms of opportunities, including access to education and training, and remuneration is also called for, both in developed and in developing countries. Removing obstacles to increased productivity by female farmers is central for enhanced food security and faster output growth in agriculture.

Worldwide, dependency ratios are still declining but expected to rise from around 2025 onwards. Dependent populations need to be provided for. Old-age pensions and social pensions play an important role in reducing the incidence and the intensity of poverty. But if poverty is to be avoided at older ages, the sustainability and adequacy of support systems must be ensured. In countries where old age pensions are norm, that requires closing existing loopholes, extending mandatory retirement age where applicable and guaranteeing a minimum, socially acceptable, level of benefits, and offering adequate risk pooling so that idiosyncratic risks are genuinely diversified and not shouldered by the individual. Pension reforms, however, do not solve for the demographic challenge; output growth is key, which further highlights the importance of the recommendations presented throughout this volume. For developing countries, with large segments of the population without access to formal protection mechanisms, coverage needs to increase. Recent experience has demonstrated that the expansion of coverage, including the provision of universal benefits, can be affordable even in developing countries. Fiscal space requires political will.

Notes

1 Secretary, United Nations Committee for Development Policy. This chapter relies heavily on research undertaken at the United Nations Department of Economic and Social Affairs under the context of the *World Economic and Social Survey 2007: Development in an Ageing World*. I am grateful for the valuable contributions received from Jorge Bravo and Igor Ribeiro and for the comments and suggestions by Jose Antonio Alonso, Sakiko Fukuda-Parr, Frances Stewart and Rob Vos. The usual caveats apply.

2 OECD. Ageing and Employment Policies - Statistics on average effective age of retirement. Available at http://www.oecd.org/dataoecd/3/1/39371913.xls, accessed on 14 November 2011.

3 The period 1990-2008 was selected—instead of a longer period—in order to increase the size of the sample. Similarly, output per person engaged was used instead of output per hour worker due to wider country coverage.

4 Recently published results from the National Transfer Account (NTA) project provide individuals' consumption age profiles from age 0 to age 90+ for 23 developing and developed countries. The NTA framework considers both private and public consumption; both are further disaggregated into education, health care and other consumption. Consumption age profiles are mean values normalized by the mean labour income of ages 30-49 in each economy. For details consult the website of the National Transfer Accounts at http://www.ntaccounts.org/web/nta/show/Methodology.

5 The ILO (2010b) indicates that currently there are some 30 developing countries with a minimum social security packages based on social transfer programmes.

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Chapter 8
Common elements for inclusive and sustainable development strategies beyond 2015

Giovanni Andrea Cornia and Rob Vos

8.1 Introduction

The real-life development strategies that have dominated the scene in recent decades have often been seen as models to be imitated but have in most cases generated unsatisfactory results. The Washington Consensus, which dominated the policy scene from the 1980s until recently, has led to greater global economic integration but also to slow growth, more instability and greater inequality. The "Chinese model", in turn, heralded by many as a pragmatic alternative blueprint for developing countries has been recently criticized, including by China's head of state, for being potentially unstable and not sustainable (both environmentally and socially), for overly relying on exports, and for suffering from under-consumption, over-investment and limited capacity to innovate (Yongdin, 2011; Roubini, 2011). In turn, the Millennium Development Goals (MDGs) agenda introduced a human development-centred development approach, but has been criticized for defining goals and targets too uniformly without considering initial country-specific conditions and for remaining vague about how to achieve those goals (see chapter 2 by Fukuda-Parr). As a result, this approach of "goals without a strategy" ended up emphasizing more increases in social spending and the mobilization of more development assistance rather than promoting the transformative changes needed to achieve a more inclusive and sustainable growth.

In view of these limitations, this chapter proposes a "minimum common denominator" policy to characterize development strategies that focus on ensuring the achievement of a broad set of human development objectives. At the same time, the strategies should recognize differences in starting conditions and address the four intertwined global crises of food insecurity, financial instability, rising income inequality and unsustainable environmental degradation.

The identification of the "minimum common denominator" policy is inspired by the comparison of seven development strategy experiences discussed in chapter 4 by Cornia and Uvalic. The analysis of that chapter concluded that the East Asian Miracle (EAM) strategy of the 1960s-1970s, and Latin America's Open Economy Redistribution with Growth (OERG) model performed the best on eleven criteria of successful development related to economic growth, social development, environmental protection, food security and democracy. None of these development models has been successful on all counts. In addition, the successes of the EAM model would be more difficult to replicate under greater initial economic openness and more democratic conditions or if required to comply with higher standards of environmental sustainability. What's more, deeper globalization and international commitments underwritten by most countries within the context of the World Trade Organization (WTO) and other multilateral agreements have limited the national policy space (United Nations, 2010).

The "minimum common denominator" policy draws further inspiration from a few general principles emanating from the development literature that is cognizant of differences in countries' initial conditions. A first principle draws on Dani Rodrik's book, *One Economics, Many Recipes* (2007), which argues that while countries may pursue the same broad economic objectives, the policy tools to meet those will need to be tailored to the institutional setting and structural characteristics of each country. A second principle is offered by Robert Wade's book, *Governing the Market* (1992), which provides suggestions on how to generate a benign interaction between market forces and state action. A third source of inspiration refers to the "search for greater policy space" by ensuring that the multilateral frameworks governing international trade, finance, and environmental protection more fully adhere to the principle of common-but-differentiated responsibilities suggested in United Nations (2010) and chapter 12 of this volume by Girvan and Cortez.

In practice, the "minimum common denominator" policy reflects the experiences of several East Asian and Latin American countries (and

possibly of a few other virtuous countries) over the last decade in an increasingly interconnected and unstable world economy. Finally, the chapter illustrates a few alternative paths fitting the conditions of different developing countries identified on the basis of their size, income per capita, exports structure, weight of agriculture, degree of industrialization, dependence on foreign capital and food imports, and so on.

8.2 The new development paradigm: synergies and trade-offs

The new "pro-poor, pro-growth, and pro-environment" (pp-pg-pe) development paradigm discussed in these pages should make explicit a broad set of goals consistent with the concept of sustainable development which was defined by the Brundlandt Commission (WCED, 1987) as the process that "meets the needs of the present without compromising the ability of future generations to meet their own needs". This implies pursuing simultaneously the goals of economic development, social progress, and environmental protection. In this view, social development is perceived as necessary to sustain both economic development and environmental protection. Put in the words of the Brundtland Commission, "[a] world in which poverty is endemic will always be prone to ecological and other catastrophes" and "the distribution of power and influence in society lies at the heart of most environment and development challenges" (WCED, 1987: para. 27 and para. 43). For instance, achievement of food security through policy support to the adoption of green agricultural technologies and the strengthening of the productive capacity of smallholder farming would simultaneously help reduce poverty and hunger, reduce inequality and protect the natural environment. Without such support, small farmers often have been forced to overexploit land causing the degradation of their main productive source and perpetuating rural poverty and inequality.

Over the last three decades, however, this "broad target setting", focusing on sustainable development goals or the narrower MDGs, was not pursued in the context of a unified development model.[1] Instead, it was expected that alternative development policy approaches, be they those emanating from the Washington Consensus or the "dirigiste" paradigm (such as China's export-led model) would serve to secure progress in human development in all of its dimensions. In the pp-pg-pe approach there is a need to spell out clearly the targets on all three dimensions and the possible trade-offs

associated with their achievement. The latter will require spelling out the means (in terms of development strategies and policies and resource allocation) to achieve sustainable development. Doing so will require a new approach, as business-as-usual cannot be an option.

Indeed, the four global crises discussed in chapter 1 of this volume are interdependent, thereby exacerbating their impact on the welfare of both present and future generations (Addison and others, 2010). An immediate concern is the solution of the financial crisis which originated in advanced economies but with nefarious impact to many developing countries. However, without fundamental change of the economic growth model, recovery from the crisis would mean that increases in greenhouse gas (GHG) emissions would accelerate again. Moreover, a total priority placed on growth reactivation could delay the search for a more equitable pattern of growth. Likewise, the trend towards rising food prices and growing food insecurity—which is mainly due to the neglect of agriculture over the last three decades—may be exacerbated by an attempt to solve climate problems through mitigation policies that encourage the reallocation of land to biofuel crops, while in the meantime the rise of temperatures and sea level will affect agricultural yields. Similarly, the inability (perhaps with the recent exception of Latin America and some sub-Saharan countries) to shift to a more equitable pattern of growth would frustrate progress in achieving greater food security even in the presence of rising agricultural output.

The close interaction between the four crises poses two methodological challenges for the new development paradigm advocated in this volume. First, the identification of policies which—while addressing directly each of the four crises—do not retard the solution of the other three and neither deter making progress in achieving poverty reduction and other human development targets. The second challenge concerns the complexity of identifying policy priorities when addressing the four interdependent crises. The complexity does not only derive from their interdependence but also from the vastly different time horizons over which the impact of those policies will be felt. For instance, efforts at dealing with the financial instability and inequality may possibly yield some visible results over a three to five year period, but making up for decades of neglect of agriculture and food systems will require a much longer time horizon, while actions at stabilizing the global climate may take as long as 30 to 50 years. This means that—whenever it will not be possible to find win-win policies leading to Pareto improvements—the choice between alternative allocations of public

funds among the four policy areas will be influenced by the choice of the social discount rate used to actualize their costs and benefits at the present time. If such rate is high (as it tends to be in poorer societies), climate change measures, and perhaps policies to fight the neglect of agriculture and inequality will take second seat. Multilateral action may then be the only solution, as discussed in chapter 5 by Opschoor.

8.3 Extent and modalities of integration in the world economy

How much more integrated into the world economy should developing countries become in the post-2015 era? Should countries aim to lift growth mainly by promoting exports and specializing in narrow product niches, as the existing discourse on globalization seems to suggest? Should they further integrate into international financial markets to dynamize domestic capital accumulation? Or, should they assign a greater role to a growth pattern led by domestic consumption, domestic investments and nationally supported R&D? In short, should all countries seek further production specialization and global integration, or should they try to rely on a more balanced pattern of growth?

This raises the question whether the benefits of economies of scale linked to specialization and those of reliance on technology transfers through imports, foreign direct investment, and integration in global value chains outweigh the associated costs in terms of exposure to volatility in global commodity and financial markets and technological dependence.

The answer will obviously depend on the size of the economy (small economies need to be more specialized than larger ones), the establishment of future of "global safety nets" compensating for global contagion (in this respect, the massive increases in IMF resources in 2009 and 2012 were moves in the right direction), the need to find a Hla Myint-type "vent for surplus" for excess output that cannot be absorbed by the domestic market, and other considerations, including the ability of a country to adopt an "open economy industrial policy" (see below). It is important to underscore that—while there are in many cases "gains from trade"—in a closely interdependent world with no global safety nets and frequent contagion generated by an unregulated financial sector, recessions spread more easily than in a world system which is still open but with "speed bumps" and controls. Greater global specialization (and world trade) may also cause further increases in the volume of carbon emissions and other environmental footprints.

Continued dependence on international finance is, in contrast, a trend which should be clearly controlled or at least moderated by means of domestic measures and through the adoption of international regulations (including a tax on international financial transactions), while at the same time promoting measures, as those introduced in East Asia since the 1960s, to stimulate domestic private and public savings (Wade, 1992). Finally, and in contrast to the other points just made, it is desirable that the international technology transfer should be continued, and that, to this end, the international rules about patents should be softened while leaving a "fair remuneration" for the inventors (Chang, 2008) so as not to hamper the adoption of new technologies, including "green technologies", by the majority of developing countries which (with the exception, in some industries, of China, India, Taiwan Province of China, the Republic of Korea and a few others) do not have the capacity of generating modern technologies endogenously and in a reasonable amount of time.

Interestingly, China, the country which is generally seen as the one which benefitted most from free trade, FDI inflows and global integration, is considering rebalancing growth towards greater reliance on the domestic market (Yongdin, 2011). The arguments normally given to justify this policy shift include: the desire to avoid an excessive dependence on export markets (Akyüz, 2011), FDI and imported technology and the dominance of foreign ownership in the export sector (Fisher, 2010); the attendant low national expenditure on R&D and low domestic consumption leading to rising income inequality; limited public investments in education, medical care and social security; an excessive trade and capital account surplus, as well as a too-high investment rate; and rising pollution and low energy efficiency. The new proposed strategy would focus more than before on the domestic market and should reverse the above unfavourable trends. In particular it would raise the share of domestic consumption and R&D expenditure on GDP; reduce the investment share and the income gap between classes and urban and rural areas, and between coastal areas and the hinterland, by changing both the primary income distribution (by letting wages rise and legislating increases in minimum wages) and by redistributing via government transfers; increase the share of the service sector; and make the economy less carbon-and energy intensive. Given the size of China, such a shift would affect world trade, GHG emissions, and global macroeconomic balances (Yongdin, 2011). Other developing countries would benefit from a rebalancing of China's economic growth model through a stronger growth of its domestic demand, a relative decline in its volume of exports and

shift in export composition towards high-tech products. Such shift would provide the developing countries with new opportunities for expanding non-primary exports to China and elsewhere and for receiving greater inflows of FDI.

8.4 Raising output in a socially and environmentally sustainable way

There is now considerable evidence that shows that, in low-income economies, progress in reducing extreme poverty depends on the growth of average incomes—which are closely related to GDP per capita—while in middle-income countries with high income inequality, poverty reduction is more sensitive to income redistribution than average economic growth (Kakwani, Khander, and Song, 2004). Progress towards other MDGs is equally dependent on both growth and greater income equality. Indeed, a broad-based increase in incomes makes it far easier to achieve household-level improvements in areas such as hygiene, nutrition, health and education and, second, because generating sustainable budget resources for governments may be as important as policies directly targeted at the MDGs. Hence, a post-2015 MDG strategy will generally need to rely on a pro-poor growth as a fundamental driver.

At the same time, the challenges relating to pressures on natural resources and human-activity induced climate change imply that a mere pro-poor growth model is not a viable option over the long run. Growth will need to be pro-environment as well. A "green growth" approach would seek synergies between economic, social and environmental objectives. This implies a major departure from conventional economic models which see environmental protection as competing with economic growth and pollution and environmental degradation as negative externalities emanating from market failures correctable by internalizing environmental costs.

The pp-pg-pe approach thus stresses the long-term benefits and synergies based on an alternative welfare concept that weighs social and environmental dimensions at least as much as mere economic gains. Realizing such benefits and synergies will be most challenging, however, as it will require a high degree of policy coherence across a wide spectrum of policies and, necessarily, a long-term perspective. High start-up costs and uncertain returns to investments in new technologies and infrastructure to underpin green growth will provide short-term challenges and trade-offs.

Hereafter we discuss some of the main national policies needed to reach this objective, while noting that the nature of an international enabling environment to support efforts at achieving a pp-pg-pe pattern of development in the post-2015 era is discussed in chapter 12 by Girvan and Cortez.

Accumulating capital with less external indebtedness and higher domestic savings

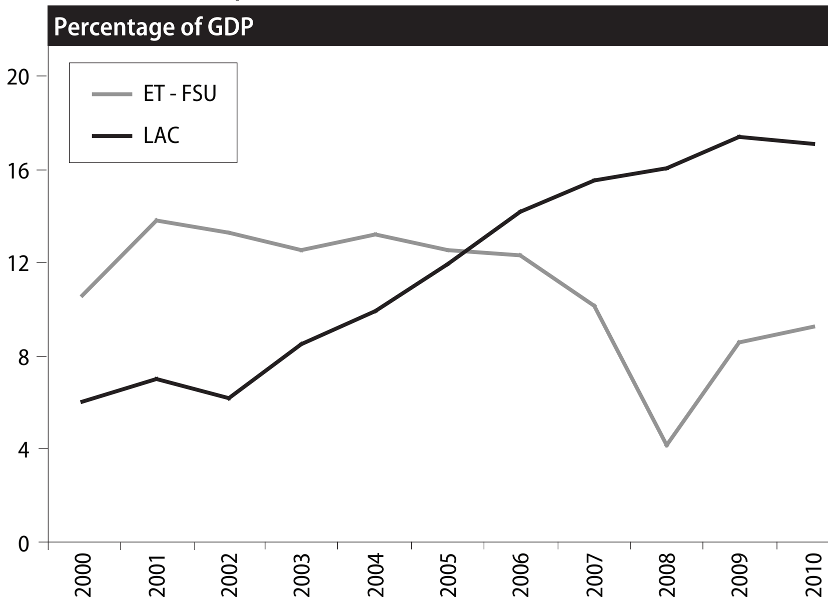
The liberalization of the capital account has been, and still is, presented as a golden opportunity to access a global pool of savings and speed up capital accumulation and job creation. However, these promises have only seldom materialized. The evidence shows that that open economies with larger domestic banking systems and long-term bond markets and higher domestic savings and investment rates tend to have smaller portfolio inflows relative to the size of their economy than those with smaller domestic banking systems (Griffith-Jones and Ocampo, 2011). In contrast, countries heavily relying on external financing have often ended up in "financial traps" characterized by currency appreciation and instability, high-risk premia, exposure to sudden stops in capital inflows, sensitivity of domestic borrowing costs to exchange rate fluctuations and risk premia on foreign loans, a need to accumulate large reserves to ensure against capital flow reversals, and slackening of domestic savings (Damill and Frenkel, 2012).

In the 2000s, the recourse to foreign savings has become more selective—e.g. for financing investments in the traded sector—while several countries with large public foreign debt started to reduce it (Cornia, 2012: table 3). As a result, external debt burdens fell markedly. Spreads on international loans have also fallen. The decline in indebtedness improved the net foreign asset position of economies in Latin America and several other regions (figure 8.1), though it worsened in several countries of South East Asia and Eastern Europe and the Former Soviet Union (EE-FSU).

Policies supporting a "pp-pg-pe" development strategy should aim to ensure to break out of the dangerous circle of insufficient domestic savings and dependence on volatile foreign savings and seek ways to structurally enhance domestic resource mobilization. This can be done by the strengthening of indigenous financial institutions, which can behave counter-cyclically as observed in the case of the Brazilian National Development Bank, BNDES, which during the 2009 crisis expanded credit to compensate the "flight to safety" of foreign capital. Greater emphasis

on the mobilization of domestic financing requires providing domestic financial institutions with infrastructural support, tax incentives and public guarantees for loans, as well as relying on existing postal office networks, which have grown into a major financial institutions in several developed and developing countries. Development of local bond markets for long-term investment finance will be equally important, as argued, for instance, by Ocampo and Vos (2008). Yet, the evidence shows that to increase the domestic savings rate—especially by low-income groups—it is necessary to ensure the credibility of macroeconomic policymaking and banking stability. It shows also that domestic savings can be achieved also by harnessing the mandatory savings of pension funds (as done in the past by Singapore and Malaysia), tightening consumption credit and, obviously, ensuring there are sufficient incentives to invest. Further, public

Figure 8.1
Net foreign asset position in Latin America and the Caribbean (LAC) and Eastern Europe and Former Soviet Union (EE-FSU), 2000-2010



Source: Cornia and Martorano (2012) based on World Development Indicators.
Note: LAC countries include: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela; the EE–FSU countries include: Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russian Federation, Slovak Rep. , Slovenia, Tajikistan,

savings can be raised to finance infrastructure development by increasing tax burdens. There are many warnings of the risk of public investment crowding out private investment, but skillfully targeted public spending on infrastructure, technological innovation, energy, health and education can stimulate growth and crowd in private investors by raising opportunities for high value-added investments, creating markets and lowering costs.

Investing in human capital

In all types of economies, both developing and developed, investing in human capital helps achieve the equity, environmental and growth objectives mentioned in the introduction of this chapter and which should be included in the post-2015 targets of the new development strategies discussed in this volume. A massive amount of theoretical and empirical literature on endogenous growth, the neoclassical human capital model, and the empirical literature on the determinants of well-being, social cohesion, civic attitudes and democracy shows there is hardly any money better spent than that on human capital, that is, on education, health and nutrition. The overall impact on long-term growth is well demonstrated in different types of economies (both traditional and modern), though issues concerning the composition of such expenditure, its (public versus private) financing, corruption and the absence of complementary inputs (e.g. infrastructure, and physical capital) may reduce its impact on efficiency and equity, and thus require major efforts at solving these allocative efficiency and political economy problems.

In addition to higher labour productivity growth, efforts at human capital formation have been shown to generate important synergies in achieving multiple MDG targets, including in reducing child and maternal mortality, fighting hunger and improving food security, and reducing poverty. In most contexts, human capital investments tend to be conducive to a reduction of income inequality. For instance, recent research confirms that an important driver of the decline in inequality observed in much of Latin America during the 2000s was the steady increase in secondary completion rates by the children of low-income household during the preceding two decades (Cruces and others, 2011). Ranis and Stewart (2000) have further described the dynamic links between education, human development and growth. Furthermore, improved education will be essential for technological innovation and diffusion needed for sustainable agriculture and moving towards low-carbon production and consumption processes (United Nations, 2011).

However, such gains are not automatic and other conditions need to be satisfied at the same time. First, productivity gains from human capital investment tend to come with important time lags. Hence it is important not only to sustain investments over prolonged periods of time but also to finance them in ways avoiding major macroeconomic trade-offs in the short run, as discussed for instance in Sanchez and others (2010) and Sanchez and Vos (2012). Such trade-offs may emerge, for instance, if involving substantial increases in public spending in non-tradables which may induce real exchange rate appreciation, especially when mainly financed by increased foreign aid and/or borrowing. Attempts at financing human capital principally through out-of-pocket household spending (e.g. through raising tuition fees and out-of-pocket health costs), as attempted in the 1990s by Washington Consensus-inspired fiscal reforms, may adversely affect human capital investment by low-income households (see e.g. Bentaouet-Kattan and Burnett, 2004 and Birdsall and others, 2006 for the case of primary school tuition fees). Second, economies will need to adjust to provide employment opportunities for more skilled workers. Lacking such adjustment and hence economic opportunities for new workers, new sources of inequality and social tension could emerge. The associated labour market mismatches and rising youth unemployment have been among the factors giving rise to the Arab Awakening at the start of the second decade of the twenty-first century, but remain critical economic and social problems to be addressed by the new regimes established in the political transition (OECD, 2011; Sanchez and Vos, 2012). Third, higher incomes associated with higher education levels may induce more energy-intensive consumption habits and shift food demand to protein-rich items, putting greater pressure on tight food markets and potentially inducing intensification of environmentally unfriendly agricultural production and land use.

The new pp-pg-pe development paradigm thus emphasizes four points in this area. First, human capital spending has to be sustained over prolonged periods of time to yield productivity gains over time. It also needs to be sustained even after once seemingly unattainable objectives (e.g. universal primary education and quasi universal immunization coverage and, in some regions, secondary enrolment) have been achieved, if sustainable growth and well-being and a steady evolution of the structure of the economy are to be achieved, and if environmental innovation is to be promoted. Second, while there are different models of delivery and financing of human capital services, it is important that this function not be left entirely in the hand

of the market, as this would inevitably increase the differential in coverage between the haves and the have-nots. Third, to avoid irreversible and permanent costs, public expenditure on education, health and a minimum of social protection has to be given priority in budgetary allocations during periods of crisis. This key change is required as the financing of these activities generally suffered during the crises and fiscal adjustment of the 1980s (Andersen, Stewart and Jaramillo, 1987) and, if to a lesser degree, during the recent food-fuel-financial crises. Indeed, Ortiz and others (2011) argue that while the adjustment policies adopted in 2009 with the blessing of the IMF by most developing countries made an explicit effort to protect social expenditure, premature public expenditure cuts since 2010 have led to cuts in health, education and basic food subsidies or to increases in VAT on basic goods consumed by the poor. As a result, cuts in public expenditure (including essential social expenditure) were expected in 70 developing countries in 2011 and in 91 in 2012. Fourth, coherence with other areas, including macroeconomic, labour market, technology, environmental, industrial and agricultural policies, is critical in order to assure investments in human capital do not lead to undesired macroeconomic distortions in the short run or lead to labour market mismatches, new social inequities or environmentally unsustainable consumption patterns in the long run.

Open-economy industrial policy

All the well-known experiences of successful economic development have involved a sustained burst of widespread income growth spread through dynamic structural change throughout the economy characterized by diversification and transformative shifts from low to high productivity sectors (Ocampo and Vos, 2008). Such pathways typically did not emerge spontaneously, but rather were pushed through strong policies stimulating new modern economic activity. Creating a virtuous circle of rising productivity, technological upgrading, dynamic economic diversification, and social progress in low-income countries typically would require a helping hand through combinations of public investment in infrastructure, modern energy supply and human capital and a set of policy incentives broadly labelled as "industrial policy", which is to be understood not merely as promoting manufacturing industries, but of modern production and service activities more in general.

Historically, such strategies involved what might be called "*closed-economy industrial policy*", as a key focus was on stimulating the development of new

production activity by protecting them from foreign competition through import tariffs and duties, subsidies as well through public investment in research and infrastructure for technological upgrading and aid in the creation of economies of scale. This approach seems to be foreclosed to most countries because of their participation in the WTO and/or regional and bilateral trade agreements they have signed. Despite this reduction in policy space, recent experiences of Australia, Brazil, Chile, China, Finland, Ireland, Malaysia, the Republic of Korea, Singapore, and Vietnam have shown that it is possible to pursue an "*open-economy industrial policy*" and diversify output and exports and raise the technology and knowledge content of the production process through proactive macroeconomic and industrial policies, both economy-wide and sector specific, or, in a less evident way, through the intelligent adoption of non-tariff barriers. Yet, such approaches have been adopted by only few lower middle-income developing countries, with the result that the structure of output and exports of many developing countries stagnated due to the dominance of the export-oriented growth model based on trade and capital account liberalization adopted in the 1980s and 1990s, and of the reduction of national economic policy space entailed by IMF policy conditionality, WTO trade rules, costly access to technology implied by intellectual property right rules (TRIPS), and/or unrestricted capital mobility.

A pp-pg-pe strategy will require active industrial policies to provide incentives for dynamic structural change that will not only lift living standards but do so in a sustainable way. In doing so, lessons can be learned from the mentioned recent successful experiences. A first powerful way to diversify output is to ensure a stable and competitive exchange rate (see section 8.5 below) which appears to have a far greater protective effects on the import-competing domestic manufacturing sector than tariff rates of 30 per cent or so (Helleiner, 2011). Small developing economies, in contrast, may opt to rely on selective entry of foreign direct investment (FDI) as a vehicle of industrial policy, the FDI creates backward and forward linkages within the national economy. Whether FDI leads to a "crowding-in" or "crowding-out" of domestic investments remains an open question, however. Ideally, FDI should be attracted to new economic activities to avoid a rise in unemployment that would result from FDI entering sectors with small scale and weak domestic firms.

A third approach, such as that followed in Chile and other countries, is of microeconomic nature. Chile diversified its export basket towards resource-based products (wood, fresh and processed fruits, wine, etc.) by generating

high levels of public knowledge, R&D and infrastructure by means of a strong and long-term alliance between the public and private sectors.

Sustainable agricultural development policies.

The food price spikes during 2007-8 and 2010-12 manifested once more inadequate progress achieved in the field of food security and agricultural growth. Several factors contributed to the slowdown in growth of food production relative to demand causing recurrent food price spikes and nutritional crises with every supply shock, as discussed in chapter 6 by Von Braun. Projections by the FAO suggest that world food production will need to rise by at least 70 per cent from present levels by 2050 in order to feed the growing and increasingly urbanized world population. This presents a huge challenge, the more so because trying to step up agricultural productivity with existing modern technologies would overstep environmental limits with potentially devastating consequences for future food supplies. At present, agriculture is the main emitter of nitrous oxides and methane (both with high global warming potential), contributing about 15 per cent of global greenhouse gas emissions in 2005, more than the transportation sector (Ackerman, Kozul-Wright and Vos, 2012: p. 89). In addition, agriculture is a major contributor to water pollution, deforestation, and land degradation. Such environmental constraints, including the effects of climate change, are already being felt on food security and livelihoods, especially among the poor. Many of the poor live in rural agricultural areas where climate change induces more frequent and severe droughts and floods. Nelson and others (2009) estimate that, by 2050, global rice production may have fallen by 12-13 per cent and global wheat production by 23-27 per cent compared with a scenario without climate change. Taking into account the impact on all crops and livestock, calorie availability in 2050 would not only be lower than in a scenario without climate change, it would actually decline.

However, these challenges also present great opportunities for successful pp-pg-pe strategies. First, strongly increasing agricultural productivity has been a common starting point of strategies of successful dynamic structural transformation. Like other East Asian fast-growing economies, China's growth acceleration began in the late 1970s with institutional reforms in agriculture that were key to a sharp rise in agricultural productivity, and to freeing labour and savings for industrial development (see e.g. Ocampo and Vos, 2008: chapter V). In more general terms, it has also been found that, in low

and lower-middle income countries, agricultural growth reduces also urban poverty, as a rise in agricultural wages and incomes raises the reservation wage of unskilled workers in cities. Second, many of the world's poor continue to live in rural areas and directly or indirectly depend on agriculture for their livelihoods. Helping smallholder farmers and their dependents increase productivity would have immediate impacts on reducing poverty and hunger. Third, agriculture is also a sector with large and relatively inexpensive potential for climate change mitigation. Enkvist and others (2007) estimate that by 2030, greenhouse gas emissions from agriculture could be more than halved from business-as-usual levels through a combination of measures that would cost less than $10 per tonne of CO_2 equivalent abated; many measures would have negative net costs because of important productivity gains. Low-cost measures include improving soil quality (e.g., by restoring degraded lands) and better management of cropland and grazing lands (e.g. by reducing chemical fertilizer use, reducing tillage, and eliminating burning of crop residues in the field) (United Nations, 2011: chapter III).

Taking advantage of these opportunities will require a radically different approach from the kind of agricultural policies implemented over the past fifty years. In large parts of the world, food systems were shaped to a considerable extent by the so-called green revolution of the 1960s and 1970s, which boosted agricultural yields as much through intensive use of irrigation water and environmentally harmful chemical fertilizers and pesticides, as through the introduction of new seed varieties. Lack of investment in rural infrastructure and education and little to no access to the new technologies, credits and land, implied that many of the world's poor farmers did not gain from the first green revolution, perpetuating poverty, hunger and food insecurity, especially in Africa. In addition, the approach of "getting the prices right" advocated by the World Bank in the 1980s seldom provided adequate incentives and subsidies to agriculture (with the obvious exceptions of China and Vietnam), while macroeconomic policy has often generated an anti-agricultural bias. Fixed exchange-rate pegs and deregulation of capital inflows led during parts of the 1990s to real exchange rate appreciations, discouraging agricultural exports and production. Greater exchange rate volatility under more flexible regimes has increased economic uncertainty, including to farm production. Financial liberalization measures in many contexts have worsened access to credit for the small-scale agricultural production units, including because of the removal of directed credit allocations to these sectors.

A new and truly green revolution will be needed in agriculture worldwide so as to reach food security that is also environmentally sustainable. An extensive menu of already available green technologies and sustainable practices in agriculture already exist and have been successfully adopted with large productivity gains in developing country contexts (United Nations, 2011: chapter III). The main challenge is to change incentive structures and investment patterns to encourage their widespread use. In developing countries, a key focus for most agricultural production should be on promoting and developing sustainable farming among smallholders, whose gains in productivity are likely to be largest, reducing rural poverty. Doing so will require a broad range of policy support measures. These need to be tailored to country-specific contexts, but—as distinct from the "single technology package" approach of the first green revolution—the minimum common denominator of the second one would be a comprehensive approach.

Needed would be a broader approach to agricultural development policies, focusing on access to land, extension services, improved inputs, credits and rural infrastructure so as to secure a greater and more predictable marketable surplus and income to farmers and inputs for agro-industrial development. Such measures would need to be complemented with support mechanisms providing farmers with access to technologies for sustainable agricultural production, including through support to producer associations that can help take advantage of economies of scale and induce dynamic local innovation processes. Water conservation and more sustainable irrigation methods, soil protection and biodiversity enhancement all would need to be part of a broader strategy with public sector support but with important potential for income gains to individual farmers, enhancing off-farm rural employment and sustainable food security. Crop and weather insurance mechanisms, which have recently been introduced in developing countries to provide income protection to farmers, have been analysed and found to be more effective when embedded in a broader agricultural development strategy (Vos and Kozul-Wright, 2010: chapter III; Linnerooth-Bayer and Mechler, 2007). However, well-targeted consumption (or income) subsidies or other mechanisms may need to be kept in place to protect the nutrition of children and low-income families from sudden variations in the price of food.

Energy and environmental policies for low-carbon growth

As cleaner technologies and diversification will be a critical part of establishing a new low-emissions growth path, a process of innovation and learn-

ing has to be ignited alongside efforts to raise the pace of capital formation. Given the scope of the challenge, this process will have to involve traditional sectors such as agriculture and forestry (see previous section), as well as more advanced sectors, especially modern energy, linked to mitigation challenges.

Energy technologies have been greatly shaping society and the environment for the past two centuries. The benefits of electrification are clear. For poor households in developing countries, having household lighting has been estimated to add between $5 and $16 per month in income gains. The added benefits of access to electricity in general would be in the order of $20-$30 per household per month through enhanced entertainment, time savings, education and home productivity (World Bank, 2008). These benefits outweigh by far the $2-$5 per month that poor households typically pay for the cost of electricity. Energy efficiencies of kerosene, candles and batteries for lighting are very low. As a result, lighting services with kerosene cost as much as $3 per kilowatt-hour (kWh), which is higher than the cost of lighting with solar electricity, at about $2.2 per kWh in poor countries. In low-income countries, diesel generators and micro-utilities typically provide lighting at a cost of $0.5-$1.5 per kWh, compared with centralized traditional utilities which often provide lighting at an effective cost of less than $0.3 per kWh. However, for traditional utilities, providing services to poor households becomes economically interesting only at demand levels of higher than 25 kWh per month, whereas poor households already derive great benefits per unit of cost in the range of 1 to 4 kWh per month (United Nations, 2011).

The economic benefits of expanding modern energy supply are large and so are the potential gains for poverty reduction and human development. About 40 per cent of humanity, or 2.7 billion people, continues to rely on traditional biomass, such as wood, dung and charcoal. Air pollution from inefficient stoves leads to an estimated 1.5 million premature deaths per year, more than from malaria, tuberculosis or HIV. About one fifth of humanity or 1.4 billion people, continues to live without access to electricity, mainly in South Asia and sub-Saharan Africa (IEA and UNIDO, 2010). Many more, especially in urban areas, have access but cannot afford to make full use of it.

The key problem is that modern energy systems are by and large locked into fossil-fuel based technologies, which account for 85 per cent of global energy supply and are the main cause of anthropogenic global warming. In pursuing pp-pg-pe development strategies, therefore, developing and emerging economies face a two-fold energy challenge: meeting the needs of

billions of people who still lack access to basic, modern energy services while simultaneously participating in a global transition to clean, low-carbon energy systems. Both aspects of this challenge demand urgent attention. The first because access to reliable, affordable and socially acceptable energy services is a pre-requisite to alleviating extreme poverty and meeting other societal development goals. The second because greenhouse gas emissions from developing countries are growing rapidly and are contributing to climate change and poor air quality, that put the health and prosperity of people around the world—but especially people in poor countries—at grave risk.

Low-income countries with still-low coverage of modern energy supply may seize opportunities by engaging in "technological leapfrogging" (e.g. Gallagher, 2006) and avoid the resource-intensive pattern of economic and energy development by "leapfrogging" to the most advanced clean technologies available, rather than by following the path of conventional energy development travelled by industrialized countries. The assumption is that if the advanced, cleaner technologies exist, they can be transferred to, and be widely deployed within, developing countries. However, leapfrogging to such new energy technologies, while it has the potential to yield important savings over the long run, faces significant obstacles. These might be on the supply side, for instance, owing to the presence of barriers to accessing the required technology, whether because of obstacles to importing the technology from abroad, as is the case for most developing countries or because of a lack of the technological expertise needed to link technology to local conditions (United Nations, 2009; 2011). Obstacles may also exist on the demand side, if a limited market size prevents economies of scale and a rapid running down of costs to make new technologies locally competitive within an acceptable timeframe. Thus, there is a role for governments, including at a local level, to build markets for new technologies, for example, by providing low-cost loans to households and businesses, providing information about new technologies, etc.

Even as the modern energy supply is already locked into fossil-fuel technologies, the fact that the major emerging economies have large markets for energy technologies provides an opportunity to develop local technology capacities and upgrade industrial capabilities, as is the case for China. Oil-rich countries with high insolation would also have a number of opportunities to diversify their industrial base and leverage the existing oil infrastructure (for example, through manufacturing and deployment of solar reactors in desert areas near existing oil facilities, with the reactors

transforming CO_2 and water into gasoline). The potential size of the energy market in developing countries along with the possibility of making improvements to already installed capacity serves as an indication of how important investment opportunities could be. However, as the initial costs and risks are likely to deter private investors, the public sector would be left with a leading role, at least in the early stages of expansion: a massive public investment push, coupled in the short term with appropriate subsidies to offset high initial prices and targeted at the most promising technology options (e.g. solar and wind), would help trigger an early cost write down.

Strategic deployment of new technologies (either for leapfrogging or energy transformations) will require combinations of incentives, regulatory measures and direct public investment. The example of the ethanol industry in Brazil demonstrates how critical government support can be, particularly during the early phase of development and deployment of a new technology and how it may need to be sustained until it has taken firm root in the marketplace (Ackerman, Kozul-Wright and Vos, 2012).[2]

Public investments will be needed to provide the basic infrastructure and, in most settings, also facilitate research and development for local deployment of technologies. Feed-in tariffs, which mandate a specific (premium) price to be paid for electricity supplied through renewables, such as wind and solar energy, have been shown to be effective means to stimulate supply of cleaner energy. Investment tax credits to firms that bring a new technology to market can lower the upfront investment costs of producing a new type of equipment, and can be tied either to costs or to the production level. These policies work to increase the supply of a new technology on the market.

To increase demand for a new technology, tax credits or rebates can be granted to purchasers as well as producers, reducing the cost differences between old and new technologies and making the lower-emitting or more efficient new products relatively more attractive. Also, vast subsidies on fossil-fuel consumption maintained by many developing countries could be gradually redeployed for subsidizing renewable energy use and purchases of high-efficiency appliances. Renewable energy market development further will need to be supported through regulatory measures that help reduce investment risk associated with the new technologies (e.g. through loan guarantees) and setting energy efficiency standards and targets for increasing renewable energy supply.

Refocusing energy and industrial policies along these lines is a necessity in order to fight climate change, but may also be expected to provide

important payoffs in terms of higher growth, job creation and poverty reduction (World Watch Institute, 2008). At the same time, however, enacting these policies will pose important macroeconomic challenges in the short to medium run. Finance-constrained low-income countries may be in need of significant additional foreign assistance to make the necessary investments in expanding modern energy supply of low-carbon intensity, including through the Green Climate Fund being established under the UNFCCC. For all developing countries, the challenge will be vast given the required investment costs and initial fiscal burden of providing the necessary incentives. Hence, supportive macroeconomic policies will be critical for pp-pg-pe strategies.

8.5 Macroeconomic and financial policies for pro-poor and green growth

A commonly held view by mainstream economists has been that macroeconomic policy should be neutral—that it should narrowly focus on maintaining macroeconomic stability and not be used to directly promote longer-term objectives in the field of growth or distribution. In this narrow view of macroeconomic policymaking, growth objectives would be best served by focusing on low inflation and balanced budgets. However, there is overwhelming evidence that erroneous macro policies can severely affect growth and distribution (and through them perhaps the environment), as argued by the debates on "stabilization overkill", the regressive nature of monetarist macro adjustment, the deflationary bias of macro policies during normal times, and macroeconomic populism (see the literature reviewed in Cornia, 2006). It shows also that pro-active macroeconomic policies can contribute to equitable long-term growth and environmental protection (e.g. through public spending on human capital and clean technologies).

More recently, there has been a shift towards a broader approach of macroeconomic policymaking, establishing "new macroeconomic fundamentals" that better fit in the globalized environment in which developing economies operate today and which explicitly aim to generate more favourable effects on growth, stability and reducing income inequality. Indeed, the new world within which macroeconomic decisions have to be taken has profoundly changed. Several macroeconomic problems of the past (such as a high external debt or inflation that led in the past to the adoption of strict and contractionary fiscal and monetary policies) have been corrected in many places. However, during the 2000s the main sources

of macro shocks and imbalances in developing countries were not due to overly expansionary domestic fiscal and monetary policies, but originated in volatile international financial and commodity markets with many of the shocks originating in developed countries and easily spread to developing countries as a result of inadequate macro-prudential bank regulation in overly deregulated but internationally integrated financial systems, the financialization of commodity markets, surging global macroeconomic imbalances, and fiscal austerity responses to sovereign debt crises. At the same time, the unprecedented development of international financial markets has drastically narrowed the space for domestic policymaking.

These new policies were broadly followed during the last decade in some Latin American, sub-Saharan African and other countries, but not in many countries of the transition economies in Eastern Europe and the former Soviet Union. The elements of this new macro paradigm are difficult to pinpoint ex ante, as they depend on a long list of local conditions. Yet, some broad principles apply fairly generally, as the new macroeconomic fundamentals aim simultaneously at (a) preventing external and internal crises, (b) maintaining a reasonable macroeconomic balance, and (c) aiming explicitly at long-term (green) growth of GDP and employment, especially in the traded-good sector, and at reducing income inequality. Some of the key features are discussed below.

Capital account regulation

Some modest results were recorded in recent time in this field, as a large number of emerging economies (Brazil, Chile, Colombia, India, Indonesia, Malaysia, Republic of Korea, Singapore, Taiwan Province of China, and Thailand) imposed capital controls to mitigate the inflow of volatile short-term capital and stem real exchange rate instability. Central banks can limit the foreign exchange exposure of domestic banks, forbid them to borrow internationally to extend loans to the non-tradable sector and introduce temporary or permanent administrative controls on inflows and outflows, and limit foreign ownership in sectors such as real estate. Key issues in this regard are the duration and efficacy of the controls. The IMF (2011) now fully supports the introduction of temporary capital account regulations during crisis periods, but countries may rather wish to have such measures in place to mitigate surges of capital inflows also during booms or seemingly normal times, thereby enhancing their domestic policy space by adding a macroeconomic policy instrument to be adjusted in line with changing economic conditions. However, capital account regulation is not a substi-

tute for sound macroeconomic policies. At best, it can mitigate capital flow volatility, but not eliminate it completely (Helleiner, 1997). Hence, it is best used as part of a broader framework of counter-cyclical macroeconomic policies and macro-prudential financial regulation.

An exchange rate regime which reduces currency crises and promotes growth

A "pp-pg-pe" paradigm requires that open economies opt for a managed float, combining exchange rate flexibility with discretionary interventions by the central bank in the foreign currency market. Such approach has recently emerged as the preferred choice of a growing number of countries. Empirical research shows that a competitive exchange rate has been critical to kick-start growth and to improve long-term economic performance (Rodrik, 2005). A managed float regime (and its supporting measures, see below) tends to reduce the risk of currency crises, and at the same time provide adequate incentives to the expansion of the traded goods sector which in many developing country contexts is an important source of employment for low-income workers. A competitive exchange rate would thus generate favourable effects in terms of reducing income inequality and increasing exports, jobs and growth.

To support their exchange rates, some countries introduced capital controls and allowed their central banks to intervene in the currency markets (see above). The management of this type of exchange rate regime is not simple and requires the adoption of other supportive measures such counter-cyclical fiscal and monetary policies and adequate accumulation of international reserves to reduce the risk of default on public and private debts and to strengthen the central banks' ability to intervene in the currency market to prevent an overshooting or collapse of the exchange rate.

Trade policy and the long-term equilibrium or surplus of the current account balance

The "pp-pg-pe" paradigm would further need to be accommodated to the multilateral trading regime. The latter has limited domestic policy space for conducting industrial policies, thus allowing for greater, transitory flexibility for low and middle-income countries will be critical for those countries to pursue strategies of economic diversification. This in turn is important to create conditions for more resilient economic growth, more

dynamic employment generation and for the development of low-carbon energy markets, as discussed above.[3] Such an approach is not inconsistent with a further drive towards trade liberalization, but one which is more gradual and embedded in a broader framework of development, that aims to avoid a collapse of the import competing sectors (as happened in many countries that fast-tracked trade liberalization during the 1990s) and actively promotes export diversification, quickly removes anti-export sector biases and promotes regional trade integration.

Countercyclical fiscal policy, tax reform, safety nets, and sustainable debt management

Contrary to the debt-led approach of the past, the "pp-pg-pe" requires a decline in structural budget deficit, as well as surpluses in "fat years" following the adoption of fiscal rules, fiscal responsibility laws or discretional decisions aiming at correcting the pro-deficit bias of the past. Obviously, such policy allows for short-term increases in fiscal deficits during crises. This new stance contrasts with the past traditional position of the IMF which demanded crisis-affected countries to quickly reduce the deficit, with yearly cuts of three per cent to four per cent of GDP which cause triggered large falls in aggregate demand, output, revenue and employment, and a rise in inequality.

The new policy stance can be facilitated where possible by the introduction of "stabilization funds" which set aside resources during periods of high demand and prices of the exported commodities and release them in crisis years, and the adoption of "fiscal contingency rules" which allow for the increase of public expenditure and permit a widening of the deficit in case of unanticipated shocks. This option will be of particular importance to countries with important natural resource endowments, but vulnerable to commodity price shocks.

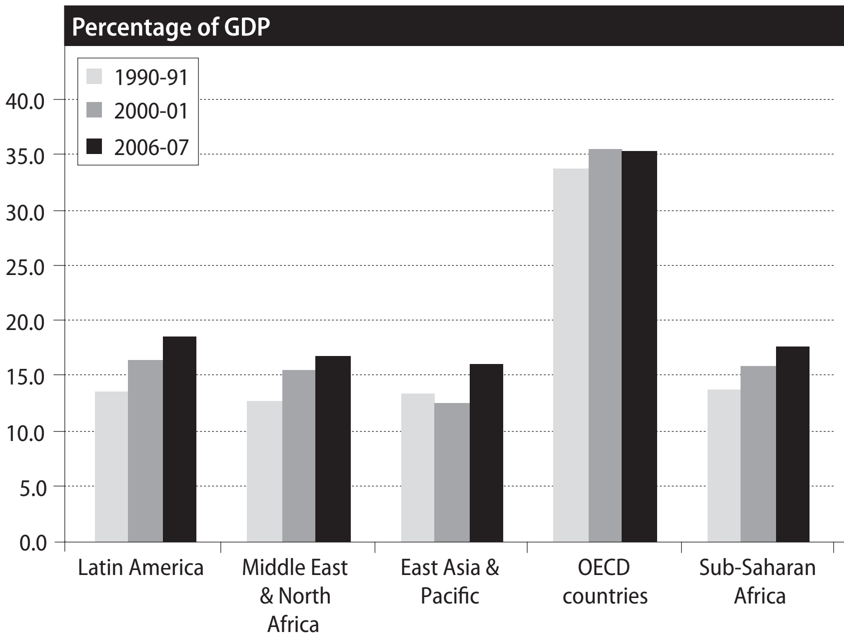
This provides credibility to an expansionary fiscal stance in countries where automatic stabilizers are weak and discretionary anti-cyclical policies are looked upon with suspicion by the markets. Symmetrically, the deficits need then to be cut gradually. Adam and Bevan (2001) suggest that deficit reductions of up to 1.5 per cent of GDP per year help re-establish fiscal balance with a minimal impact on growth, but larger reductions can hurt growth.

A "pp-pg-pe" fiscal policy needs also to be supported—both in normal times and during fiscal adjustments—by income transfer programmes

targeted at the poor, as in Mexico's *Oportunidades* and India's National Rural Employment Guarantee Scheme, which have come to play the role of "automatic stabilizers" for the many who are not eligible for unemployment insurance.

A further key element of a "pp-pg-pe" fiscal policy is a rise in tax-to-GDP ratios to levels permitting an adequate financing of public goods, some redistribution and the preservation of macroeconomic stability (Cornia, Gomez-Sabaini and Martorano, 2011). Tax ratios have risen in many developing countries, especially those in Latin America (figure 8.2), with much of the additional revenue coming from personal and corporate income taxes, pragmatic presumptive taxation, financial transaction taxes, consumption taxes on luxury items and reduction of regressive excises.

Figure 8.2
Average tax-to-GDP ratio in the main developing regions, 1990-2007



Sources: Cornia, Gomez-Sabaini and Martorano (2011).

Furthermore, the pp-pg-pe strategy would need to be supported by reducing regressive biases in tax and public expenditure policies. The new development model proposed in this volume will have to correct the often

limited distributiveness of public expenditure and, especially, taxation. While tax ratios may have increased recently, in most countries the "actual tax revenue" remains substantially below the "potential tax revenue", that is collectible revenue on the basis of an international norm (Cornia, Gomez-Sabaini and Martorano, 2011). There is a need therefore to propose a new "fiscal pact" aiming at raising the revenue/GDP ratio mainly through a rise in the value added tax (VAT) and progressive income and wealth taxes, as well as in "purpose taxes" aiming at reducing carbon emissions and other negative environmental effects.

An active tax policy (including "environmental taxes") leading to a higher and more progressive taxation generates several positive effects in terms of greater macroeconomic stability, lower inequality of the post-tax distribution, an increased supply of pro-growth and pro-poor public goods (infrastructure, human capital, law and order) and discouraging environmental damage.

As pointed out in the relevant literature reviewed in Cornia, Gomez-Sabaini and Martorano (2011), the ability of governments to raise taxes will depend very much on the "fiscal exchange" between the government and the citizens. Higher taxation is justified in fact, not for rent-seeking elites who captured the state, but only if a greater amount of public services is provided to the population, ideally in an increasing progressive way. Indeed, the pp-pg-pe development paradigm requires giving greater priority to public investment and social expenditure (education, health, nutrition, housing, and social protection) in ways that are pro-poor and that stimulate a low-carbon and pro-poor growth. The widespread rise in, among other things, primary and secondary school enrolment and vaccination rates financed through taxation (and in some cases aid) during the 2000s is an example of how such "fiscal exchange" can have a strong immediate impact on education and health, and a delayed one on poverty, inequality and future GDP growth. Evidence for a number of Latin American and South-East Asian countries further suggests that the incidence of public social expenditure (which focused more than before on services benefitting mostly the poor) became more progressive, as it improved the distribution of human capital among students and, with a lag, among workers. Moreover, as noted above, the "pp-pg-pe" paradigm would further encourage gradual increases in social insurance spending (by extending the scope of formal employment and pension coverage) and social assistance schemes such as the successful conditional and non-conditional cash transfers. The latter have proven to come at relatively low

cost (0.5 - 1.0 per cent of GDP) in most contexts, while generating large and measurable effects in terms of lower poverty incidence and inequality.

Finally, well-managed debt-financed public spending strategies may need to be part of the broader policy framework. As indicated earlier, important upfront public investments will be needed in many contexts to jumpstart sustainable agricultural development, sustainable energy strategies, broader economic diversification, and social infrastructure for human development. The costs of fiscal incentives promoting the pp-pg-pe strategy should be accounted for as well. Debt financing will be sustainable as long as the medium-term growth gains can be assured. This will require putting effective medium-term expenditure frameworks in place as part of the counter-cyclical macroeconomic policy regime, complemented by a credible tax reform programme and coherent with agricultural, industrial, energy and social policies.

Countercyclical monetary policy

While the liberal stance has traditionally aimed at single digit inflation by raising the policy rate (Blanchard and others, 2012), the new paradigm considers that monetary policy should not exclusively target low and stable inflation, but give at least equal consideration to adequate job creation and a fair income distribution. Thus the recommended approach would accept a more gradual decline of inflation, which in any case is already much lower than in the past, or even allow moderate rates of inflation to persist. This means that the nominal interest rate ought to increase less markedly than in the standard approach. This policy should help contain cost-push inflation, and at the same time avoid a contraction in investment and growth that would negatively affect employment. At the same time, the new stance argues also that monetary policy should be actively used for the sterilization of changes in the foreign exchange market, and that, in extreme cases, capital controls might be necessary to preserve monetary autonomy.

Prudential regulation of the financial sector

As suggested by the depth of the current sovereign debt crisis in Europe, a pp-pg-pe development strategy must strive to minimize the deleterious fluctuations of globalized financial markets. In this respect, future policy design can be inspired by the lessons that have emerged recently in some developing regions. Indeed, contrary to the case of the OECD and European

transition economies, the last decade witnessed fewer financial, currency, sovereign debt and/or banking crises in developing countries. For the case of Latin America, Porzekanski (2009) talks of a "missing financial crisis". In turn, Rojas Suarez (2010) described that Latin American governments made progress in the past decade in reducing currency mismatches, adopting managed floating exchange-rate regimes, implementing more credible monetary and fiscal policies (see above), using capital controls, reducing external indebtedness, and accumulating foreign-exchange reserves. She also argued that Latin American governments enhanced the capitalization, funding and supervision of their banking systems, encouraged the development of local bond and other capital markets, introduced a stricter prudential regulation of their domestic financial system, enhanced risk-assessment mechanisms in a number of large banks, developed appropriate legal, judicial and accounting frameworks, while assigning a greater role in the financing of economic activity to state banks as these amplify much less than foreign banks the impact of global financial fluctuations on the domestic economy.

In addition, because the likelihood of large and unexpected international shocks will likely remain considerable in the foreseeable future, the minimization of their impact requires that multilateral organizations stand ready to provide liquidity to developing countries, a point more fully discussed in chapter 12 by Girvan and Cortez. Positive changes in this direction have already emerged with the increase in funding and broader role played by the IMF in lending greater amounts of resources with easier access and conditionality.

8.6 Minimum common policy denominators, but ... one size does not fit all

The above discussion represents contours of "minimum common denominators" valid for different types of developing economies. Yet, in view of their heterogeneity it is important to explore in a somewhat greater detail the nature of the growth drivers and policies which will ensure the achievements of a pg-pp-pe pattern of growth—despite initial differences in the degree of food security, environmental footprints of key economic sectors, economic size, income per capita, prevailing production and export structures, weight of rural and agriculture-dependent population, degree of industrialization, dependence on foreign capital and food imports, and so on. By way of example, we present three stylized archetypes of developing coun-

tries to illustrate what the priorities and policy options would be if pp-pg-pe strategies were to be pursued.

Low-income agricultural countries

Agriculture remains the mainstay of many low-income economies in Africa and South Asia. As much as 60 to 80 per cent of the population still lives in rural areas, 50 to 70 per cent of the workforce is engaged in agriculture, and low land and labour productivity underpin high rates of poverty, food insecurity and processes of environmental degradation. Nonetheless, agricultural output accounts only for between 25 and 35 per cent aggregate GDP because of low, stagnant or even declining land yields. Today, these economies produce, on average, 30 per cent less food per person than they did in the 1960s. A stagnant food production promises even bleaker conditions for the long run, as by 2050 Africa (to which many of these poor countries belong) will have to increase food supply by 300 per cent in order to feed a projected population of 2 billion. With current policies, it is unlikely that such objective can be achieved and may remain challenging even if the policies suggested in section 8.4 are pursued.

It is obvious that raising agricultural productivity should be a first priority for these economies in order to secure higher income growth, employment creation and food security. The evidence in favour of such strategy is overwhelming (Byerlee, De Janvry and Sadoulet, 2009, De Janvry and Sadoulet, 2010; FAO, 2012, United Nations, 2011: chapter IV). Also, as indicated in section 8.4, there are ample technological options to do so in a sustainable way and with a focus on smallholder farming to generate the pro-growth, pro-poor and pro-environment outcomes. Economic theory and the recent experience of India, China and Vietnam show also that—in these types of economies—long-term development can hardly take place in the absence of an equitable modernization of agriculture and a rise in land yields. Low-income countries can learn from these experiences, but can gain further by ensuring environmental sustainability. Indeed, a strong agriculture reduces the prices of "wage goods" (food) and in this way keeps down real wages in industry and services, provides inputs to manufacturing, constitutes a large market for domestic industrial production, improves the balance of payments and reduces its volatility. Sustainable water and forest management, improving soils, deployment of environment-friendly agricultural techniques tend to add important opportunities for rural

employment creation and poverty reduction, next to ensuring food security becomes sustainable over time.

The new paradigm must therefore correct the relative neglect of agriculture[4] and reverse the decline in investment and cultivated land of the last 30 years, which were two key factors contributing to the global food crises of 2007-2008 and 2009-2011. It must also aim at stabilizing food prices, enhancing food security and enhance income distribution and ease the structural transformation of low-income rural nations towards manufacturing and modern services, as it began to happen during the last 10-15 years in Bangladesh.[5]

Given the weakness or absence of the credit, input and factor markets, the development of agriculture cannot rely solely on market forces but should count also on public interventions aiming, inter alia, at:

- Increasing the use of improved seeds and modern inputs (including irrigation and fertilizers) in a broadly egalitarian agriculture. The overall success of the "green revolution" in India and Bangladesh suggests there is an ample margin for improvements in yields, while learning from past mistakes in terms of the negative impact on the environment, by focusing on sustainable technologies as discussed in section 8.4d.
- Restoring selected and sustainable subsidies to modern agricultural inputs as well as price stabilization mechanisms that were eliminated during the "get the prices right" era. Subsidies to inputs such as (organic) fertilizers and improved seeds may help smallholder farmers to access technology and markets until output growth has stabilized at a high level. With its StarterPack program, in 2002 Malawi began a program of subsidies for seeds and fertilizers with good returns in terms of maize output (Dorward, and others, 2010).
- Raising the allocation of public expenditure on extension services for an equitable diffusion of new agricultural technology and cooperative credit (ibid.). To avoid inflationary pressures, such increase in public expenditure on agriculture needs to be accompanied by an increase in tax revenue and greater foreign aid to agriculture. Many developing countries—including in economies where agriculture is dominant—have already intensified their effort in the tax area, but that further initiatives may be required.
- Carrying out research on neglected crops (many of them African crops), with the international research community playing a fundamental role as during the "green revolution" of the 1960s. The improved seeds and

technologies for the African agriculture should remain (as they were in the past, and unlike at the present time) "international public goods". Aid to R&D in food research in selected regional institutions should also continue and be deepened towards adaptation of sustainable farming techniques to local circumstances (United Nations, 2011).

- Expanding investment in human capital, especially in rural areas, and "leapfrogging" into a rapid expansion of modern, but sustainable energy supplies, as discussed in, section 8.4.
- Phasing out agricultural subsidies in developed countries, a factor behind the rapidly increasing food imports and declines in agricultural production in developing countries. Otherwise, countervailing duties should be imposed on subsidized food imports from developed countries, while at the same time lowering tariffs on seeds, fertilizers and transport equipment.

Low and middle-income primary commodity exporters

These countries, in particular those exporting energy and metals, face considerable challenges linked to the volatility of their real exchange rate, Dutch Disease effects, high income inequality, strong dependence on imported food, environmental problems, and difficulties in diversifying the economy over the long term. Measures that have been shown to be able to address these issues include:

- The creation of domestic fiscal stabilization funds (such as the Chilean Copper Stabilization Fund), which stabilize public revenue in years of low commodity prices and so avoid large public expenditure cuts that exacerbate the impact of the shocks on growth, inequality and food security.
- Complementary policies that facilitate sterilization of excess foreign exchange earnings during booms, for instance through the use of offshore sovereign wealth funds which would store exports proceeds that cannot be absorbed productively into the economy. Sterilization of excess foreign exchange earnings this way could help avoid Dutch Disease problems and management of these resources to be such to promote intergenerational equity.
- Active promotion of a diversification of domestic production through the management of the exchange rate (which tends to appreciate), coherent industrial policies, and policies promoting energy transitions

towards use of renewables. This is particularly urgent in the case of fuel-exporters, assuming that in the coming decades the use of fossil-fuels is to be drastically reduced worldwide and hence new income sources will need to be created rapidly.

- Explicit taxation of the resource sector, so as to finance not only the diversification of the economy but also for reducing some of the highest income inequality via non-contributory income transfers to the poor (as currently done in several South American and South Eastern African countries).
- Policies to address the environmental costs of the mining and large-scale agriculture and livestock activities.

Emerging economies with a growing manufacturing sector

In many low-middle income, labour-abundant countries a key growth driver is labour and skill-intensive manufacturing and other rural non-farm (RNF) activities which include, for instance, agribusiness, fisheries, retail trade, cottage industries, marketing services, construction, transport, and various services—activities which, as in the famous case of the Chinese TVE, support rural-based industrialization and industrialization tout court. In China and Bangladesh, for instance, between 40 and 50 per cent of rural employment is in RNF. This task is facilitated by the rise of agricultural income made possible by the agricultural modernization which creates a market for non-traded goods (e.g. construction and services) and for "locally or regionally traded goods", that is goods that are highly perishable, entail high transport cost, or satisfy the preferences of local consumers in some regions, but not others.

Besides an increasing capital accumulation and facilitating technological innovation by the private sector, the structural transformation towards such a "broad-based industrialization" generally requires:

- Investing in physical infrastructure (roads, improved transportation and communications, electrification, linkages to nearby domestic markets). The presence of developed rural towns and rural-based agro-industry and low transport costs may facilitate the linkage between rural and urban areas and facilitate both production and exchange. A further step could be the creation of mini industrial parks equipped with electricity, water, gas, storage space and able to facilitate the transfer of technology among firms.

- Increased access to skills, and availability of finance.
- A reduction of transaction costs for the creation of firms, particularly small and medium-sized enterprises (SMEs). Given their lower investment per capita and greater flexibility, SMEs can promote a "broad-based (or popular) industrialization" and play a central role in soaking up surplus labour.
- Reducing the licensing and administrative barriers to access credit, investment goods and technology.
- Attracting, in the more advanced low-income countries, FDI to build hub-and-spoke SME clusters in which the latter work as subcontractors of the foreign firms, benefiting from their technical knowledge and spin-offs of skilled personnel. A number of developing countries (including some East Asian ones, Costa Rica, and others) have been highly successful, for different reasons, in attracting greenfield FDI. Success of these measures requires also ex ante evaluation of the environmental impact of industrialization and orientation of investments and incentive structures towards low-carbon energy generation as well as substantial improvements in energy efficiency in order to transition towards a green economy along the lines of coherent industrial, energy, environmental, fiscal and monetary policies, as outlined in section 8.4e.

8.7 An enabling global environment and policy space

The "minimum common denominator" for policymaking was derived in part from the development experiences of past decades of East Asian and Latin American countries. None of these fit the "pp-pg-pe" paradigm in full. In particular, achieving green and inclusive growth has been elusive in most cases as pro-environment objectives hardly featured and pro-growth targets typically received greater weight than equity considerations in the development strategies of the past. Moving forward, applying the pp-pg-pe paradigm thus will be a challenge for all countries, as there are no tested recipes as yet. Hence, a lot of policy experimentation will be needed to find successful pathways for sustainable development. The elements of the "minimum common denominator" may serve as a guide.

The policy experimentation will have to take place in an increasingly interconnected and unstable world economy. This, as well as international rules setting through the WTO and international financial regulation, have provided developing countries with less policy space than may have

existed before. A more enabling global economic environment in terms of less global market instability and greater flexibility in multilateral rules setting would help developing countries regain the policy space they need. Balancing objectives for, on the one hand, a fair but non-discriminatory trading system, sound multilateral environmental agreements, and strict regulation of financial markets, and, on the other hand, adequate policy space for developing economies to find their own pathways to overcome structural hurdles towards greater and sustainable prosperity, will obviously be challenging.

The Brundtland Report (WCED, 1987) laid out the principle of common-but-differentiated responsibilities to guide collective action and frameworks for global governance towards the common objective of global sustainable development. Applying this principle in practice has proven to be very difficult, if only visible in the long stalled negotiations for the, supposedly developmental, Doha Round of trade negotiations and difficulties to reach binding targets for greenhouse gas emission reductions that recognize differentiated responsibilities. The "minimum common denominators", as spelled out in this chapter, imply developing countries would need considerably more national policy space, especially in earlier stages of development. The subsequent chapters in this volume elaborate on the pitfalls of present mechanisms of global economic governance and how these would need to be reformed to provide a better enabling environment and also the policy space developing countries need in order to effectively pursue pp-pg-pe development strategies.

Notes

1 Social and environmental targets were set by sectoral initiatives, starting with the MDGs, however, without taking into account possible trade-offs among them while flatly ignoring the issue of income inequality. In any case, such uncoordinated approach was not able to address simultaneously the intertwined problems caused by the quadruple crises discussed in the text.

2 The government of Brazil had an essential role to play in providing incentives to scale up production and in setting up a clear institutional framework. This role included setting technical standards, supporting the technologies involved in ethanol production and use, providing financial advantages, and ensuring appropriate market conditions. Replacing old technologies, like gasoline in the case of Brazil, with renewable sources entails the challenge of making complementary investments along the supply chain. In the particular case of gasoline, consumers are reluctant to buy cars using a new fuel that may be difficult to find. Service station owners are not interested in investing in a parallel fuel distribution system, since the number of potential users is usually very small. This is why government policies to spur investment and drive demand for selected technologies are so important.

3 See chapter 12 by Girvan and Cortez for the implications for the international trading regime.

4 The dominance of macroeconomic and liberalization concern of the 1980s and 1990s and low food prices during a decade diverted everyone's attention from the problems of declining availability and poor distribution of farmable land (at times in spite of important land reserves), limited availability of irrigation, very low rates of fertilizer use and no or weak price stabilization mechanisms, low national and international R&D expenditure on African crops (millet, sorghum, cassava and yam), the absence or imperfection of factor markets (land, credit and insurance), as well as declining public and private investments in agriculture. The new investments in the land by foreign countries (generally referred to as "land grabs") are unlikely to solve this problem, though more research is needed on this topic.

5 Bangladesh is notable for some success in this regard. In this country the green revolution pivoted around a widespread use of high-yielding varieties of rice and other cereals, the increased use of chemical fertilizers and pesticides, and a rapid increase in irrigation through both deep- and shallow-tube wells. The new technology and related improvement in market systems have spread across the country, and double cropping (sometimes triple) has become typical in many areas of Bangladesh, which, in recent years, has become self-sufficient in food grains.

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Chapter 9
Building a stable and equitable global monetary system

Bilge Erten and José Antonio Ocampo[1]

9.1 Introduction

The recent global financial crisis brought back the reform of the international monetary system into the center of global policy debates. Major concerns have been the problems generated by the fact that a national currency remains at the center of the global monetary system, the recessionary (or deflationary, as they are usually called) effects of the asymmetric adjustments of deficit vs. surplus countries during crises, and the possible recessionary effects of the accumulation of large amounts of reserves as a precautionary measure by developing and emerging economies ("self-insurance", as it has come to be called). One of the large holders of dollar reserves called for the gradual replacement of the dollar with the Special Drawing Rights (SDRs) at the center of the system (Zhou, 2009), bringing the world back to similar calls made during the early 1970s (Williamson, 1977). However, the collapse, at that time, of the Bretton Woods arrangement led to what effectively can be characterized as a global monetary "non-system".

This chapter argues that the most promising way to reform the international monetary system to increase its stability and equity characteristics is indeed to fully employ the SDRs, which remain one of the most underutilized instruments of international economic cooperation. When they were created, the Articles of Agreement of the International Monetary

Fund (IMF) were reformed to express the aspiration of "making the special drawing right the principle reserve asset in the international monetary system" (Article VIII, Section 7 and Article XXII). However, after a promising start, as the initial issue in 1970-72 represented about 8 per cent of global non-gold reserves, SDRs came to occupy a rather marginal role as a reserve asset, coming to represent only a fraction of one percentage point before the 2009 allocations. In its April 2009 London Summit, the Group of 20 (G-20) revitalized this dormant element of global monetary cooperation, leading to the largest issuance of SDRs in history, which nonetheless brought its share in global non-gold reserves to only about 4 per cent. This also revived the policy and academic debates about the role of the SDRs in a more ambitious global monetary reform.[2]

Given the major problems that the current system faces, there are three distinct purposes for using this mechanism of international economic cooperation in an ambitious way. First, placing the SDRs at the center of the international monetary system could free the international monetary system from the vagrancies of having to depend on the monetary policy of the leading country (or, if we want, countries or regions), which may not be managed to take into account its international repercussions. The seigniorage associated with the additional demand for global reserves would also accrue to the IMF member states as a group. Second, by issuing SDRs in a counter-cyclical way, new SDR allocations during crises would have the potential of reducing the recessionary bias associated with the asymmetric adjustments of surplus and deficit countries. Third, SDR allocations could reduce the need for precautionary reserve accumulation by developing countries, and would represent a lower cost of building self-protection than accumulating international reserves through borrowing or building up current account surpluses.

There are also several potential benefits for developing countries in a new arrangement of this sort. First, although, given the current structure of IMF quotas, more than half of SDRs allocations are distributed to developed countries, developing and emerging economies benefit from such allocations, particularly because they tend to use them in a more active way. Second, following the discussions of the 1960s and early 1970s, there are also ways of including a "development link" in SDR allocations and in the way they are used by the international community. One mechanism would be to include a criterion of demand for reserves in SDR allocation. Another would be to design mechanisms by which unutilized SDRs are used

to provide or, as we would prefer, *leverage* financing for development. In the latter case, they can be also used to finance the provision of global public goods. In both cases, they would represent part of the alternative "innovative financing for development" that have been a subject of significant attention in recent years.[3] It is important, however, to clearly separate the monetary functions of SDRs to which we referred in previous paragraphs from their potential use as an instrument of development finance.

Any reform of the international monetary system should finally increase the voice and participation of developing countries in international economic decision-making, as called for in the Monterrey Consensus (United Nations, 2002). This implies a reform in the quota and vote shares in the IMF to make them more coherent with today's global economy, as well as dynamic, and to improve other aspects of their governance structures. A more inclusive and equitable system could also be improved by building a multilayered architecture in which global institutions interact with a denser body of regional arrangements.

The chapter is organized as follows. After this introduction, the second section will briefly analyze the current problems of the international monetary system, the growing demand for international reserves, and the history of SDR allocations up to date. The third section will make a novel contribution by focusing on the "market" for SDRs, i.e., how and why SDRs have been transacted. A major implication of this section is that, if this is going to become a major instrument of international cooperation, the market for SDRs has to increase substantially. The fourth section focuses on ways of making a more active use of SDRs for global monetary reform. The fifth deals with the possible development dimensions of SDRs. The analyses of all these sections indicate that most interesting proposals imply changes in the IMF's Articles of Agreement and a much larger "market" for SDRs. The sixth section deals with governance reforms. Finally, the paper will conclude by drawing major conclusions and policy recommendations.

The chapter covers only part of the broader agenda of global financial reform. There are at least four complementary issues not dealt with here: the need for stronger prudential regulation and supervision to prevent financial crises, adequate IMF credit lines in terms of both credit conditions and conditionalities, capital account regulations and international debt workout mechanisms (for an analysis of this broader agenda, see Ocampo, 2011 and Griffith-Jones and Ocampo, 2012).

9.2 Problems of the international monetary system and the demand for reserves

The international monetary system shows three fundamental problems (Ocampo, 2010 and 2011). The first one, which was that highlighted by John Maynard Keynes during the debates that led up to the Bretton Woods agreements, is that the present international monetary system has a bias against countries running balance of payments deficits (Keynes, 1942-43). The countries in external surplus have no strong incentive to adjust, and thus the burden of adjustment falls mainly on deficit countries, and generally takes place with a lag and rather abruptly when deficit financing suddenly dries out. The asymmetric adjustment tends to generate a global recessionary effect if the corrections that deficit countries need to adopt to balance their external accounts do not find financing in adequate quantities, and if those adjustments are not offset by expansionary policies in surplus countries. This problem can be called the *anti-Keynesian bias* of the system.

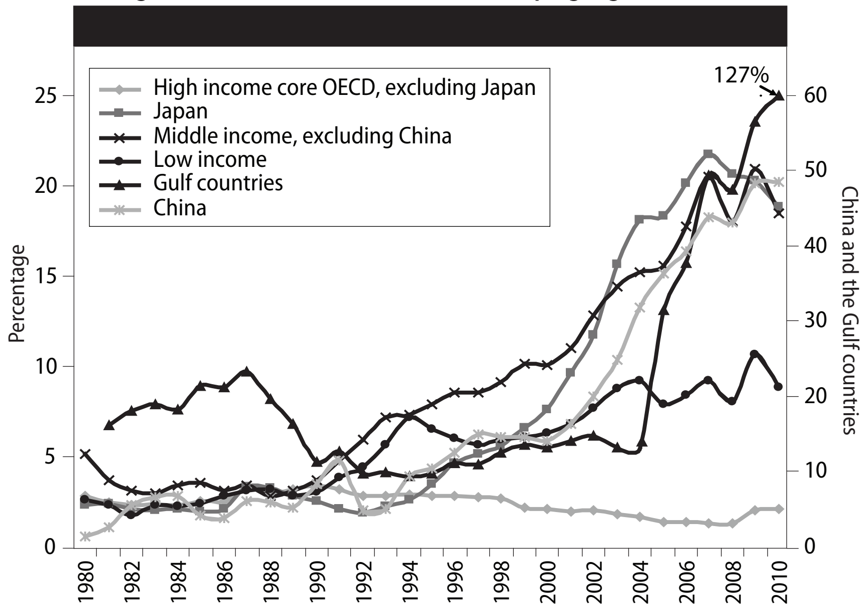
The second problem, which has become known as the *Triffin dilemma,* after the pioneering work by Robert Triffin (1961, 1968), arises from the fact that an *international* reserve system based on a *national* currency (the United States dollar) has some inherent instabilities. In particular, the only way that the rest of the world can accumulate net assets in dollars is if the United States runs a balance of payments deficit. But that can lead to a loss of confidence in the dollar and, more generally, has led to strong cycles in the value of the main international currency and in the U.S. current account deficit, which strongly affects the rest of the world economy. More generally, global monetary conditions are largely determined by the monetary policy of the United States, which is designed with no regard to its global repercussions. According to the reformulation as a "general dilemma" by the late Padoa-Schioppa (2011: 63-64), "the stability requirements of the system as a whole are inconsistent with the pursuit of economic and monetary policy forged solely on the basis of domestic rationales in all monetary regimes devoid of some form of supranationality".

The third problem of the current international monetary system is its inequitable character. The need to accumulate international reserves forces developing countries to transfer resources to those countries that issue reserve currencies. This *inequity bias* has been magnified in recent decades by financial and capital market liberalization and by the strongly pro-cyclical behavior of the capital flows toward developing and emerging economies. This behavior has generated a massive accumulation of foreign exchange reserves as a form of self-insurance against abrupt interruptions

in international financing. This accumulation can also be seen as a rational response by each country to a system that lacks a "collective insurance" in the form of adequate IMF emergency financing. It also generates a "fallacy of composition", as the collective attempt by these countries to accumulate reserves may generate current account surpluses that act as a global recessionary bias, or increase the demand for "safe" assets which, if not matched by an increased supply, may have global financial repercussions, particularly on the risk premia of those assets considered "safe". Inequity may thus lead to instability; for this reason, we can call this problem the *inequality-instability* link.

Reserve accumulation in developing countries has indeed risen sharply since the 1990s and diverged from the advanced country trends. Figure 9.1 and table 9.1 indicate that the foreign exchange reserves of low-income and middle-income countries were not unlike those of high-income countries in the early 1980s, about 3-4 per cent of GDP. The initial point of divergence took place in the 1990s following the 1980s debt crisis of Latin America and Africa, and intensified after the 1997-98 East Asian crisis. The

Figure 9.1
Average tax-to-GDP ratio in the main developing regions, 1980-2010



Sources: Total reserves minus gold series, World Bank, World Development Indicators, based on information from IMF.

Table 9.1
Accumulation of Foreign Exchange Reserves, 1982-2010

	In millions of United States Dollars						Per cent of GDP					
	1982-90	1991-97	1998-02	2003-07	2009	2008-10	1982	1991	1998	2003	2007	2010
High-income: OECD	43,582	35,752	62,539	147,718	366,984	201,903	2.58	3.23	3.81	4.95	4.85	6.34
Core OECD	33,027	4,482	-15,369	407	201,532	80,120	2.33	3.22	2.66	1.84	1.31	2.13
Japan	5,588	20,164	48,307	98,320	12,871	27,825	2.12	2.07	5.59	15.68	21.76	18.85
Others	4,967	11,106	29,600	48,991	152,581	93,957	9.99	7.81	15.65	20.04	18.39	26.34
High-income:non OECD	2,630	18,023	12,018	103,910	75,754	105,948	17.14	21.67	31.88	37.56	54.51	111.57
Gulf countries	-2,269	1,306	4,125	73,358	-15,650	44,698	18.06	12.64	12.48	13.21	49.31	127.08
Excluding Gulf countries	4,898	16,717	7,894	30,552	91,404	61,250	14.85	29.61	44.15	64.22	61.99	99.37
Middle-income	6,289	55,601	64,135	566,392	617,384	599,862	4.20	5.64	10.17	17.05	26.32	28.94
China	2,725	16,168	29,673	247,831	466,784	445,266	5.59	11.51	14.63	24.87	43.80	48.75
Excluding China	3,564	39,433	34,462	318,561	150,600	154,596	4.04	4.93	9.12	14.51	20.52	20.04
Low income	205	680	825	2,975	12,099	4,290	2.41	4.58	6.90	9.91	10.47	11.69
World	52,706	110,056	139,517	820,996	1,072,221	912,002	2.66	4.26	5.82	8.30	11.99	15.17
Excluding China and Japan	44,393	73,724	61,536	474,845	592,566	438,911	2.66	4.52	5.50	6.45	8.78	10.96

Source: World Bank, World Development Indicators, based on information from the IMF. The countries were classified according to World Bank list of economies reached online on 18 July 2011, which divided economies among income groups according to 2010 gross national income (GNI) per capita, calculated using the World Bank Atlas method. The groups are: low-income, $1,005 or less; middle-income, $1,006–12,275; and high-income, $12,276 or more. Figures are period averages.

essential reason, as already noted, is that many developing countries sought instruments to protect themselves against global financial instability and to manage pro-cyclical flows of capital which are particularly destabilizing. Together with the intentions to avoid conditionalities associated with IMF lending, this generated a massive accumulation of reserves.

Before the recent financial crisis in 2007, middle-income countries excluding China held reserves equivalent to about 20 per cent of GDP and low-income countries about 9 per cent. China's reserve accumulation has doubled from about 20 per cent in 2002 to over 40 per cent in 2007, which is of course much beyond the "self-insurance" motive and reflects an explicit policy to keep an undervalued exchange rate and run current account surpluses. The resulting reserve accumulation process was a massive transfer of resources from developing and emerging world to reserve-issuing industrialized countries. The "self-insurance" motive did pay off, however, as reflected in the reduced vulnerability of many parts of the developing and emerging world during the recent global financial crisis. After the use of some reserves for liquidity purposes during the crisis, the share of reserves in GDP fell and then rose over 20 per cent for middle-income countries and over 10 per cent for low-income countries in 2009, though they declined slightly in 2010.

In contrast to this pattern of reserve accumulation, the trend for high-income core OECD countries remained fairly constant about 2 per cent. The only high-income OECD country that followed a different pattern was Japan, particularly up to 2007. It has since then slightly reduced its reserves, which nonetheless still represented a little less than 19 per cent of its GDP in 2010. In turn, the most aggressively accumulating countries have been the Gulf countries, whose reserves reached 49 per cent of GDP in 2007 and an astonishing 127 per cent in 2010. This reflects the decision to save a large part of the windfall generated by high oil prices since 2004, in a significant break with past policy of overspending oil price booms. They were followed by China with reserves of close to half of GDP.

Overall, the world accumulation of reserves as a share of GDP increased from 4.3 per cent in 1991 to 12.0 per cent in 2007, and reached 15.2 per cent of world GDP in 2011, or from 4.5 per cent to 8.8 per cent and 11.0 per cent if China and Japan are excluded. During 2003-2007, reserve accumulation was $475 billion on average when China and Japan are left out, and continued at not a dissimilar pace in 2008-10, $439 billion. The associated amounts have been $821 billion and $912 billion including them.

SDRs are defined by the IMF as an "international reserve asset".[4] However, under the current rules, countries have to pay interest on allocations of

SDRs, but receive interest on holdings. In this sense, SDRs are peculiarly both an asset and a liability, and perhaps should be best considered as a credit line which can be used unconditionally by the holder, i.e., an unconditional overdraft facility. This is, of course, a legacy of the debates of the 1960s, when France, against the view of most countries (including the United States) opposed the idea of creating a pure reserve asset (Solomon, 1977, chapter VIII; Lombardi and Milsom, 2012).

According to exiting rules, the IMF makes general allocations of SDRs following three criteria: (i) a *long-term* need, (ii) of a *global* character, and (iii) with the purpose of *supplementing* existing reserve assets. Five-year-period reviews are undertaken to decide whether there is such a need. So far there have been three general SDR allocations. The first was done in 1970-72 for a total amount of SDR 9.3 billion, and the second in 1979-81 for SDR 12.1 billion. The last round that took place in 2009 included two different decisions: (i) an allocation that had been approved in 1997, partly to compensate members that had joined after 1981 and never received SDRs before; this allocation had been included in the Fourth Amendment of the IMF Articles of Agreement, which was finally approved by the U.S. Congress in 2009; and (ii) in response to the global financial crisis, the G-20 agreed to boost liquidity through new SDR allocations, which involved the issuance of SDR 161.2 billion, equivalent to $250 billion.

Interestingly, although allocations are made according to the long-term needs, the 2009 allocations were clearly argued on counter-cyclical grounds (IMF, 2009b). The sudden stops and reversals in capital flows in several developing countries during the crisis increased the need for reserves as a buffer against these shocks. Given the large contraction in the global economy, the restricted availability of external financing was expected to last a long time. This was seen as a major justification for the allocation.

SDR allocations are made according to quotas of each country in the IMF, and therefore they are much larger for high-income countries. Table 9.2 shows that during the first set of allocations in 1970-1972, high income countries received 74 per cent of total allocations (with a very tiny share for the non-OECD group), while middle-income countries received 23 per cent and low-income countries only about 3 per cent. The distribution improved slightly over time. With the second round of allocations in 1979-1981, the share of high-income countries declined to 69 per cent (with a significant increase in the share of the non-OECD group) while the middle and low-income countries' shares rose to 28 per cent and those of low-income countries marginally so. In 2009, the quota redistribution benefited slightly

more the middle-income countries, with 29 per cent of the allocations, while the low-income countries actually saw their share decline from 2.8 to 2.0 per cent. The decline in the share of OECD countries was mostly reflected in the rise of the share of non-OECD, mainly the Persian Gulf countries.

Table 9.2
SDR allocations by level of development, 1970-2009

	Allocations (in millions of SDRs)			Allocation to each group as a share of total allocations (percentage)		
	1970-72	1979-81	2009	1970-72	1979-81	2009
High income: OECD	6,818	7,956	114,905	73.8	66.2	62.9
Japan	377	514	11,393	4.1	4.3	6.2
Excluding Japan	6,441	7,442	103,512	69.8	61.9	56.7
United States	2,294	2,606	30,416	24.8	21.7	16.7
High income: nonOECD	41	363	10,797	0.4	3.0	5.9
Gulf countries	1	286	8,835	0.0	2.4	4.8
Excluding Gulf countries	40	77	1,962	0.4	0.6	1.1
Middle income	2,144	3,359	53,347	23.2	28.0	29.2
China	0	237	6,753	0.0	2.0	3.7
Excluding China	2,144	3,122	46,594	23.2	26.0	25.5
Low income	230	338	3,604	2.5	2.8	2.0
Total allocations	9,234	12,016	182,653	100.0	100.0	100.0

Source: IMF, International Financial Statistics.
Note: Figures are end of period data.

As the demand for reserves has ballooned, one additional complication of the reserve system is the growing scarcity of “safe assets”. The securities issued by the U.S. Treasury have so far been perceived as the safest assets, a fact that is facilitated by U.S. securities having the largest and most liquid market in the world. This has allowed the United States to pursue an entirely autonomous monetary policy. While the safe haven status of the dollar has not yet been disrupted, the ongoing global imbalances, in which United States continues to run current account deficits, maintain the risk that confidence in the U.S. dollar may be eroded at some point in time. Furthermore, the euro crisis has generated a sense that the second global

reserve asset is riskier than it had been perceived. Under these conditions, it can be argued that the demand for SDRs to *supplement* existing reserve assets has significantly increased. As it would be argued below, SDRs can also play a role in the prevention of a disorderly collapse of a reserve currency, an issue that came to the fore in the 1970s when proposals for an IMF "substitution account" were presented.

9.3 The "market" for SDRs (transactions of SDRs)

SDRs are "central bank money", since essentially only central banks accept them as means of payment and private parties are not allowed to hold them under the current rules. In addition, SDRs can be used to pay the IMF and they can be used by a few other international organizations such as the Multilateral Development Banks and the Bank of International Settlements. The core difference of SDRs from other reserve assets is that they cannot be directly used to intervene in the foreign exchange market. They have to be converted into the currency needed to undertake those interventions.

There are two ways in which SDRs are transacted: (i) transaction by agreement, and (ii) transaction by designation of the IMF. Transactions by agreement require a bilateral agreement between participant countries, after which the IMF typically mediates the transaction. If a member country has balance of payments needs to engage a large volume of SDR transaction that exceeds the system's absorption capacity, the IMF would designate members with strong external positions to exchange SDRs for freely usable currencies in order to maintain the liquidity of the SDRs. The transactions by designation guarantee that the SDR market clears in the case that voluntary transactions fail to meet the demand. Under the current IMF Articles, the IMF has the legal right to designate members to provide reserve currencies and accept SDRs up to the point where their holdings above allocation (i.e., excess holdings) are equal to twice their allocation amount. For over two decades, the designation mechanism has not been used as the voluntary arrangements have worked well without recourse to designation.

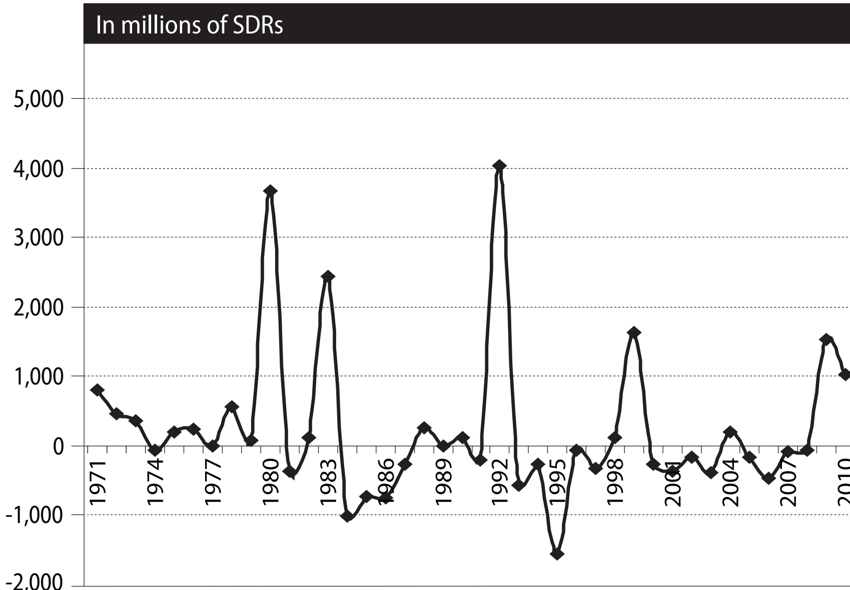
Central banks differ in terms of the nature of their use of SDRs. Some use a passive holding strategy, which means that their net drawings rely on the transactions demand for SDRs involving two major objectives. First, central banks use SDRs to finance their balance of payments needs. This is most obvious during crisis periods, when international private financing dries out, and it results in converting SDRs into other reserve currencies through voluntary arrangements. Second, central banks use SDRs in transactions

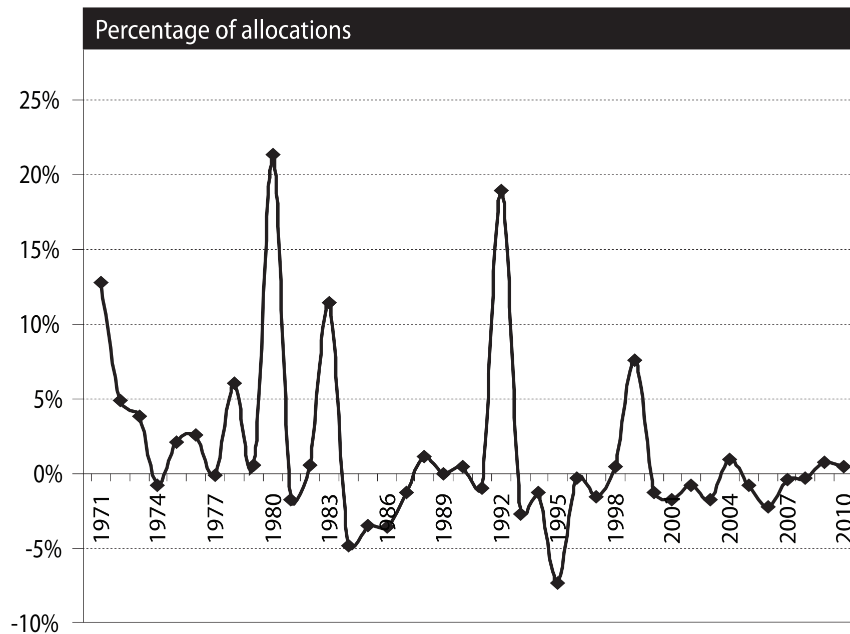
that involve the IMF, mainly to pay back the IMF; the IMF cannot use those SDRs to lend, an issue to which we return below. Third, some central banks have a more active management of their SDR holdings as part of their reserve portfolio strategy. This active strategy also involves voluntary agreements between members that wish to transact SDRs in return for currencies under the mediation of the IMF. These "market makers" involved in voluntary agreements include Austria, Belgium, Denmark, the European Central Bank, Finland, France, Germany, Japan, Netherlands, Norway, Sweden, Switzerland, United Kingdom, and Venezuela. All of these participants have two-way arrangements of buying and selling SDRs, except Germany, which has only a one-way arrangement to sell SDRs (IMF, 2009b).

The review of history indicates certain trends in the SDR market that are important for understanding how the market has so far functioned. The first important fact to notice is that there is a small but growing amount of SDR transactions, which tend to intensify during global crises. Figure 9.2 shows the *change* in net SDR drawings by IMF members, which is an approximation of the flow of SDRs.[5] The peak points correspond to global crises of one character or another. They include: the United States dollar depreciation of the late 1970s, which led the United States to use part of its SDRs; the 1980-1984 Latin American debt crisis; the crisis of the European exchange rate mechanism in the early 1990s; the series of crises in emerging economies in the late 1990s and early 2000s; and the 2008-2011 ongoing global financial crisis. In turn, the pronounced upward trend in the *stock* of net drawings shown in figure 9.3 indicates that market for SDRs grew over time, with accelerations during periods of global financial stress. Total net drawings as a percentage of total allocations have actually been large, fluctuating between 30 to 50 per cent since the early 1980s. The peak years of 1980, 1983, 1992, and 1999 coincide again with crisis periods. As a proportion of allocations, the market for SDRs of course fell substantially with the large 2009 allocations.

Table 9.3 shows the net SDR holdings of countries according to their levels of income at the peak years identified above, as well as 2008 and 2010. There are several interesting patterns that emerge from this disaggregation. Interestingly, high-income OECD countries excluding Japan have been large users of SDRs allocations, a fact that indicates that they are an important reserve asset even for the richest countries of the world. Such net use take place during global crises, but are still small relative to the large size of allocations they receive. Japan has been mostly on the buyer side of the market, accumulating SDRs above its allocations, except for 1992. The

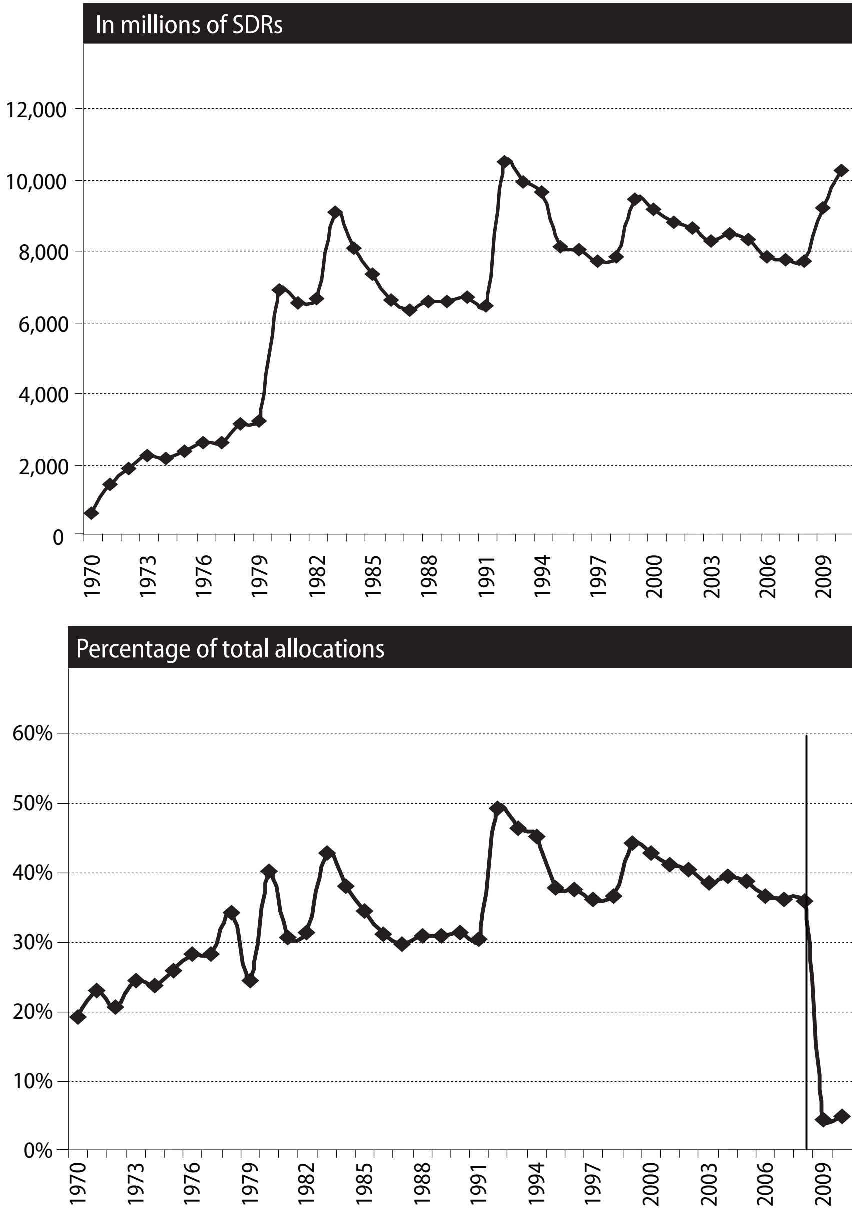
Figure 9.2
Change in total net drawings, 1970- 2010





Sources: Total reserves minus gold series, World Bank, World Development Indicators, based on information from the IMF.

Figure 9.3
Total net drawings of SDRs, 1970 -2010



Source: International Financial Statistics, the IMF.

United States drew almost SDR 2 billion in 1980 and was a still a net seller in 1983 but has been a net buyer in subsequent peak years. In turn, high-income non-OECD countries have overall been net buyers of SDRs except the year 1999. The Gulf countries play a large role in this regard. Excluding Gulf countries, the rest had rather small net drawings in 1980 and 1992 in both absolute and relative terms.

In any case, developing countries tend to use their SDR holdings more frequently. According again to table 9.3, middle-income countries had significantly large net drawings in all peak years. China has been the exception, drawing its SDR allocations only in 1980, and accumulating SDRs over its allocations since then. As a share of allocations to the group,

Table 9.3
Net SDR holdings by level of development, 1980-2010

	Net holdings (in millions of SDRs)						Net holdings as a percentage of allocations to each group					
	1980	1983	1992	1999	2008	2010	1980	1983	1992	1999	2008	2010
High-income: OECD	-3,248.5	-3,146.7	-4,265.2	-59.4	-746.8	619.6	-26.7	-21.3	-28.9	-0.4	-5.0	0.5
United States	-1,996.2	-99.5	1,284.7	2,639.4	1,164.6	1582.4	-16.4	-0.7	8.7	17.8	7.9	1.2
Japan	640.2	956.6	-96.2	1,043.8	1,077.0	1108.0	5.3	6.5	-0.7	7.1	7.3	0.9
Others	-1,892.6	-4,003.8	-5,453.6	-3,742.6	-2,988.5	-2070.8	-15.6	-27.1	-36.9	-25.3	-20.2	-1.6
High-income: nonOECD	44.9	398.7	108.6	-13.2	512.6	496.0	17.4	98.7	0.7	-0.1	114.4	4.4
Gulf countries	63.0	329.5	137.7	-105.5	405.3	358.1	24.4	81.6	0.9	-0.7	90.5	3.2
Excluding Gulf countries	-18.1	69.1	-29.0	92.3	107.3	138.0	-7.0	17.1	-0.2	0.6	23.9	1.2
Middle-income	-1,866.9	-3,641.0	-3,777.1	-2,322.9	-1,891.9	-4,613.4	-42.8	-66.2	-25.6	-15.7	-33.7	-7.8
China	-42.4	83.2	68.3	302.8	541.8	1026.1	-1.0	1.5	0.5	2.0	228.8	14.7
Excluding China	-1,824.5	-3,724.2	-3,845.4	-2,625.7	-2,433.7	-5,639.5	-41.8	-67.7	-26.0	-17.7	-45.2	-10.9
Low-income	-372.3	-467.9	-508.2	-524.5	-447.0	-1,057.6	-82.6	-82.3	-3.4	-3.5	-78.7	-25.4
Total net drawings	-6,917.9	-9,105.3	-10,509.9	-9,455.0	-7,699.7	-10,263.6	..	..	..	..	..	..
Total allocations	17,230.8	21,249.5	21,278.2	21,376.7	21,433.3	203,902.5	..	..	..	..	..	..

Source: IMF, International Financial Statistics
Note: (-) sign indicates net drawings, (+) sign indicates net holdings. The numbers are totals of each income group in millions of SDRs.

the middle-income countries excluding China drew much larger shares compared to high-income countries, ranging from 18 to over 68 per cent depending on the peak year. In turn, the use of SDR drawings in allocations is highest for the low-income countries. During the recent financial crisis, they drew close to 80 per cent of their allocated SDRs, prior to the large 2009 issuance.

The role of high-income countries in the market for SDRs is again highlighted in table 9.4, which shows a list of the largest participants in SDR exchanges for the periods of highest SDR usage. It was predominantly the high-income countries and oil-rich middle-income countries which bought and sold large amounts of SDRs during peak periods. Among these, the United States was the largest drawer of SDRs in 1980 followed by the United Kingdom, Australia, and Canada. On the net holder side was Japan, followed by Germany, Belgium, Saudi Arabia, and Iran. Saudi Arabia remained among top five net buyers of SDRs in the subsequent peaks, but Iran was replaced by Libya. China joined the net buyers in 1999, and

Table 9.4
Largest net frawers and holders of SDRs at peak years

In millions of SDRs											
Largest Net Drawers of SDRs											
1980		1983		1992		1999		2008		2010	
United States	-1,996	United Kingdom	-1,419	United Kingdom	-1,520	United Kingdom	-1,539	United Kingdom	-1,622	Ukraine	-1,304
United Kingdom	-1,168	Canada	-759	France	-962	France	-827	India	-679	United Kingdom	-967
Australia	-390	France	-658	India	-678	India	-678	Italy	-533	India	-681
Canada	-286	India	-577	Germany	-599	Italy	-580	France	-453	Serbia	-443
India	-188	Australia	-394	Italy	-529	Australia	-418	Brazil	-358	France	-394
Largest Net Holders of SDRs											
1980		1983		1992		1999		2008		2010	
Japan	640	Japan	957	United States	1,285	United States	2,639	United States	1,165	United States	1,582
Germany	452	Germany	330	Libya	220	Japan	1,044	Japan	1,077	Japan	1,108
Belgium	102	Saudi Arabia	291	Mexico	109	Switzerland	345	China	542	China	1,026
Saudi Arabia	88	Libya	99	Kuwait	104	Libya	314	Libya	526	Libya	533
Iran, I.R. of	41	Norway	89	Austria	69	China	303	Saudi Arabia	282	Singapore	248

Source: IMF, International Financial Statistics.

climbed to third largest buyer position in 2008 and 2010, following the U.S. and Japan. On the other hand, the United Kingdom stayed on the seller side of the market, and interestingly the largest seller until 2010, when Ukraine displaced it from that position. The other top five varied among France, Italy, India, Australia, and more recently Brazil and Serbia.

Three major conclusions can thus be derived from looking at the market for SDRs. First, despite their low share in allocations, developing countries tend to use their holdings frequently for their balance of payments needs. Allocations of SDRs and, particularly, asymmetric allocations—an issue to which we return below—would thus have positive development implications. Second, SDRs are, in any case, an important reserve asset for developed countries, as reflected in their dominant role both on the buyer and seller side. Finally, however, the market is very small, as at their peak net drawings have only reached slightly over SDR 10 billion, a minute proportion of global reserves.

9.4 SDRs as an Element of Global Monetary Reform

There are several constraints that must be taken into account for a more active use of SDRs, many of which would require changes in the IMF Articles of Agreement, but others have to do with the nature of SDRs. All proposals also require a much larger market for SDRs, which can still follow the current scheme, or allow for some private use. However, although a private use could certainly increase the market for SDRs, it is not strictly essential, as long as countries (central banks) maintain the existing commitment to accept SDRs as payments from other countries (central banks). For this reason, in the proposals that we present, we will assume that they continue to have their current character of "central bank money". We will briefly return to the question of private use below.

The most important constraint relates to the fact that the IMF accounts are divided between the "general resources" and the SDR accounts. This severely limits the use of SDR allocations. In particular, under the current rules, and in contrast to other money creators (central banks), it is not possible to finance IMF lending using SDR allocations. The most important reform that should be introduced is, therefore, a change in the current rules that will make the SDRs the major and indeed possibly the unique form of financing of IMF lending, entirely replacing in the latter case both quotas and Arrangements to Borrow. The simplest way of doing so would be for the unused SDRs to be treated as deposits in (or lending to) the IMF, which

would use these funds to finance its lending to member countries in need (United Nations, 2009; Ocampo, 2011). This would also be a step to fulfill Polak's (1979) proposal to make the IMF a fully SDR-based institution. A substitution account would have to be created to allow the IMF to regulate changes in demand for national (or regional) reserve currencies by central banks, an issue that is critical in the transition to a more fully SDR-based system (see below).

An ambitious reform to address the problems of the current reserve system and the shortfall of safe assets would thus be to design an SDR-based global reserve system, or at least moving to a fully SDR-funded IMF. The major advantages of IMF acting as a quasi-world central bank are threefold: (i) sharing seigniorage (e.g. the seigniorage would accrue to the IMF member states according to their quota distributions or alternative SDR allocation formula, instead of the reserve-issuing countries); (ii) delinking the creation of international reserve assets from any particular national or regional currency, thus helping to overcome the Triffin dilemma; and (iii) controlling liquidity in a counter-cyclical way.

Proposals for SDR allocations follow two models: one-time (e.g. IMF allocations for five-year periods when judged necessary) vs. regular allocations. In order to ensure a stable source of liquidity in world markets, in either case the SDRs should be allocated on a counter-cyclical basis. This means increasing the supply of SDRs in periods of global financial stress and reducing their supply, including by partly destroying them when financial markets become more stable. Such counter-cyclical allocations are crucial to offset any inflationary pressures that might otherwise arise.

Proposals of new SDR allocations vary based on the criteria used to estimate them. The most recent IMF report uses three conventional criteria: reserve coverage of imports (which is not important today), coverage of short-term debt and broad money (IMF, 2011b). Their estimates suggest a considerable rise in the projected demand for reserve assets. While the 5-year estimates for 2009 (IMF, 2009b) ranged of an additional demand of about $700–900 billion, the projection for the same period has gone up to $800–1,600 billion starting in 2011. On an annual basis, the IMF recommends SDR allocations of $117-133 billion a year for three years beginning in 2014 to maintain a stable level of supply for global reserve assets.

Table 9.5 provides a list of studies that have proposed allocation of SDRs, their methods of estimation, and the amounts of issuance estimated. Regardless of differences in estimation techniques, it is seen that most recent studies propose a consistent amount of regular allocations ranging about

Table 9.5
Estimates of SDR allocations, 2009-2011

Study	Method of Estimation	Proposed Amount to Issue
International Monetary Fund (June 2011)	Precautionary demand for reserves estimated based on (i) imports, (ii) short-term external debt, and (iii) broad money.	$117–133 billion annually for three years beginning in 2014.
Ocampo (2011)	Close to but slightly less than average reserve accumulation in 2003-08 (excluding China and Japan)	$250-300 billion annually
Stiglitz and others (2011)	Recommendation based on the previous issue of SDRs equivalent to 250 billion by the IMF in 2009.	SDR 150-250 billion annually over the next three years, which equals $240-400 billion at current exchange rates
International Monetary Fund (January 2011)	Half of the average precautionary demand for reserves over 2000-09 (Obstfeld, Taylor, and Shambaugh, 2008).	$200 billion annually
International Monetary Fund (2010)	Less than average reserve accumulation over 2000-9	$200 billion or more annually for some years
Kenen (2010)	Recommended "to raise the share of the SDR in total reserves".	SDR 200 billion annually, which equals $320 billion at current exchange rates
Williamson (2010)	Annual average increase of the holdings of non-gold reserves over 2003-08.	SDR 457 billion, or more realistically SDR 200 billion annually, but asymmetrically distributed: about 80 per cent of allocations to developing countries, and 20 per cent to industrial countries, with allocations within each group determined according to IMF quotas.
Greenwald and Stiglitz (2008)	Global reserves were about $3 trillion in 2008. Assuming the demand for reserves increases at the average rate of world trade (about 7 per cent), this amount would satisfy the demand for reserves without a US payments deficit.	$200 billion annually
Bergsten (2009)	Seen necessary for a "more balanced composition of global reserve assets".	Annual distributions totaling $1 trillion over the next five years
United Nations (2009)	Average annual reserve accumulation in 1998-2002 as lower bound, and that in 2003-07 as upper bound.	$150-300 billion annually

Source: Authors' compilation.

$200-300 billion annually. Studies generally rely on an indicator of global demand for additional reserves with a precautionary motive. One of the effects of these regular allocations would be a significant diversification of reserves. For example, the IMF (2011a) estimated that an annual allocation of $200 billion would increase the share of SDRs in total reserves to about 13 per cent by the 2020s. Many analysts, notably the Stiglitz Commission, have made the case for regular allocations, and suggested that they should be in the range of $150-300 billion a year (United Nations, 2009, ch. 5). More recently, one of us has suggested that, given that average annual reserve accumulation in 2003-2008 excluding China and Japan, an allocation of something in the order of $250-300 billion a year would be reasonable (Ocampo, 2011). A more recent recommendation by a group of experts is even larger: $240-400 billion (Stiglitz and others, 2011).

An implicit assumption in all these estimations is that, although the allocation of SDRs would provide alternatives to the Treasury securities issued by the United States and other reserve currency issuing countries, the rapid increase in the demand for "safe assets" by central banks implies that they meet the criterion of "supplementing" existing reserve assets.

In the transition towards an SDR-based reserve system, one of the technical difficulties that IMF faces is the creation of a "substitution account," which would allow countries to exchange their dollar reserves and those denominated in other currencies for the SDRs and SDR-denominated assets issued by the Fund through off-market transactions. This would prevent an abrupt depreciation of the dollar or the euro if large holders of such reserve assets try to sell them in the foreign exchange market. In this sense, the substitution account would be essential to maintain the stability in exchange rate movements, and it would be also highly useful and perhaps an essential instrument in a multi-currency arrangement to prevent excessive exchange rate volatility.

By allowing countries to transform their dollar reserves or reserves denominated in other currencies into SDR denominated assets in an off-market reserve pool, the creation of a substitution account is a necessary ingredient of a substantial reform of the international reserve system. Similar to the three-stage transition envisioned by Kenen (2010), one can think of three periods in which the functions of the substitution account change to eventually transform the SDR into a fully developed reserve asset. In the earlier period after which the substitution account is established, countries can exchange the reserve assets they have for SDRs issued for that purpose by the substitution account. The potential costs arising from maintaining

the value of the reserves deposited in the account can be shared between the reserve-issuers (the United States and the eurozone countries) and the reserve-holders (the majority being developing and emerging countries). In the subsequent period, each country that has a need to intervene in the foreign exchange market would be able to freely transfer some of its SDR claims for the currency of intervention to the substitution account, or by selling its normal SDRs allocations to the country issuing the currency that it needs to access. In the final phase, the substitution account can be consolidated with the general accounts of the IMF and any distinction between the SDRs created through substitution and SDRs created by periodic allocations would disappear. A substitution account could still be kept to help the IMF regulate changes in the demand by central banks for other reserve assets.

Some analysts have found the SDR-based reform of the reserve system inadequate because a major boost to the role of the SDRs relies on its transformation into an asset held by the private sector (Cooper, 2009; Eichengreen, 2009; Padoa-Schioppa, 2011). However, even aside from the fact that this imposes additional demands on the reform of the system, the private use of SDRs could generate problems of its own, particularly speculative changes in the demand for this global reserve asset, as well as strong opposition to a reform of the system by the United States. For this reason, it may be better to think of an SDR-based system in which national or regional currencies continue to play the major role in private transactions.

Indeed, the absence of private market use for SDRs does not prevent their use as a central bank asset and payments instrument. As long as central banks agree to accept SDRs from one another in exchange for convertible currencies, the SDR performs the function of medium of exchange in inter-central bank transactions. It could be argued that the inability of SDRs to be used for central banks to intervene in the foreign exchange market raises the question of whether SDRs are a better asset for central banks to hold (Williamson, 2009). However, this inconvenience can be overcome again as long as each IMF member maintains its obligation to freely accept SDRs in exchange for their currencies. One of the functions of a permanent substitution account could be for it to provide national or regional currencies for intervention by central banks.

The IMF had a framework to issue bonds that was approved in the early 1980s but was never used before 2009. When the IMF began facing cash flow problems in financing its administrative costs in 2008, the proposal to

issue bonds was revived. In 2009, the IMF began issuing SDR denominated bonds to attract funding from emerging economies (IMF, 2011). However, these bonds were designed to be traded only between IMF and the central banks of its members. They pay an interest rate linked to the SDR interest rate and have a short maturity, ranging from 12 to 18 months.

The SDR-denominated bonds bring several advantages for emerging and developing countries. First, they reduce the dependence of central banks on U.S. government securities, and thus allow them to diversify the currency composition of their reserve holdings as the SDR itself is composed of four different currencies. As long as the interest rates earned by government securities of the United Kingdom, Japan and the Eurozone countries are higher than the U.S. Treasury bills (as is currently the case), the SDR-denominated bonds are also an attractive investment. These bonds also allow developing countries to limit their financial support for the IMF to a particular period, instead of an open-ended commitment through the New Arrangements to Borrow (NAB), thus also providing them leverage to push further quota reforms (Prasad, 2009).

A first and moderate step for the IMF to enhance the private SDR market is to expand the issuance of SDR-denominated bonds and to allow these bonds to be held by the private sector, with the IMF itself and/or major central banks acting as "market makers" that provide liquidity to the instrument. In the long term, once sufficient market depth and liquidity is established, the SDR-denominated securities could replace other global assets in pricing risk globally, and thereby become "an embryo of global currency" (IMF, 2011).

9.5 The development dimensions of SDRs

Development dimensions of SDRs as a monetary instrument

There are three development dimensions of SDR allocations as a purely monetary instrument. First and foremost, since developing countries tend to use their SDRs more frequently, a larger SDR allocation would benefit them in particular. It would basically give them an unconditional overdraft facility over which they can draw when external financing dries out.

Second, keeping SDRs as a strict monetary asset, there is the possibility of asymmetric allocation rules. This idea is similar to the proposals presented by developing countries in the debates on global monetary reform of the early 1970s (Committee of Twenty, 1974), but the reasons are different

today. Beyond the fact that IMF quotas do not accurately reflect the share of developing countries in the world economy today, the evolution of reserve accumulation indicates that, due to the procyclical shocks they experience from global financial markets, emerging and developing countries have a "revealed" preference for a much higher level of reserves. To overcome these problems, there is both a need to reform quota allocations at the IMF regularly to reflect the changing shares in the world economy, but possibly also to include as a criterion in SDR allocations the divergent demand for reserves among countries of different levels of development.

One alternative, which has been proposed by Williamson (2010) would be to issue to emerging and developing countries 80 per cent of SDR allocations and the remaining 20 per cent to industrial countries, with country allocations within each group following IMF quota distributions. Another alternative, as indicated, would be to explicitly introduce the demand for reserves into the criteria for SDR allocations. One simple way of doing so would be for quotas from middle and low-income countries to be weighted by a factor that represents the several times they tend to demand reserves as a proportion of GDP relative to high-income economies. For example, their quotas could be weighted by a factor of 5, which is in fact significantly below the recent historical ratio of the demand for reserves as a proportion of GDP in middle-income vs. that typical of high-income countries;[6] those from low-income countries could of course be weighted by a larger factor for strictly redistributive purposes. One benefit of any of these mechanisms of asymmetric SDR allocations is that they would reduce the transfer of resources from developing to industrial countries.

Third, Ocampo (2011) has proposed a "development link" in SDR allocations that avoids its being treated as a fiscal transaction. The alternative draws from that proposed by the Group of Experts convened by UNCTAD in the 1960s (UNCTAD, 1965) as well as one alternative version of the proposal presented by developing countries during the 1972-74 discussion on international monetary reform (Committee of Twenty, 1974; Williamson, 1977, chapters 5-6; Toye and Toye, 2004, chapter 10). It would allow the IMF to use the SDRs that are not utilized by member states, and which, as indicated above, would be treated as deposits of (lending by) countries in the IMF, to buy bonds from multilateral development banks, which would then finance development or global public objectives. Alternatively, countries with excess holdings of SDRs could invest in bonds of multilateral development banks. This proposal was endorsed by the Stiglitz Commission (United Nations, 2009). Given that such bonds would

be at market rates, they would be used for non-concessional lending by multilateral banks. However, if this source of financing was combined with some grant element (that could be possibly financed by revenues from a currency transactions tax, but could also rely on traditional ODA), it could also help finance concessional lending by multilateral development banks. This can be done on an individual basis or collectively if there is a reform of the SDR mechanism.

Note that this "development link" does not require asymmetric issuance but would make a more positive use of allocations to developed countries and other countries with excess reserves, such as China and the Gulf countries. If adopted, the resources available for development finance could be proportional to unused SDRs allocated to high-income countries. If the IMF goes with $240–400 billion annual allocations, the funds going to industrial countries would be over $144–240 billion and a conservative estimate of $100-200 billion could be used to finance development and/or global public goods.

Use of SDRs as an innovative source of development finance

The idea of using SDRs issued to industrial countries for development purposes and the provision of global public goods has been proposed by Soros (2002) and Stiglitz (2006), among others. George Soros also suggested in the Copenhagen climate change conference of 2009 using SDRs to create a "fast-start green fund", an idea that was backed in January 2010 by the then IMF Managing Director, Dominique Strauss-Kahn and has been supported by civil society organizations (ActionAid, 2010). Again, the idea of using part of the SDRs for international aid goes back to the discussions of the 1960s and early 1970s.

Donating SDRs for development or climate change purposes is possible, but costly for the donating country, since it would still have to pay interest on the donated SDRs to the IMF. An alternative would be to pay the interest from IMF accounts through a reassessment of gold reserves. Indeed, Soros (2009) called for this option if the industrial countries agreed to donate their unutilized SDRs from the 2009 allocation to a Global Green Fund.

The difficulty of all these proposals for funding global public goods or development is that they mix monetary and fiscal operations. Since SDRs are strictly a monetary asset that can only be used by central banks and international financial institutions under the current rules, their allocation for development purposes or global public goods means that they have to

be donated or transferred by a central bank or an international financial institution. This essentially entails using them as a *fiscal* instrument, which goes beyond their function as a strictly monetary instrument. The fiscal use of SDRs can create problems in practice because each time they would have to be approved by national parliaments in each member country and that it might even be legally complex (or even illegal) to make a fiscal use of a central bank asset (Ocampo, 2011). Of course, a reform of the IMF Articles of Agreement could open the possibility for the use of SDRs with this purpose.

An alternative proposal is the creation of "trust funds", which can be the capital, for example, of a "Green Fund" (but it can be also a development fund with other objectives, such as infrastructure). Industrial as well as other countries would place their unused SDRs into the trust funds as "equity", possibly oversubscribing the required equity to guarantee the liquidity that is essential for a reserve asset. One of the advantages of investing the unused SDRs over donating them is that the transferring countries would not bear the cost of making interest payments to the IMF. The interest required could easily be obtained from the return on the equity of the Green Trust Fund (Bredenkamp and Pattillo, 2010). It would, of course, make sense for this Fund to prioritize its lending, whether concessional or not, to developing countries.

9.6 Reform of governance structures[7]

Substantive reforms of the international monetary system must be matched by the design of appropriate governance structures. As already noted, the call to increase the "voice and representation" in international economic decision-making goes back to the Monterrey Consensus, to which we must add the fact that developing countries' shares in IMF quotas do not reflect their shares in the world economy today. In 2006 and 2008 modest agreements were adopted on reforming quotas and votes in the IMF Board, which entailed a redistribution of the quotas and a tripling of basic votes. In October 2010, just before the heads of state meeting in Seoul, the ministers of the G-20 agreed on, and the IMF Board approved in November 2010 a more ambitious reform. It included doubling the quotas, revising the allocation of quotas and voting power of developing countries while protecting those of the poorest countries, reducing by two the European representatives in the IMF Board and electing all of its members.

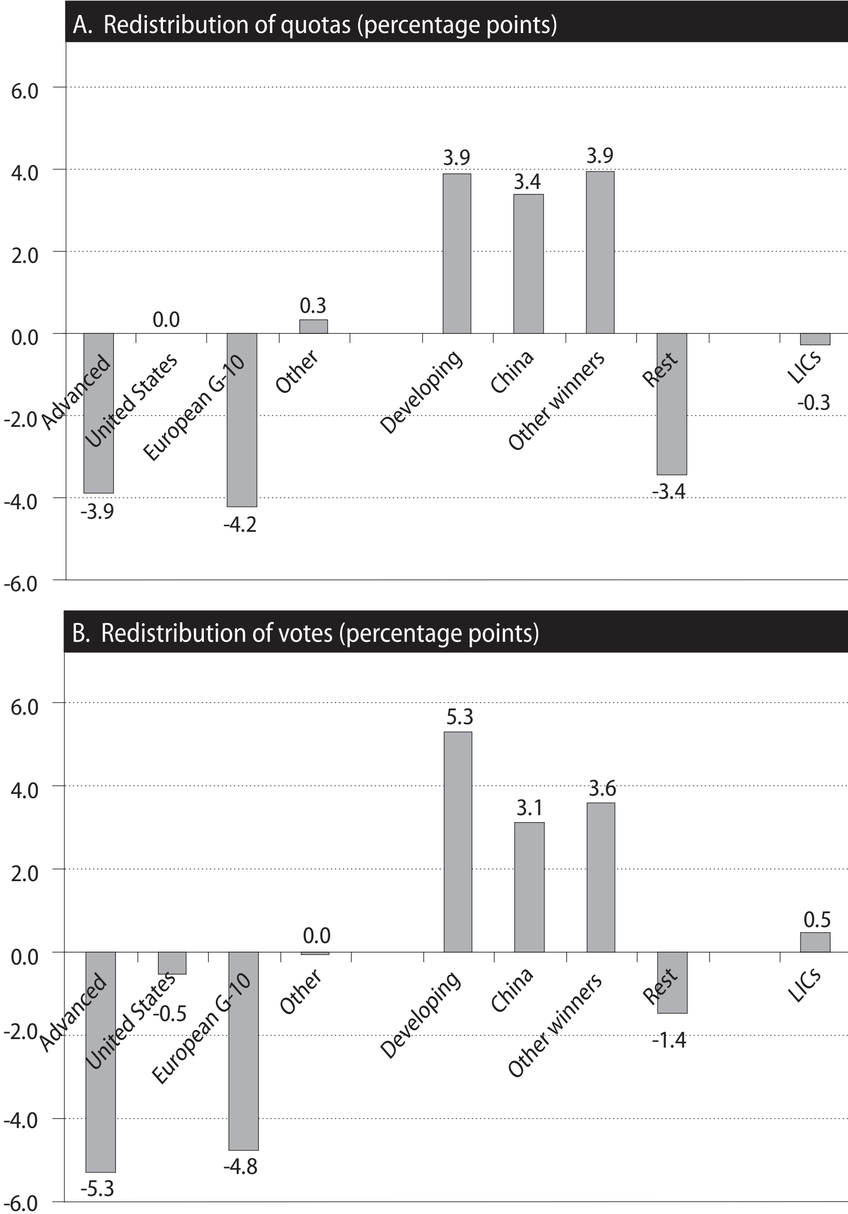
Relative to the pre-2006 situation (i.e., prior to the Singapore 2006 annual meeting), the accumulated increase in the quotas (3.9 percentage points)

and voting power (5.3 points) of developing and transition economies was less than expected by these countries, and the large gains by some of them (China, Republic of Korea, Brazil, India, Mexico, and Turkey, in that order), which adds up to 7.3 and 6.7 percentage points in terms of quota and voting power, respectively, came partly at the expense of other developing countries (figure 9.4). Furthermore, although the quota and voting power of European countries was reduced, its over-representation continued to be a problem, as is the under-representation of some emerging economies relative to their actual share in the world economy. Given relative trends in the growth of different countries, this problem is likely to worsen over time. There is, therefore, a need for agreement on a transparent formula that would allow quotas to be regularly revised to reflect changes in the shares of different countries in the world economy.

To these we must add other important proposals on governance made on various occasions, including by the 2009 Commission for IMF Governance Reform headed by Trevor Manuel (IMF, 2009a): a reduction in the threshold of votes needed to approve important IMF reforms from the current 85 per cent to, for example, 70-75 per cent; the creation of a Council of Ministers with effective powers to adopt the most important political decisions, thus replacing the International Monetary and Financial Committee; and a clear redefinition of the relations among this Council, the Board, and the Administration. The G-20 also agreed that the senior management of the Bretton Woods Institutions (BWIs) should be chosen on the basis of transparent and open processes, based on the merit of the candidates and not on their nationality. However, these principles were only very partially followed during the election of the IMF Managing Director in 2011 and the President of the World Bank in 2012, which therefore saw the continuity of the unwritten rule that has been in place for close to seven decades according to which the IMF is headed by a European and the World Bank by an American. It would also be useful for the staff of these institutions to be more diverse, not just in terms of nationality but also in terms of gender, education, professional experience and schools of thought.

The broader issues on global economic governance relate, however, to what one of us has called "elite multilateralism" –i.e., to the G-20 (Ocampo, 2011). The creation of this G at a leaders' level was, of course, a step forward compared to the G-7, in terms of representation of developing countries. But this solution also created problems of its own because of the ad hoc nature of the co-operation mechanism adopted, including the way in which the membership was defined, which implies the exclusion of some large

Figure 9.4
Redistribution of quotas and votes in the IMF (compared to the pre-2006 situation)



Notes: European G-10: Belgium, France, Germany, Italy, Netherlands, Sweden, Switzerland, Developing countries, Other winners: Brazil, India, Mexico, Turkey and Republic of Korea, LICs: Low-Income Countries.

countries (Nigeria is the most prominent case) and (once again) the over-representation of Western Europe. Beyond that, however, this has created a distorted system of governance, by which a body that represents the full membership (the IMF Board) has become a mechanism to rubber stamp in some occasions the decisions made by a limited number of them (those that are G-20 members). It also represents a distortion of IMF governance, as most members of the IMF Board represent constituencies and not individual countries.

This preference for "Gs" over representative international institutions has deep historical roots in the case of major industrial countries, and reflects a revealed predilection of these countries for mechanisms over which they can exercise greater influence, but such bias may now be affecting other G-20 members. The basic problem is the challenge of overcoming the tension between representativeness and the legitimacy associated with it, on the one hand, and power structures, on the other. This issue is sometimes expressed as the tension between inclusiveness and effectiveness, but this is clearly a wrong way to pose it, as national democracies have shown that representative institutions can be effective. It is, of course, true that some decision-making processes may require small bodies, but this is not inconsistent with the principle of representation, as those small bodies can be embedded in larger representative institutions that elect their members according to agreed criteria.

Therefore, although Gs can play an important role in placing new issues on the agenda and facilitating consensus among major powers, and in general in steering changes that generate a consensus among the most influential countries, no structure of governance can generate legitimacy as long as decision-making processes are not inclusive. For this reason, the G-20 should be seen as a transition to a more representative, and thereby legitimate, mechanism of international economic co-operation, such as the Global Economic Co-ordination Council proposed by the Stiglitz Commission (United Nations 2009b, ch. 4; Ocampo and Stiglitz, 2011).

Finally, the global monetary architecture should rely more broadly on regional institutions. Indeed, in a heterogeneous international community, the creation of *networks* of global and regional institutions can provide a better system of governance than arrangements based on single global organizations. This is based on old federalist principles: regional and sub-regional institutions give stronger voice and a sense of ownership to smaller countries. These institutions are, therefore, more likely to respond to their demands. This has already been recognized in some areas, such

as the system of multilateral development banks, where the World Bank is complemented by regional development banks and, in some parts of the world, by sub-regional (in particular, in Latin America and the Caribbean, as well as in Europe) and inter-regional banks (the Islamic Development Bank). Although the density of institutional arrangements is quite diverse around the world, their historical record is broadly positive.[8]

The creation of such an institutional network is particularly urgent in the monetary arena, where the IMF should make more active use of regional institutions, such as the Chiang Mai Initiative and the Latin American Reserve Fund, and support their creation in other parts of the developing world. The creation of a European Financial Stability Facility and the more permanent European Stability Mechanism are also major steps in that direction. Indeed, the IMF of the future should be designed as the apex of a network of regional reserve funds (or equivalent regional arrangements) rather than a mere global fund (Ocampo, 2006). Aside from its benefits in terms of participation by all countries, this design would be much better for promoting macroeconomic policy dialogue and crisis prevention and management at the world level.

In the design of such a structure, careful consideration should be given to the links between global and regional arrangements. In this regard, during the recent crisis, Europeans chose rescue packages that mixed resources from the IMF and the European Financial Facility. In contrast, as access to Chiang Mai swap credit lines beyond a certain limit (20 per cent of the agreed lines, now increased to 40 per cent) requires an IMF program, countries that may have used the initiative during the crisis (Indonesia and the Republic of Korea) chose not to do so as they were unwilling to agree on any such program. In turn, the use of the Latin American Reserve Fund has traditionally been delinked from any IMF program. The links between the IMF and regional arrangements must be subject, therefore, to flexible designs and possibly to a variable geometry.

9.7 Conclusions

This chapter argues that it is possible to make SDRs a more relevant instrument of international monetary cooperation by transforming it openly into a pure reserve *asset* (rather than an unconditional overdraft facility) and moving into a fully SDR-funded IMF. Under the recommended system, SDRs would be issued in a counter-cyclical way and would be treated as deposits of countries in (or lending to) the IMF, which this institution can

in turn lend to countries. This is true even if SDRs are kept as a means of payment among central banks. Such a system would go a long way to correct some of the three basic deficiencies of the current global monetary system. Given that part of the seiniorage associated with global monetary creation would be allocated to all countries, and that developing countries tend to use their SDR allocations more frequently, this reform would by itself benefit developing countries in particular.

Different estimates of SDR allocations indicate that a range of $200–300 billion a year is a safe, even a conservative estimate. If issued in a counter-cyclical way, the amount of issuance during crises can be substantially higher. The most recent Fund proposal is to allocate $117–133 billion a year for three years beginning in 2014.

Several development dimensions could be added to such reform, including: (i) asymmetric allocations of SDRs, which favor developing countries, or take into account the demand for reserves in the allocation formula; (ii) allowing the IMF or member countries to use unutilized SDR allocations to buy bonds from MDBs, and (iii) converting the unutilized SDRs of industrial and other countries into equity of global funds for leveraging resources to finance development, climate change mitigation or to provide other global public goods.

Complementary reforms include a substitution account which would allow an orderly and smooth transition from major reserve currencies to SDRs, and the issuance of SDR-denominated bonds as an alternative to other major short-term assets.

A major policy implication of this chapter is that, if SDRs are going to become a major instrument of international cooperation, the market for SDRs has to increase substantially. The analysis of the SDR market has shown that net drawings of SDRs were only slightly over SDR 10 billion at their peak levels, which is a tiny proportion of global reserves. Also, although developing countries tend to use their holdings more frequently, the developed countries play a dominant role both on the buyer and seller side of the SDR market, indicating that SDRs are also an important reserve asset for developed countries, and that their increased supply would benefit these countries as well, especially during periods of financial turmoil.

All these reforms must be accompanied by major reforms of global governance. These include, first of all, the use of formal institutions that include all countries rather than only the largest of them. It also includes regular mechanisms to update IMF quotas, a reduction in the threshold of votes needed to approve IMF reforms, a redefinition of the relations

among this Council, the Board, and the Administration, and strong rules that guarantee that senior management of the BWIs are chosen on the basis of transparent, open and merit-based processes. Finally, in terms of contributions to global stability as well as voice of smaller countries, the system should rely on a network of the IMF and regional monetary arrangements.

Notes

1 Postdoctoral Research Scholar of the Committee on Global Thought at Columbia University, and Professor and Fellow of the Committee on Global Thought at Columbia University, respectively. This paper was prepared for the UN Committee for Development Policy and draws from work by both authors for the UN Department of Economic and Social Affairs. We thank José Antonio Alonso and Norman Girvan for comments to a prior version.

2 See, in this regard, United Nations (2009) and the symposium on the issue in the *Journal of Globalization and Development*, Volume 1, Issue 2, 2010.

3 See, among others, Landau (2004) and Atkinson (2005). See also the initiatives of the Leading Group on Innovative Financing for Development (see in this regard, United Nations, 2011).

4 See, for example, http://www.imf.org/external/np/exr/facts/sdr.htm.

5 Net drawings are estimated as the absolute value of all negative net SDR position of individual countries, and is the measure used here of the *stock* of drawings (figure 9.3). In turn, the change in net asset positions is considered as an approximation of the flow of SDRs (figure 9.2).

6 Indeed, for the period 2000-2010, reserves as a proportion of GDP were on average 15.9 per cent in middle-income countries, excluding China, vs. 1.7 per cent in high-income countries, excluding Japan. So, a simple ratio between the two would be 9.2 times.

7 This section draws extensively from Ocampo (2011).

8 See, in this regard, the contributions to Ocampo (2006), and the evaluation of the contribution of different regional mechanisms to international monetary stability by McKay, Volz and Wölfinger (2011).

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Chapter 10
From aid to global development policy

José Antonio Alonso

10.1 Introduction

Over the last decade, the international community has taken visible steps forward in reforming the international cooperation system. This includes a greater focus on aid ownership by recipient countries and renewed commitment to the coordination, harmonization and alignment of donor policies. The 2005 Paris Declaration, the subsequent Accra Agenda for Action in 2008 and the Busan Partnership for Effective Development Co-operation in 2011 are agreements that imply a certain rebalancing of the relationships between partners and donors. Nevertheless, recent external evaluations of this process show that the advances have been smaller than initially committed to by donors (OECD, 2011a).

These changes in development policy were accompanied by devoting a greater focus to targeting resources to the poorest countries. As a result, low-income countries (LICs) and, particularly, nations in Sub-Saharan Africa have become more significant aid recipients, while middle-income countries (MICs) have seen their share reduced in the allocation of official development aid (ODA). There has also been a change in the sectors targeted by aid, with more resources going to social sectors (like education and health), at the expense of those oriented to the economic structure of recipient countries.

During the last decade, aid resources were also significantly increased, reaching their historical highest level in 2010. Even so, the volume of aid fell below donors' previous commitments. In any case, the current crisis has begun to affect ODA, which reduced its volume in 2011. Doubts about the future trend of aid demand that new financial mechanisms be employed to combat poverty and to face new global issues. These new financial sources should be more dynamic and less discretionary than ODA.

Despite the changes promoted within the aid system, there is a feeling that development policy is not up to the challenges of today's reality. Although the international aid system has changed, the international reality has changed more profoundly and more rapidly. A list of the most relevant changes in the international arena comprises the growing heterogeneity of the developing world; the new geography of global poverty; the emergence of new regional and global powers from the developing world; the presence of new development aid players; and, finally, the enlargement of the sphere of international public goods. Implementing the right response to the challenges arising from these changes will demand deeper reform of the aid system.

The debate over such reform comes at a time when there seems to be a renewed scepticism about the effectiveness of international aid. Fuelling that scepticism are meticulous research papers (Rajan and Subramanian, 2008, for example) as well as essays, varying in approach and quality but with high media impact (Moyo, 2009, for example). However, this scepticism about aid effectiveness does not always seem well founded, both in macro-level estimations and in micro-level impact evaluations (Riddell, 2007).

This chapter aims to contribute some reflections and evidence on these matters, in light of the post-2015 agenda. The chapter is structured around five sections, in addition to this introduction. The second section analyses the evolution of aid in relation to the crisis; the third section is aimed at reviewing the conclusions of the specialized literature on the overall effectiveness of aid; the fourth section discusses the relationship between the agenda for the reform and the studies on aid effectiveness; the fifth section compares the reforms of the development aid system with the changes experienced in the international system; and in the final section, by way of a conclusion, three foreseeable scenarios for the aid system are presented.

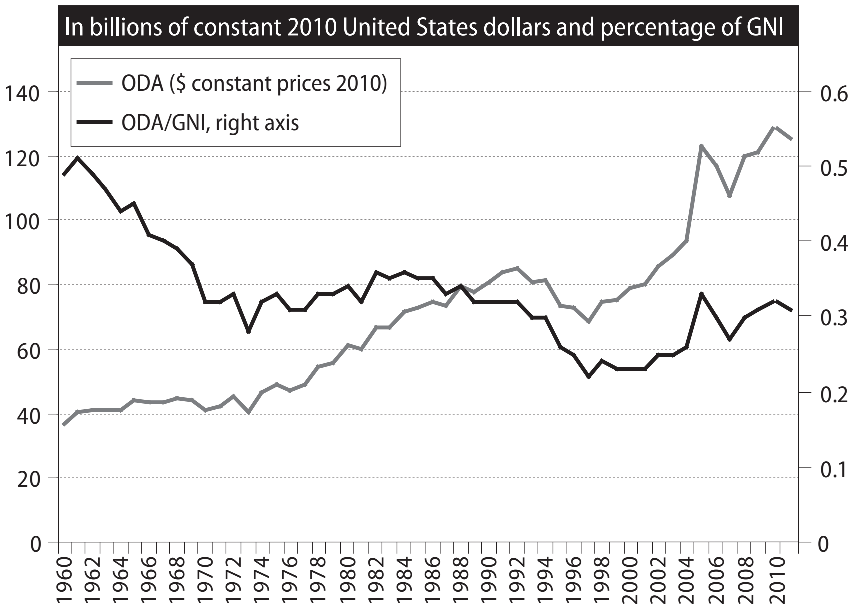
10.2 Aid and development finance

Aid: resistance to growth

In the course of its history, growth in development aid has been rather limited: between 1960 and 2011, the volume of ODA[1] (at constant prices) tripled despite the fact that, during this same period, the number of donor members on the Development Assistance Committee (DAC, OECD) increased from 8 to 24 and the level of GNI per capita for this group of countries quadrupled (figure 10.1).

The gentle growth in total sums of aid has been accompanied with a falling trend in the ratio of ODA as a percentage of the GNI of the donors. For the past two decades, that coefficient has remained below 0.33 per cent (0.31 per cent in 2011). Therefore, despite the repeated commitments of donors, at the beginning of the second decade of this century, only five countries were meeting the agreed-upon goal (0.7 per cent), and the average ratio was below half that coefficient (0.31 per cent).

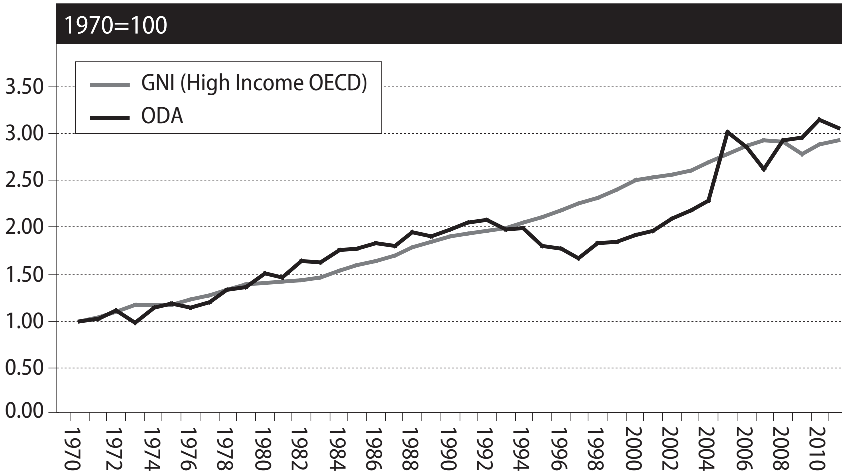
Figure 10.1
Trends in ODA, 1960-2010



Source: DAC (OECD), DAC Statistical Tables.

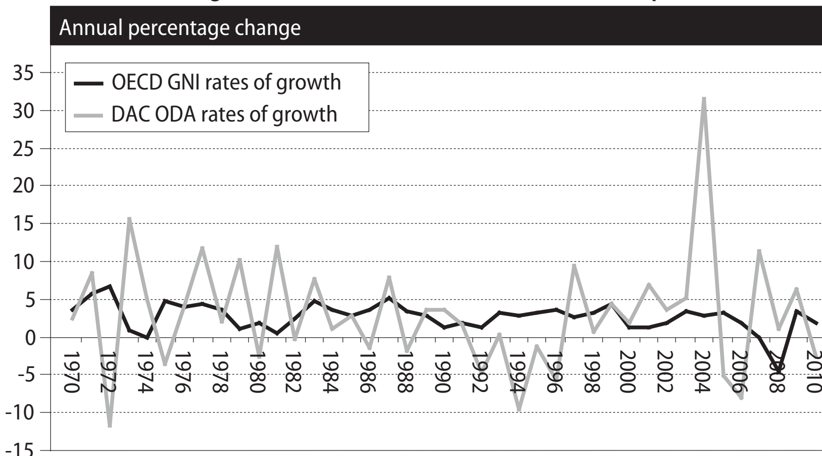
When both variables—ODA and the OECD GNI—are considered, the dynamism of the former is not higher than the latter's, a necessary condition to increase the ratio ODA over GNI (figure 10.2). Moreover, the connection between the growth rates of the OECD GNI and ODA is very limited, showing that donors' economic situation is only a minor factor in explaining aid disbursements (figure 10.3).

Figure 10.2
Trends in ODA and GNI of OECD at constant prices, 1970-2010



Sources: DAC (OECD), DAC Statistical Tables, and World Bank, World Development Indicators.

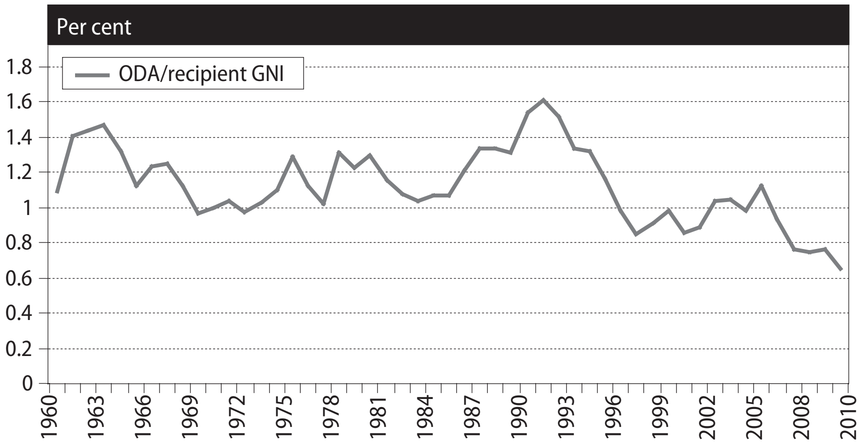
Figure 10.3
Annual rates of growth of GNI of OECD and ODA at constant prices, 1970-2010



Sources: DAC (OECD), DAC Statistical Tables, and World Bank, World Development Indicators.

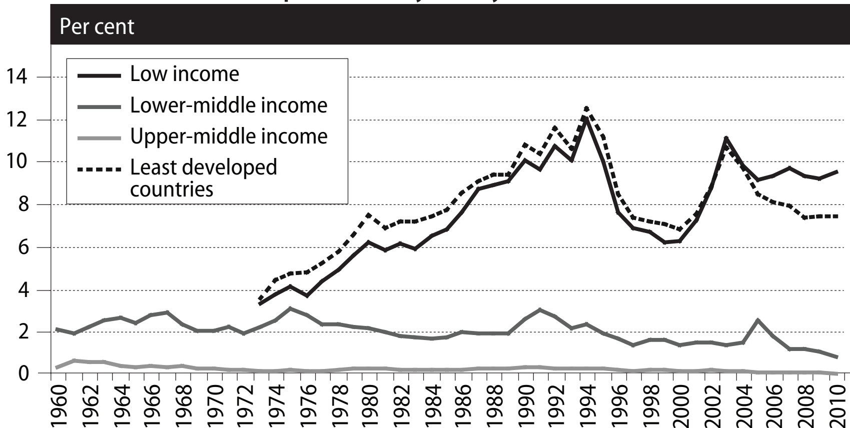
Finally, neither does there seem to be an expansive trend in aid in relation to the respective GNI of recipient countries. When the developing world as a whole is considered, the ratio of aid to the GNI of recipient countries has followed a slightly decreasing trend, although with variations, depending on the period (figure 10.4). When the group is divided up into three income levels, considering also the United Nations Least Developed Countries group (LDCs), only those in the LICs and LDCs groups demonstrate an increasing (although variable) tendency in their ratios (figure 10.5).

Figure 10.4
ODA as a share of recipient country GNI (low and middle-income countries), 1960-2010



Source: World Bank, World Development Indicators.

Figure 10.5
ODA as a share of recipient country GNI by level of income, 1960-2010



Source: World Bank, World Development Indicators.

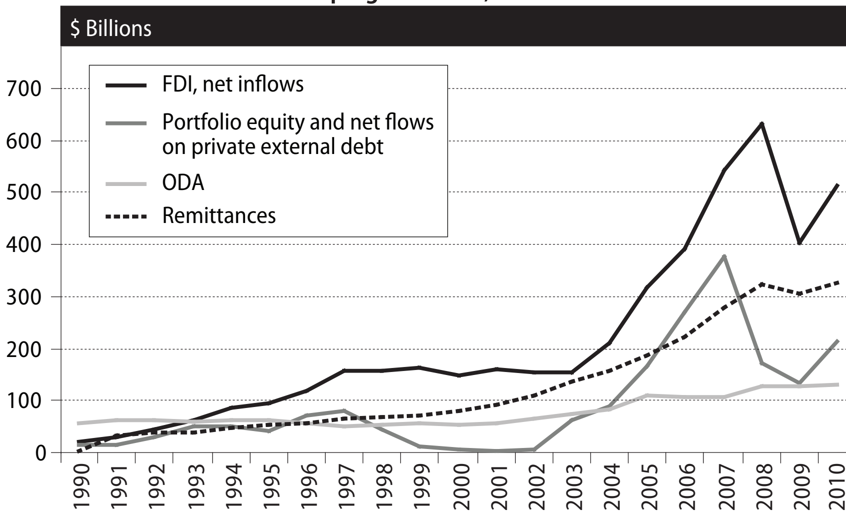
In short, over the years, aid has proven to have very limited elasticity to growth, even in periods of prosperity in the donor countries. This is a trait that should be taken into account in order to set realistic commitments for the future.

Public and private funds

The limited dynamism of aid is in contrast to the unprecedented expansion in private financial flows to developing countries in the last two decades (figure 10.6). In that period, the rate of growth in aid is lower than that of the remittances of migrants, direct investments, or other private flows. As a consequence, there has been a notable shift in the structure of international financing of developing countries, with private funding gaining in importance at the expense of public funding. In this context, it is not surprising that some sectors have questioned the importance of aid in the future development agenda. It would seem as if development aid were condemned to become increasingly irrelevant in a world of globalized financial markets.

Such a conclusion, however, may well be incomplete, for at least three reasons. First, the overall picture presents a version of composition fallacy: the data as a whole masks varying individual behaviour among the different groups of countries. The contribution of aid to total international financial

Figure 10.6
Financial flows to developing countries, 1990-2010



Source: World Bank, World Development Indicators.

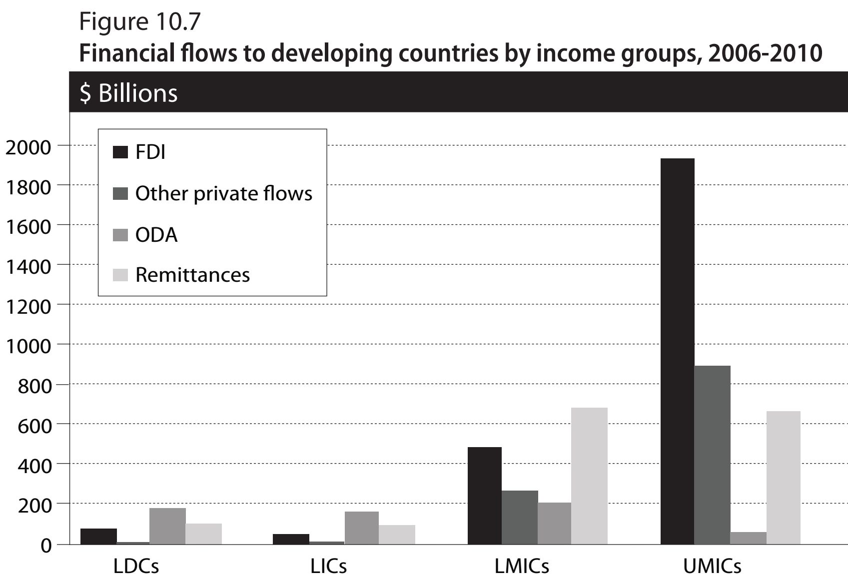
flows is clearly irrelevant in the case of the upper-middle-income countries (UMICs), more significant in the case of the lower-middle income countries (LMICs), and by far the greatest source of international funding in the case of the LICs and the LDCs. In fact, in the LDCs, the volume of aid in the most recent five-year period was higher than all other sources of international financing put together (figure 10.7).

Second, the relevance of the funding sources should not only be considered in terms of volume, but also in terms of predictability. In this aspect, aid remains clearly more predictable than private flows. Lastly, for many countries, the most important aspect of aid is not so much the volume of resources it represents, but its effects as an incentive to promote changes or as a means for leveraging additional resources in the market. In sum, aid should be considered mainly as a catalytic means (not a central one) to promote development (Kharas and others, 2011).

Current crisis: the need for new financial sources

From 1997 through 2010, international aid maintained a positive trend of growth, with minor setbacks. Nevertheless, in 2011 aid fell 2.7 per cent in

Figure 10.7
Financial flows to developing countries by income groups, 2006-2010



Source: World Bank, World Development Indicators.

real terms as a consequence of the current crisis, and forecasts point to new decreases in future years. The tendency is clear: in 2010, eight of the 24 DAC members reduced their aid, with that number climbing to 16 in 2011. Given the severity of the crisis and of the fiscal adjustments in donor countries, there is justified concern about the future evolution of aid.

Evidence of the effects of previous economic crises on aid flows is, however, not conclusive. The crises in early 1990s led to disparate results in terms of effects on aid, with significant reduction in some cases (for example, Japan or Finland), null effect in others (Norway or Sweden), and even a slight increase elsewhere (France). Econometric analysis does not shed much more light. The statistical association between expenditure on aid and donors' economic cycles is either weak (Dang and others, 2009) or non-existent (Pallage and Robe, 2001; Round and Odedokun, 2004). Similar results can be found in the relation between aid resources and the donors' output gap, with some authors finding a positive sign (Bertoli and others, 2008) while others are unable to identify any relationship (Faini, 2006). There is perhaps a slightly higher level of consensus around the link between fiscal balance and aid: fiscal surplus (deficit) in a donor country tends to have a positive (negative) effect on aid (Faini, 2006; Bertoli and others, 2008; Allen and Giovannetti, 2009).

This last result supports pessimism about the evolution of aid in coming years. With continuing tight budgets in OECD countries, it will be very difficult for donors to meet their commitments in terms of aid. This is why several sectors have proposed the need to open the cooperation system to new sources of financing that are subject to a lower degree of discretionary decisions by donor governments.

A new, strong argument has recently emerged in support of the same idea: the need for new resources to finance international public goods. Some of those goods are intimately related to the development agenda but would be difficult to finance through ODA. According to the OECD, $320 billion per year is needed to pay for mitigation of and adaptation to climate change, on top of the $130 billion in development aid; and climate change is only one of the international public goods under consideration, although doubtless the most challenging.

Proposals in this field are very diverse. Many fall under the category of "innovative financing sources" (even though some of them are very old) (table 10.1). These proposals can be divided into six groups: i) proposals aimed at gathering together resources (both public and private) to focus on a global priority; ii) proposals to allow an anticipated use of resources through

the securitization of future aid funds; iii) initiatives aimed at encouraging voluntary private contribution in tasks of social or environmental interest; iv) proposals aimed at encouraging a better use of private resources that have a potential development effect; v) new mechanisms aimed at strengthening the capacity to leverage new resources for aid; and vi) new taxes on negative international externalities.[2] Some of these instruments are already in use (the International Financial Facility for Immunization, IFFi, or taxes on airline tickets); others have been used nationally, without international agreements (carbon emissions taxes, for example); and still others are being debated at the moment (a tax on financial transactions, for example).

The search for alternative financing sources should be guided by some normative criteria. Six criteria seem particularly relevant:

- *Additionality:* the resources should be (at least partly) additional to ODA.

Table 10.1
Innovative Finance for Development Mechanisms

	Characteristics	Examples
Traditional	Public resources	ODA from developed and emerging sovereign donors
	Private resources	Private contributions to development cooperation system
Innovative	New Institutions for frontloading resources	International Financial Facility for Inmmunization (IFFi) Advance Market Commitments
	New ways to put together public and private funds for specific goals	Global Fund/GAVI
	New mechanisms for voluntar contribution	Global or national lotteries/ Digital Solidarity Social Fund/ REED
	New incentives for a better use of private resources	Corporate Social Responsibility/ Support to some uses of remittances/ Clean Development Mechanisms/ Carbon Funds
	New ways of leverage	Public-private partnership in infrastructure investment/ Development Finance Institutions
	New levies	Airlines ticket taxes/ Tobin tax/ Financial transactions tax/ Carbon emision tax

- *Sufficiency:* the instruments proposed should mobilize sufficient resources in relation to the size of the tasks they need to tackle.
- *Efficiency:* the instruments proposed should generate the lowest possible costs without penalizing economic growth.
- *Effectiveness:* the instruments proposed should be easy to implement.
- *Fairness:* the new initiatives should favour a more equal distribution of resources.
- *Predictability:* the resources of the new funding sources should be easy to predict, to avoid instability.

When all these criteria are considered, the mechanism that has emerged as a possible answer is the tax on international financial transactions. As well as being discussed in the European Union, such a tax has been studied by the Leading Group on Innovative Finance for Development. This group commissioned a technical document that suggests the application of a tax on financial transactions in foreign currencies, destined to finance development aid.[3] Even a very low tax rate of 0.005 per cent could raise between $30 and $50 billion, and the revenue raised could be increased if other types of financial transactions were also subject to the tax. In any case, this is only one of the options: other proposals (carbon emissions, for example) are also technically viable.

10.3 Aid effectiveness

Aid effectiveness: a blurred literature

Beyond aid volume, it is also necessary to consider the effectiveness of aid. However, the specialized literature on this subject shows ambiguous and disparate results. Although carried out in a relatively similar theoretical framework, the studies vary in relation to the control variables used in convergence equations, in their handling of the endogenous nature of aid, and in the assumption of non-linearity of aid.

In terms of this last element, some authors suppose that the impact of aid is conditioned by certain recipient countries' characteristics. The influential works of Burnside and Dollar (2000 and 2004) stand out in this approach. These authors show that aid effectiveness depends on the institutional framework and policies put into place by the recipient. As a consequence, the authors advocate a greater role for selective aid allocation, giving aid only

to countries with good policies and institutions (World Bank, 1998). Other authors follow the same approach but incorporate another variable related to the recipient country's circumstances. Among the factors considered have been an export price shock (Collier and Dehn, 2001), the degree of vulnerability (Guillaumont and Chauvet, 2001), previous conditions of violence in the country (Collier and Hoeffler, 2004), political instability (Chauvet and Guillaumont, 2004), the level of democracy (Svensson, 1999), or the limited size of the government (Economides and others, 2008). In all these papers, the effectiveness of aid is confirmed, although the results are highly sensitive to the methodologies used in the respective estimations (Roodman, 2007 a and b and Easterly and others, 2004).

Another evidence of non-linearity is the presence of diminishing returns. In all cases where an appropriate variable was incorporated, the estimation confirms the existence of decreasing marginal returns on aid (Hadjimichael and others, 1995; Durbarry and others, 1998; Hansen and Tarp, 2001; or Rajan and Subramanian, 2008). Although it is debatable where the threshold lies, it seems that after a certain level, the accumulation of aid can end up having negative effects on the recipient country. Many of the studies incorporate the existence of decreasing marginal returns, stating that aid is effective in itself, without conditioning by the recipient's policies.

This new generation of studies has also opened up some new issues worth considering. For example, Lensink and Morrisey (2000) showed that instability of aid flow impacts negatively on aid effectiveness. In this study, aid effectiveness is related less to the characteristics of the recipient than to the donor's ways of operating.

Some categories of aid (like humanitarian aid) have no relationship at all to the recipient's growth, while others (like health or education expenditure) only produce effects in the very long-term. For that reason, Clemens and others (2004) refine aid flow, leaving only those elements that have an effect on growth within a relatively short time-scale. After such aid segregation, the results point to a positive robust relation between aid and recipient growth.

Some authors admit that aid can be effective in some places but not in others. For example, Dalgaard and others (2004) confirm that aid is not effective around the tropics, but that it has a positive effect on growth in non-tropical countries. Unfortunately, as Roodman (2007b) highlights, these results are highly dependent on the behaviour of a limited number of countries. In the same vein, Herzer and Morrissey (2009) confirm that aid can have a negative effect on growth in some countries, although the variables that explain such results are not totally intuitive.

Among the most sceptical studies, and also among the most influential, are those by Rajan and Subramanian (2005 and 2008). These authors cannot find any robust relationship whatsoever between aid and growth. The explanation of this result rests on: i) the deterioration of the quality of governance that aid can produce in a recipient country; and ii) the negative effect that aid has on the recipient country's competitiveness, which refers to the problem known as Dutch disease.

Besides these studies, others have tried to conduct meta-studies in order to evaluate the literature already carried out. The first is an article by Doucouliagos and Paldam (2008), who review over a hundred studies. The results they reach are as follow: (i) first, aid has a small negative effect on savings and an equally small, but insignificant, negative effect on investment; (ii) the effect of aid on growth is positive, but not significant; and (iii) the effects associated with conditional estimates cannot be replicated. The authors admit the pessimistic tone of their conclusions.

The second study reveals a more optimist spirit: Arndt and others (2009) carry out an application of the Rubin Causal Model to the most recent publications on the effect of aid. Their results suggest that aid impact on economic growth exceeds its supposed contribution to generating capital stock (estimated by Rajan and Subramanian, 2005), indicating that aid also positively influences the evolution of total productivity. According to the value of the confidence intervals, they cannot rule out the possibility that elasticity falls into the negative zone, but that it is positive wherever the results are the most solid.

Aid, institutions and taxation

One dimension that can explain the disappointing effect of aid is its impact on institutional quality: aid can open space to rent-seeking activities and harm accountability in recipient countries (Moss and others, 2008). The empirical studies on this subject have contributed to consolidating the negative image of aid (Bräutigam, 2000; Knack, 2004; Bräutigam and Knack, 2004; Djankov and others, 2008).

Nevertheless, these studies raise two important elements for criticism: i) they do not specify a convincing model of institutional quality, raising suspicion of omitted variables; and ii) they consider the relationship between aid and the quality of institutions to be linear (although there are many reasons to think that the relationship has diminishing returns).

In a previous estimation, Alonso and Garcimartin (2013) argued that institutional quality can be mainly explained through four variables: the country's level of income per capita, the average years of citizen education, the level of social inequality (with negative sign), and the level of tax resources. In Alonso and Garcimartin (2011a) the authors included aid (measured as a percentage of GDP averaged over five years)[4] into this explanatory structure. If only ODA is included (in constant dollars or PPP), the coefficient is not significant (although it has a positive sign); however, when squared aid is incorporated (to reflect diminishing returns), both are significant, with aid having a positive sign and squared aid a negative one. In other words, aid has a positive effect on institutional quality, but is subject to diminishing marginal returns, so that from a certain threshold the total impact becomes negative.

Habitually considered among the negative effects of aid is its perverse impact on incentives to set up a solid tax system in the recipient country. But a tax system is crucial to consolidating accountable institutions, and for moving a country from aid dependency to self-sufficiency (Tilly, 1992; Moore, 2009; and Kaldor, 1963).

Previous works that studied the effect of aid on taxes led to notably pessimistic results (Heller, 1975; Cashel-Cordo and Craig, 1990; and Khan and Hoshino, 1992); however, the most recent work has not been so conclusive, and the empirical evidence is ambiguous. Thus although Bräutigam and Knack (2004) find a negative relation between aid and tax effort, other studies are incapable of finding any relationship at all between the variables (Ouattara, 2006; Morrissey and others, 2007; Teera and Hudson, 2004); and the fullest works on this area detect a positive, although weak, relationship (Gupta, 2007; Clist and Morrissey 2011; Brun and others, 2007).

Another study that confirms this last result is Alonso and Garcimartin (2011b). They estimate a structural equation of tax effort in which, alongside the most traditional variables, they include aid and income distribution. Their results suggest that the aid coefficient is significant and positive in all cases, as well as the Gini index, although with negative sign. Given that the impact of aid can be conditioned by the institutional quality of the recipient country (Azam and others, 1999), Alonso and Garcimartin, 2011b) incorporated the product of institutional quality by aid into their previous estimation. The results reveal that both the aid coefficients and those of the interactive term (aid by institutional quality) are significant. This means that aid positively influences tax resources, but its effect is not linear and

depends on the quality of institutions: in a context of bad institutions, the impact of aid on tax collection could be negative.

The overview carried out in the previous two sections is sufficient to confirm that the existing literature on the relationship between aid and growth is far from conclusive. Despite that, the results that could be the most plausible would point out that: (i) the effect of aid seems easier to detect in the short-term than in the long-term (Clemens and others, 2004), although in the long term could also exist a positive effect (Minoiu and Reddy, 2009); (ii) aid seems more effective in contexts where it contributes to relaxing restrictions or factors of vulnerability of recipient countries (Collier and Dehn, 2001; Guillaumont and Chauvet, 2001; Collier and Hoeffler, 2004); (iii) the relationship between aid and growth seems to be subject to diminishing returns (Hadjimichael and others, 1995; Hansen and Tarp, 2001); (iv) there may exist national factors, specific to recipient countries, that condition aid effectiveness, but there is no certainty about what those factors are; and (v) finally, aid can positively influence institutional quality, and there is nothing to suggest that it has necessarily a negative effect on taxes (Gupta, 2007; Brun and others, 2007), but nevertheless, due to its decreasing returns, from a certain threshold, aid effects on both institutional quality and taxation can become negative (Alonso and Garcimartin, 2011b).

10.4 Aid effectiveness: donor response

The Paris Agenda: some critical observations

The widespread doubts about aid effectiveness have motivated donors to start a revision of aid management practices. The origins of this process can be tracked back to the document *Shaping the 21st Century*, approved by the DAC in 1996, but the drive for reform gained a renewed boost at the end of that decade as a result of the revision of the HIPC initiative, the debates around the Millennium Declaration, and the dynamic that accompanied the Monterrey Conference on Financing for Development. This reforming spirit was translated into a series of high-level meetings organized by the DAC. At the second, convened in Paris, five central principles were defined in relation to aid effectiveness: (i) recipient ownership of development interventions; (ii) alignment of donor strategies and procedures with strategies and management systems of the recipient countries; (iii) harmonization among donors; (iv) management through results, both for donors and recipients; and (v) mutual accountability. These principles were

revised and expanded at the summits held in Accra in September 2008 and in Busan in December 2011.

The OECD's DAC has undertaken to follow the process through three reports (in 2006, 2008 and 2010). The picture that emerges from the last report is ambiguous: progress has been made, especially in the use of reliable public management systems and in the coordination of technical assistance, but commitments are still far from being met (OECD, 2011a).

In principle, the dynamic that started with the Paris Declaration has to be judged positively. The agreements have been directed at correcting two important problems that penalize aid effectiveness: the existence of perverse incentives stemming from asymmetric information within the aid chain, on one hand, and high transaction costs from the proliferation of donors and fragmented interventions on the other. However, there are two limitations worth highlighting here: (i) the process was mainly led by the donors (through the DAC), even when recipient countries were invited to attend; and (ii) their assumptions are shot through with an excessively technocratic (and rather naïve) vision of social dynamics (Whitfield, 2009).

The first problem refers to the system of principal-agent relations on which aid chain is based, and that condition the incentive framework in which the players act (Gibson and others, 2005; Martens and others, 2002). The fungibility of aid is a manifestation of this problem. Resolving problems of incentive caused by this system of relationships is not simple. In the past, donors sought solution in conditionality, as a sort of implicit contract between donor and recipient. But in a context of imperfect information, it is not plausible to expect an optimal contract design that would exhaustively define in advance all conceivable states of nature. As a consequence, a problem of time-consistency in donors' behaviour is highly probable. Besides that, it is also debatable whether, in such a climate, the donor is in a better position than the recipient to define responses to the development problems that the recipient is facing.

The only possibility for progress on correcting problems of asymmetric information would be through stricter alignment of the goals of both parties in the transaction: and that is precisely the meaning of the principle of *ownership*. In this case, the recipient defines its priorities more clearly, and the donor identifies those areas in which it wants to contribute aid. However, the ways in which these responses have been handled are open to some criticisms. Four are worth highlighting here:

- First, there has been a certain reduction—which could be called technocratic—in the concept of ownership. The reduction has been such

that, frequently, ownership (a process that is eminently political) has tended to be confused with the capacity of a recipient government to define a comprehensive development plan with sets of indicators and solvent systems for monitoring progress.

- Second, an excessively naïve perception of social dynamics has supported the national development strategies. The demand for national consensus as condition for aid support is simply misguided. In societies that are socially fragmented, public action is the result of a confrontation between visions and interests, and of an institutionally channelled political struggle.
- Third, the alignment of the donor with the goals of the recipient has tended to be understood as a merely functional problem of adapting priorities, as if there were a substantial match between the interests of the two parties involved. But that dialogue should be thought of as a strategic game, because there could be also divergence of interests (Whitfield and others, 2008).
- Lastly, the approach was accompanied by highly intrusive formulas of negotiation and aid control by donors. However, as a recent investigation revealed, success can be achieved by much simpler means (World Bank, BMZ and GTZ, 2007).

The other problem of aid that donors have tried to tackle is connected to high costs of transactions of aid. This problem has been increasing as a result of the proliferation of players in the aid system, and the growing fragmentation of their actions (Acharya and others, 2004; IDA, 2007). Donors have tried to address this problem by defining a more active coordination process, and by ensuring a fuller integration of their initiatives into the budgetary procedures of the partner country. The principles of harmonization and alignment are steps toward those goals.

Nevertheless, there have been several limitations in the implementation of these principles. Firstly, the experience shows that donors have been enormously resistant to progress in formulas for directing support budgets. Secondly, despite the fact that some conditions have been eliminated, aid conditionality still remains in many cases. Lastly, limited achievements have been made on complementarity and labour division among the donors.

Aid dependency

Perhaps the most relevant criticism engendered by the Paris Declaration is the absence from consideration of one of the chief problems affecting

aid effectiveness: the dependency that aid generates in many developing countries. However, since one of the results most regularly obtained in studies on aid effectiveness is the fact that aid presents decreasing marginal returns, its impact can turn negative beyond a certain threshold.

Data reveal that levels of dependency are high in a wide range of countries. There are about 40 countries where the proportion of aid is higher than 10 per cent of GDP. Generally, that coefficient is multiplied by a factor of between three and four, to determine the proportion of aid in the public resources. In these cases national institutions are being pushed to direct more attention toward their relationship with international donors than toward the demands or requirements of their citizens.

Resolving this problem does not necessarily mean an unexpected withdrawal of resources of aid. For some recipients, aid resources are a source of financing social policy that is currently difficult to replace. Aid dependency, however, makes it doubtless necessary to: (i) be much more cautious around plans to increase aid, on the understanding that more is not always better; (ii) establish plans to gradually downsize aid in those cases where such a decrease is viable; (iii) pay greater attention to existing routes for mobilizing domestic resources from developing countries, which would involve strengthening tax systems as well as tackling tax evasion and illegal finance flows; and (iv) finally, dedicate more resources to providing international public goods related with development goals.

10.5 Changes in the international system: challenges for aid policy

As was emphasized at the start, while the aid system has changed, international realities have changed even more rapidly and more profoundly. Among the main changes are the following five.

Heterogeneity in the developing world

International aid was born in the 1950s, confident in a unified diagnosis of the problems characterizing under-development. Now, the heterogeneity of the developing world makes impossible the assumption of a unique diagnosis and therapy for the developing world. In fact, during the last five decades, developing countries followed very different trends. One group—strikingly, the countries located in East and Southeast Asia—have managed

to drive a successful growth process and they have been converging towards the leaders. Another group—the Least Developed Countries—have increased their development distance from leading countries, catching in a kind of poverty trap (Guillaumont, 2009). Finally, a third large group of countries is situated between these extremes, having increased their levels of internal heterogeneity.

In sum, the last fifty years has produced a double divergence, meaning that: (i) the arc of income distribution at a global level opened up, reflecting the growing distance between the extremes; and (ii) the heterogeneity among developing countries increased (Ocampo and Vos, 2008).

Two panels offer a simple way of illustrating this summary graphically: in the first, the increasing relations between the richest and the poorest country and between the richest and the poorest decile of countries (in terms of GDP per capita PPP) are shown (figure 10.8a); in the second, the increasing heterogeneity is measured through the evolution of the coefficient of countries' GDP per capita in PPP over time (figure 10.8b). As a consequence of this double process, it is increasingly difficult to identify the reality of developing countries under a single diagnostic.

The need to respond to this growing heterogeneity constitutes a challenge for the aid system, presented with two extreme options: either to maintain an integral perspective, working through a differentiated agenda in accordance with the heterogeneous conditions of developing countries, or else to transform aid into a focused policy, aiming to specialize in fighting extreme poverty in the poorest countries.

The MDGs seems to point to this last option, demanding aid to be focused on the poorest countries, at the expense of the middle-income countries. Without a doubt, there are reasons to back this trend: as aid resources are scarce, they should focus on the more needful countries. Despite that, there is another, equally reasonable option for maintaining a wider scope to promote developmental incentives in accordance with countries' needs.[5] Such an approach would involve perpetuating the comprehensive character of development policy, transforming it into a global policy, with differentiated agendas, in keeping with the characteristics of all needful countries, including those MICs with severe vulnerabilities.

Among the arguments that can be offered in support of this second option are the following five (Alonso, 2007): (i) more than 70 per cent of the world's poor population lives in MICs (see next section); (ii) some MICs are highly vulnerable to circumstances in international markets; (iii) MICs are key to the provision of international public goods, particularly environmental

Figure 10.8a
Arch of wealth (GDP per capita) distribution, 1950-2008

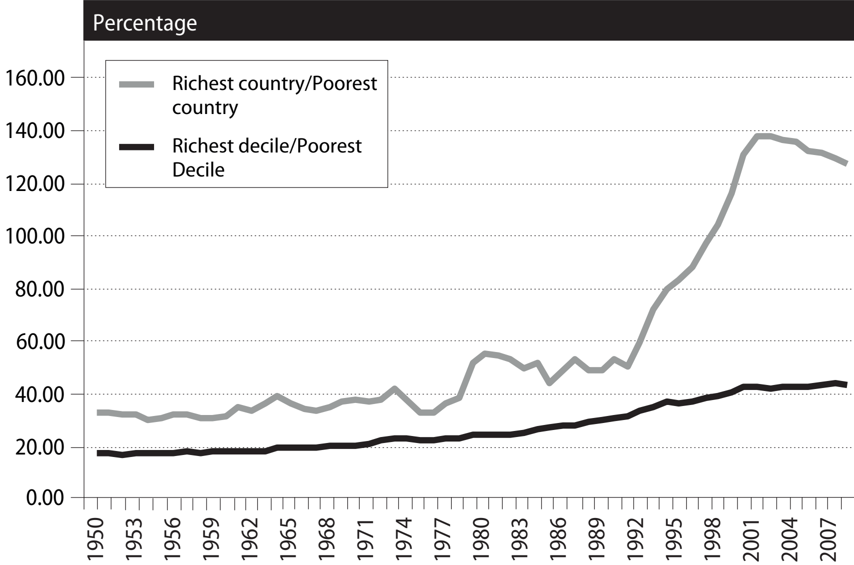
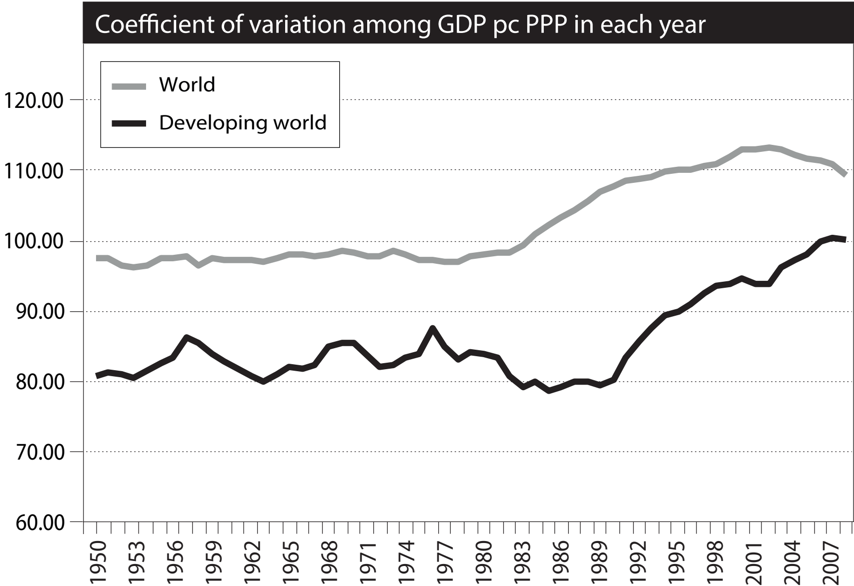


Figure 10.8b
Trends in heterogeity in GDP per capita, 1950-2008



Source: Maddison (www.ggdc.net/MADDISON/oriindex.htlm).

ones; (iv) some MICs have a crucial demographic or economic weighting in their regional environment, so their success can stimulate progress in third countries; and (v) lastly, it is important to build an aid system that is incentive-compatible with the aims of development, avoiding perverse incentives that could result from an abrupt frontier between countries that are the subject of aid.

The new geography of global poverty

With the definition of the MDGs, there emerged a more demanding requirement to focus aid on the poorest countries. As a consequence, in the past decade the proportion of international aid directed to MICs decreased significantly: from about 57 per cent in the 1990s to 37 per cent in 2009/2010. In the other direction, LDCs and LICs increased their quotas from about 43 per cent in the 1990s to 62 per cent in 2009/2010 (table 10.2). So, the purpose of promoting a more poverty-focused type of aid seemed to be on the right track.

Table 10.2
Allocation of ODA by income levels of recipient countries, 1990-2010

Per cent				
	1990-1993	1998-2000	2006-2008	2009-2010
LDCs	31.8	32.0	35.1	36.6
LICs	10.2	12.5	17.2	16.0
LMICs	49.4	47.1	39.7	28.9
UMICs	8.6	8.5	7.9	8.5

Source: DAC (OECD), DAC Statistical Tables.

The problem is that the new pattern of aid distribution does not match the new geography of global poverty. Analysis of where the poorest populations live shows that most are located in MICs. More precisely, there are as many as a billion poor people—two thirds of the total—living in MICs, with the remaining third (close to 300 million) living in LICs (Sumner, 2010 and 2011). This pattern is entirely new, because in 1990, 94.5 per cent of poor people were living in LICs and only 5.5 per cent in MICs (table 10.3).

This important swing is almost entirely due to the graduation from LIC to MIC status of a significant number of countries, some of them with very large populations (such as China, Indonesia, India, Nigeria, and Pakistan). Although this shift in the geography of poverty might be the result of

changes in a reduced number of countries, it expresses a tendency that will probably maintain over time. Global poverty is not only, nor predominantly, a low-income country issue anymore.

The new geographical pattern of poverty mounts a new challenge for international aid: Should the recommendation to reduce aid to MICs be maintained? Some believe that MICs are rich enough to tackle their own problems, including their national pockets of poverty. But others think that if people (and not just countries) are to matter, there is good reason to combat poverty where the impoverished actually live. However, international support should be graduated in relation to the capacities and resources of each country.

But if aid wants to contribute to reducing poverty in MICs, it should take into account that the poverty in these countries is more a consequence of bad distribution of national income than of a low average income. So, combating poverty will require changes not only in international income distribution, but also in internal income distribution.

Table 10.3
Distribution of global poverty ($ 1.25 per day) 1990 vs 2007

	Non-adjusted base years				Adjusted base years			
	1990		2007		1990		2007	
	Millions	%	Millions	%	Millions	%	Millions	%
LICs	1,596.1	94.5	305.3	24.1	1,632.5	93.1	342.7	29.1
MICs	93.2	5.5.	960.4	75.9	121.4	6.9	836.0	70.9
Total	1,689.3	100	1,265.7	100	1,753.9	100	1,187.7	100
China and India	1,137.9	67.4	673.0	53.2	1,123.6	64.1	561.3	47.6
MICs minus China and India	n.a.	n.a.	287.4	22.7	n.a.	n.a.	274.6	23.3
LICs minus China and India	458.2	27.1	n.a.	n.a.	509.0	29.0	n.a.	n.a.

Source: Sumner (2011).

Multi-polarity

Development aid was born in a bipolar world, characterized by the presence of two blocs in conflict; today, that international reality has disappeared. Instead, a more complex and multipolar world is being consolidated. New international powers from the developing world are being added to traditional powers, and some of these new powers are highly dynamic.

This change also has important implications for the aid system, since some of these emerging powers—along with other developing countries—have become actively involved in sustaining their own development cooperation programs. The exact volume of this South-South aid is not known. Deficient registration systems in the countries involved contribute to the lack of information in this area. In any case, according to the DAC report (DAC, 2011b), the South-South cooperation from 25 non-DAC countries reached as much as $10.6 billion (8 per cent of total ODA), the most significant contributors being Saudi Arabia (at $3.4 billion), China ($2 billion) and Turkey ($968 million). That said, these estimates do not include all the new donors, suggesting that the total figures must exceed those mentioned.

South-South cooperation incorporates important new elements into the aid system. On the one hand, because this aid is more horizontal, it is easier for the recipient country to control, while its activities also generate a clearer "double dividend"—with benefits for donor and recipient alike. But beyond these factors, most important to note is that South-South aid contributes to spreading a sense of shared responsibility, and not only from traditional donors, in the task of correcting international inequalities.

Apart from its potential, South-South aid poses a challenge to the commitments and structure of the governance of the aid system. Again, this opens up two different options: (i) try to preserve the consensus on which traditional aid policy has been built, seeking to add new donors to this tradition; or (ii) open up debate on new aid practices, in order to define a new consensus that involves the new players without renouncing accumulated aid experience. In the first case, DAC could continue to play its role as a central force in the debate and definition of aid policy; in the second case, however, a more inclusive forum should be sought, in which all involved countries are represented.

International public goods

The globalization process now underway has tended to accentuate interdependencies of all types between countries, increasing indirect effects of a transnational character. As a consequence, the sphere of international public goods (IPGs) has extended from these interdependencies. These goods are characterized by strong externalities, which means that once provided, their benefits are available for everyone in an unlimited way. Such public goods are very diverse in nature and related to the international regulatory order, the sustainability of life, and the possibility for societies to advance (table 10.4).

Table 10.4
Spheres of international public goods

Main objective	Area
Configuration of Social Order	International Justice
	International Norms
	International Institutions
Preservation of Life	Control of Contagious Diseases
	Global Common Goods (Climate Change, Biodiversity, Ozone Layer, International Fisheries)
	Protection from Crime and Drug-Trafficking
	Peace and Security
Wealth Promotion	Financial Stability and Macroeconomic Coordination
	Knowledge Diffusion
	Trade Insertion

The characteristics of public goods dictate that the market is incapable of ensuring their efficient provision, and some form of collective action becomes required. In the international sphere, the response must be carried out through diverse coordination and voluntary cooperation formulas between the players. The multilateral system is the most appropriate framework to promote such cooperative action. However, there is a widely shared view that this multilateral system, in its current form, does not meet the conditions necessary to efficiently promote the IPGs that society demands.

A strong relationship exists between the IPGs and the development agenda. The developmental impact of a new vaccine against malaria (an IPG) can be bigger than that promoted by aid; and the fight against climate change (another IPG) is required for any viable future development. Given their link, two options are conceivable: either to maintain both spheres as separate agendas, or to merge them in a progressive way within a broader global public policy.

There are reasons to try to preserve the demarcations of current aid policy: in the end, the traditional agenda (the eradication of poverty) has yet to be achieved. However, in an interdependent world, it is difficult to achieve effective results in the fight against poverty if action is not simultaneously taken in the sphere of IPGs. This suggests the need for an increasingly integrated perspective for both agendas. Such integration does not necessarily suppose the dissolution of the aid policy into the new

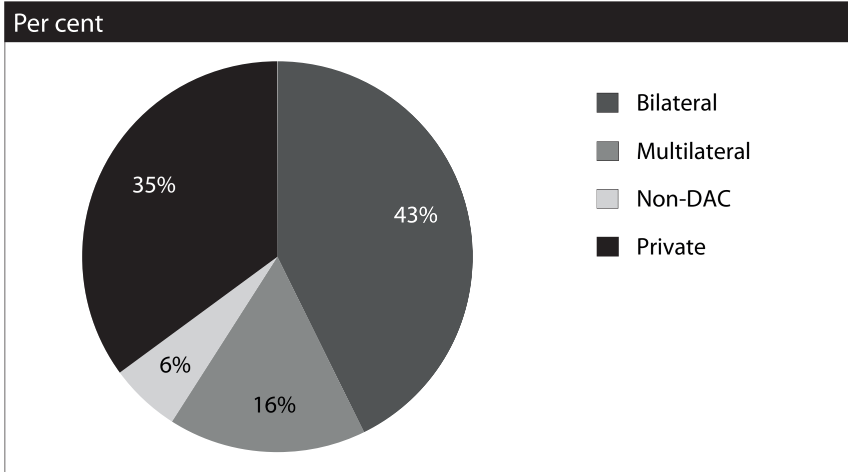
tasks around the provision of IPGs, but rather an effort to identify the inter-linkages between the two agendas. And besides that, it is necessary to complement aid with new financing sources to support the IPGs agenda.

New actors, new instruments

Since the 1990s, the number and diversity of aid providers has increased rapidly. As a consequence of this process, today the global aid architecture is more complex and fragmented than before, with costs in terms of aid effectiveness insofar as the level of coordination among the actors is very low. However, the process has also a positive face: the aid system seems to be more rich and vigorous inasmuch as new actors, with different experience and resources, are implied in the aid policy. In the last decade, three new actors have emerged with special force. First, as we have seen, emerging economies are providing significant resources through South-South cooperation. Second, the private sector, directly or through its foundations, is increasingly supporting international aid programs, besides promoting other activities ("social corporate responsibility", for example) that, while not being ODA, can have developmental effects. Finally, as a consequence of the partnership between official and private donors, new global funds have emerged in the field of development cooperation. The composition of aid resources shows, albeit in an incomplete way, the more complex structure of the cooperation system, with the new actors (emerging donors and private sources) funding, in 2009, about $70 billion (near 40 per cent of total aid) (figure 10.9).

With the new actors, the development cooperation system has also increased the range of its available instruments. Most of these new instruments are connected with private sector involvement on development activities. For example, in the last two decades, new financial instruments have been used by donors to promote the private sector in partner countries. Specialized institutions (the Development Finance Institutions, DFIs) are in charge of managing these financial instruments that include equity investment (directly or through investment funds), loans, and guarantees, amounting to nearly 6 per cent of total ODA. In the same vein we could cite the Aid-for-Trade Initiative (AFT), promoted by the WTO to assist developing countries in increasing their exports of goods and services, to better integrate into the multilateral system and to benefit from increased market access.

Figure 10.9
Composition of aid by main channel, 2009



Source: Kharas and others (2009: 5).

The proliferation of actors and instruments has led to a system that lacks coherence. As a consequence, overlap and contradictory efforts are possible, reducing the level of effectiveness of the whole system. The Paris Agenda has tried to curb this problem, calling for donors to achieve more coordination, harmonization, and division of labour. But this approach faces two problems: (i) more and more developmental actors and instruments are operating in a field wider than ODA; and (ii) to be effective, donor specialization and coordination should be locally based, in a way that suits the needs of partner countries.

In relation to this process, the system of development cooperation has two alternatives. On the one hand, donors could again focus their attention within the borders of ODA, in order to reduce the level of complexity of the system. However, the problem is that an increasing number of development activities would then be left out of their focus. Alternatively, donors could accept that the cooperation system has definitively changed: a precise border between aid and non-aid no longer exists (Severino and Ray, 2009). The enlargement of the cooperation system perimeter, with new actors, instruments and goals, demands a move from ODA to a more complex global development policy.

10.6 Concluding comments

The analysis here carried out confirms that the international development aid system is undergoing a period of irreversible changes. It is impossible to predict whether international aid will be capable of adapting, or whether it will become increasingly irrelevant. Three possible forward-looking scenarios shall be considered here, although in reality there may be some variation or overlap between them:[6]

Scenario 1: Reduction and focus

The first scenario could come about as a result of the progressive loss of drive in the aid reform agenda, and by the relegation of international aid to a minor role in the donors' interests. The severe effects of the economic crisis on many OECD countries could lead to a new phase of "donor fatigue", with a negative effect on aid resources. The limited achievements of the Paris Agenda could lead to revisionist attitudes, aiming to return to more traditional formulas for managing aid. The Paris Agenda might not be abandoned completely, but efforts would be focused on just some of its elements, reducing its degree of complexity. In that case, it is likely that aid would maintain its traditional agenda, without new elements related to providing IPGs. In keeping with the general approach of this scenario, the governance of the aid system would continue to function around the OECD's DAC, with this institution progressively enlarged as long as new OECD members take part, eventually inviting even non-OECD donors or recipient countries to participate in some of their decisions.

Scenario 2: Deepen the path to reform

A second possible scenario is based on the idea that the Paris Agenda was the result of a significant international agreement that is producing results and that, if properly updated, would allow for the aid system to be improved. This process would be compatible with a reduction in rates of growth in aid, and with a search for alternative financial resources. In terms of the aid effectiveness programme, some aspects of the Paris Agenda could be deepened, particularly those which increase the decision-making ability of the recipient country. The purpose would be to build an agenda more focused on countries' specific needs, less general and catch-all in nature. The

monitoring of aid should be less intrusive by the donor in order to favour ownership of projects by recipients. The rest of the Paris Agenda principles would also be maintained, meaning more aid through budget support, reducing conditionalities as much as possible, improving predictability, ensuring that a multilateral approach is favoured, as well as increasing coordination among donors. The goal here would be to work towards results using simpler indicators and incorporating clearer sustainability criteria, reinforcing accountability and the transparency of donors and recipients. New donors would be encouraged to become more actively involved in the new consensus, and they would be encouraged to apply agreed-upon principles to their own practice as donors. This scenario could be developed through peer review processes involving the new donors, carried out in cooperation with the DAC and UNDCF. Support for new (predominantly private) players in the aid system would also be maintained, but keeping the perimeter of ODA well defined. Lastly, environmental sustainability would be incorporated into development aid policy, although aid and IPG provision would be maintained as relatively independent agendas.

Scenario 3: Reconfiguration of the system

The starting point for the third scenario is a more radical assessment of the processes of change that the international system is undergoing. The aim would be to define a new global approach to correct international inequalities and deal with transnational externalities. To tackle that task, it is essential to overcome the traditional separation between donors and recipients on which the aid system is based, creating a framework of shared, although varying, responsibilities, in which industrial countries, but also developing countries with sufficient experience and resources, can take part in the tasks of international cooperation. This scenario would entail a revision of the MDGs as the prime development agenda to promote another, more wide-ranging agenda, based around three large tasks: i) guaranteeing the provision of basic social services to the world population; ii) providing IPGs; and iii) promoting convergence between countries (Severino and Ray, 2009). This new agenda should also include a displacement of concerns from aid to development, while the concern about development transcends the area of financing (and financing goes beyond ODA). Issues associated with the international regulative frameworks (trade, investment and technology, etc.) would also enter into this sphere to ensure a better

distribution of development opportunities, including penalizing those practices which hinder that objective (illicit financial flows, fiscal paradises, etc.). This global approach would have to be compatible with promoting donor support alignment with country-owned and country-led national strategies. In order to make such a policy feasible, it would be necessary to seek an international tax model that could provide complementary financing for development cooperation. As a consequence, a new structure of governance is needed in order to ensure that donor and recipient countries, public and private partners are all represented.

It is clear that the intensity of reform increases as we move through the scenarios from (a) to (c); and the risk of losing valuable aspects of the aid system that should perhaps be conserved also grows. As always, it is important to find a balance between the legacy inherited and the need to meet the changes taking place in society. The first scenario is clearly insufficient to respond to changes already underway, while the third scenario incorporates excessive and ill-defined components. Some point between the second and third scenarios might be the best option for transforming aid into an effective instrument for development in the post-2015 era.

Notes

1 The concept of ODA is defined by the DAC. Even though some components of ODA (such as debt relief or tied credits) are subject to controversy, we will follow the standard classification that the DAC proposes.
2 Alternative classifications can be found in Sandor and others (2009) or Girishankar (2009).
3 See: http://leadinggroup.org/IMG/pdf/Rapport_TTF_AN.
4 Those components that behave more erratically (humanitarian assistance, food aid and debt relief operations) were removed from ODA.
5 In fact, such a proposal would supposedly exchange the binomial logic of "graduating" countries for a continuous logic of "gradual support".
6 Evans (2011) offers an alternative vision of future scenarios.

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Chapter 11
International migration in the development agenda

José Antonio Alonso

11.1 Introduction

One of the most conspicuous signs of the process of globalization is the increase in international migratory flows. According to the United Nations, there were about 214 million international migrants in 2010. In relative terms, this corresponds to over 3 per cent of the world population. The percentage does not seem exceptionally high, especially when compared to the proportion of other cross-border economic transactions. However, the social and political relevance of migration goes beyond numbers: migration involves people, with their social relations and capacity of agency.

In fact, today migration is powerful force of social change and cultural interaction in the countries that are involved. It has developmental effects on both the home and host countries, and provides migrants themselves with significant opportunities to progress. Nonetheless, migration remains subject to restrictive legislative frameworks, which have been reinforced during the current economic crisis. This restrictive tone contrasts with the increasing liberalization of other economic flows illustrating the unbalanced nature of the globalization process.

Besides that, the current restrictive regulation is contrary to both the need for migrant labour in developed countries and the need for employment opportunities for people living in developing countries. The gap between these needs and the norms regulating migration has led to large numbers

of immigrants living irregularly in their host countries. This has costs, not only for the immigrants themselves, but also for the democratic climate of the host societies.

The above notwithstanding, it is worth stating that migration, when suitably regulated, can potentially improve global efficiency and reduce international differences in labour prices, as both theoretical and empirical studies have confirmed. Aside from this global effect, migration is also an effective, although notably selective, means of increasing the possibilities for individuals to improve their living conditions. It is, therefore, an important development factor, especially if we consider that people (not only countries) matter (Clemens, 2010; Nussbaum, 2000).

Of course, migration can also entail costs, both for the countries of origin (breaking of family structures, destruction of emotional ties, loss of dynamic sectors of the population, etc.), as well as for the recipient countries (costs in social services or in social integration policies, for example). Furthermore, when emigration becomes a widespread and intensive phenomenon, it can feed a vicious circle that promotes a regressive dynamic of depopulation and the abandonment of productive activities in migrants' communities of origin.

All benefits and costs of migratory flows need to be considered through adequate policies, both in countries of origin and in host countries. Even so, national responses are not sufficient: migration is a global phenomenon that requires a global approach, especially if we consider that migration falls into an area not yet covered by any formal international regime: neither a global regulatory framework nor a specialized multilateral institution to regulate the phenomenon currently exist.

In the following sections, the present chapter will analyse current migratory flows by taking into account their effects on development.[1] The second section reviews trends in international migration; the third section examines the aggregated economic effects of international migration; the fourth section is focused on remittances and their effects; the fifth section analyses the effects of skilled workers' migration from developing countries; the sixth section is dedicated to analysis of regulatory responses to the phenomenon; and section seven presents some conclusions.

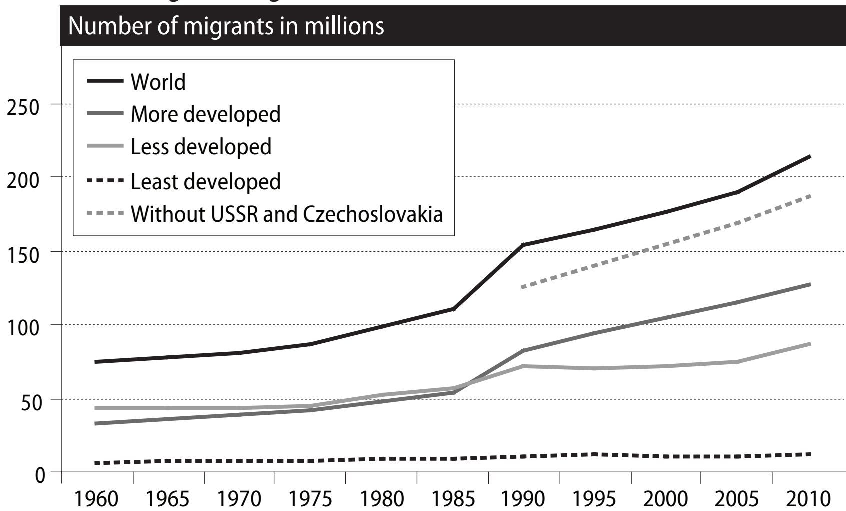
11.2 Migration flows

The size of migration

United Nations' data over the last five decades confirms that the trend in international migration has been upward, in keeping with the process

of globalization.[2] This upward trend shows a (somewhat artificial) jump around the 1980s, as a result of the sudden migrant status acquired by former USSR citizens as a consequence of their living in regions different from their birthplaces (later converted into independent countries).[3] Apart from that phenomenon, excluding the USSR and Czechoslovakia, the upward tendency has been maintained, with a slight acceleration in the last three five-year periods (figure 11.1).

Figure 11.1
Trends in global migration, 1960-2010



Source: United Nations (UNDESA): International Migrant Stock. The 2008 Revision (http://esa.un.org/migration)

In dynamic terms, in the 30 years between 1980 and 2010, the total number of migrants increased by an average annual rate of 2.6 per cent. As a consequence of this upward trend, there were about 214 million migrants in the world in 2010. This figure is most likely an underestimate of the true magnitude of the phenomenon, because undocumented immigrants are not adequately included in the data. Tentative estimates put the ratio of undocumented migrants in a wide range of between 5 and 30 per cent of registered migration, depending on the nation in question.

Since the mid-1980s, more developed countries have become the major destination of migrants, and by 2010 those countries concentrated 60 per cent of migrants (table 11.1). More specifically, Europe and North America

have the highest number of migrants, followed by Asia, with a relatively similar number. While the growth rate of the stock of migrants in more developed countries was 3.3 per cent for the period that of the migrant stock in less developed countries reached 1.7 per cent.

Table 11.1
Destination countries: stock of migrants, 1960-2010

Millions of people											
	1960	1965	1970	1975	1980	1985	1990	1995	2000	2005	2010
By region											
Africa	9.1	9.4	9.9	11.0	14.0	14.4	16.3	17.9	6.5	17.0	19.2
Asia	28.5	28.2	27.8	28.0	32.1	37.2	49.9	47.2	50.3	53.3	61.3
Europe	14.2	16.6	18.8	20.1	21.9	23.4	49.3	55.2	58.2	64.1	69.8
Latin America	6.0	5.8	5.6	5.7	6.0	6.2	6.9	6.0	6.3	6.6	7.5
North America	12.5	12.7	12.9	15.3	18.1	22.1	27.6	33.5	40.3	44.5	50.0
Oceania	2.1	2.5	3.0	3.3	3.7	4.2	4.7	5.0	5.0	5.0	6.0
World	75.4	78.4	81.3	86.7	99.2	111.0	154.9	165.0	176.7	190.6	213.9
By income level											
More developed	32.3	35.4	38.3	42.4	47.4	53.6	82.3	94.9	105.0	115.4	127.7
Less developed	43.1	43.0	42.9	44.3	51.8	57.3	72.5	70.1	71.7	75.2	86.2
Least developed	6.4	6.9	7.2	6.8	9.1	9.1	10.9	12.2	10.2	10.4	11.5

Source: United Nations (UNDESA). International Migrant Stock. The 2008 Revision (http://esa.un.org/migration).

If the relative percentage of immigrants over host populations is considered, North America and Oceania are those with the highest coefficients (at 14 per cent and 16 per cent respectively), followed by Europe at 9 per cent (table 11.2). In the other regions, immigrants represent less than 2 per cent of the host population.

The above data could suggest that managing the influx of international migrants is a problem exclusive to developed countries. However, the phenomenon is more complex, as becomes clear when the countries with the largest amount of immigrants are identified (figure 11.2). Some developed countries stand out here, including the United States, Germany, Canada, France, the United Kingdom and Spain; nevertheless, developing countries like India, Pakistan and the Ivory Coast also occupy leading positions. This

Table 11.2
Regional distribution of migrants, 1960-2010

Percentage of local population											
	1960	1965	1970	1975	1980	1985	1990	1995	2000	2005	2010
By region											
Africa	3.2	3.0	2.7	2.7	2.9	2.6	2.6	2.5	2.0	1.9	1.9
Asia	1.7	1.5	1.3	1.2	1.3	1.3	1.6	1.4	1.4	1.4	1.5
Europe	3.4	3.8	4.1	4.3	4.5	4.8	6.9	7.6	8.0	8.8	9.5
Latin America	2.8	2.3	2.0	1.8	1.7	1.6	1.6	1.3	1.2	1.2	1.3
North America	6.1	5.8	5.6	6.3	7.1	6.2	9.7	11.2	12.8	13.5	14.2
Oceania	13.4	14.3	15.4	15.8	16.4	17.0	17.8	17.5	16.3	15.2	16.8
World	2.5	2.4	2.2	2.1	2.2	2.3	2.9	2.9	2.9	3.0	3.1
By developmental level											
More developed	3.4	3.5	3.6	3.9	4.2	4.6	7.2	8.1	8.8	9.5	10.3
Less developed	2.1	1.8	1.6	1.5	1.6	1.6	1.8	1.6	1.5	1.4	1.5
Least developed	2.6	2.5	2.3	1.9	2.3	2.0	2.1	2.0	1.5	1.4	1.3

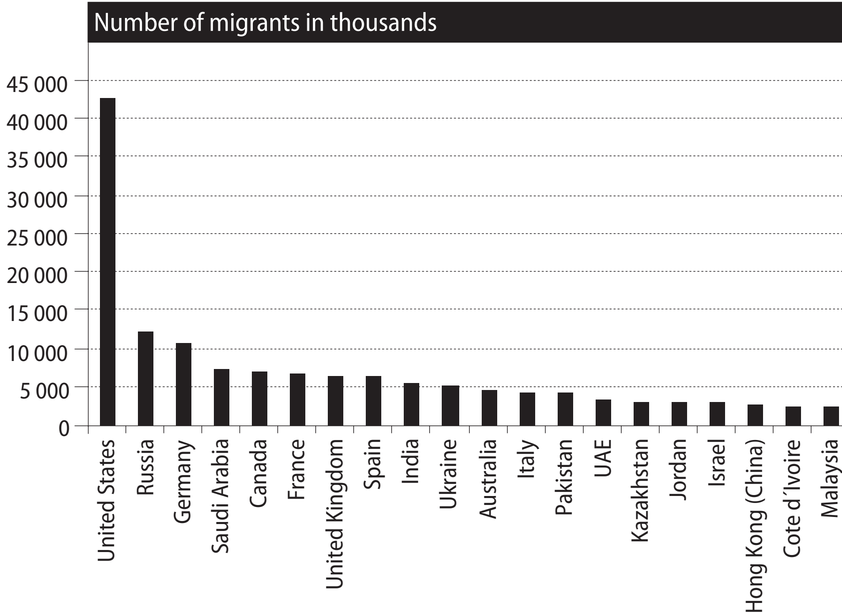
Source: United Nations (UNDESA). International Migrant Stock. The 2008 Revision (http://esa.un.org/migration).

suggests that: i) having a large immigrant population is not a characteristic exclusive to developed countries; and ii) the distinctions between host, origin and transit countries in terms of migration is increasingly blurred. A good number of countries (such as Mexico and India) fall into all three categories.

The study of bilateral flows confirms the global nature of the migratory phenomenon (figure 11.3). In 2000, according to the *Migration Development Research Centre*, 79.7 per cent of migratory flows came from developing countries; 45.3 per cent went to developing countries, and the remaining 34.4 per cent was bound for developed countries. In turn, 16 per cent of the total emigration from developed countries went to other developed countries, while 4.2 per cent went to developing countries.

All data suggest that we are living in an *era of mass migration*, even if the economic crisis is temporarily curbing flows. But this phenomenon is not new in history. In particular, historians have documented large-scale migratory movements between 1840 and the start of the First World War, in the so-called *first era of mass migration* (Hatton and Williamson, 1998, 2005). The intensity of migration in that period was even higher than today.

Figure 11.2
Main recipient countries of migration, 2010



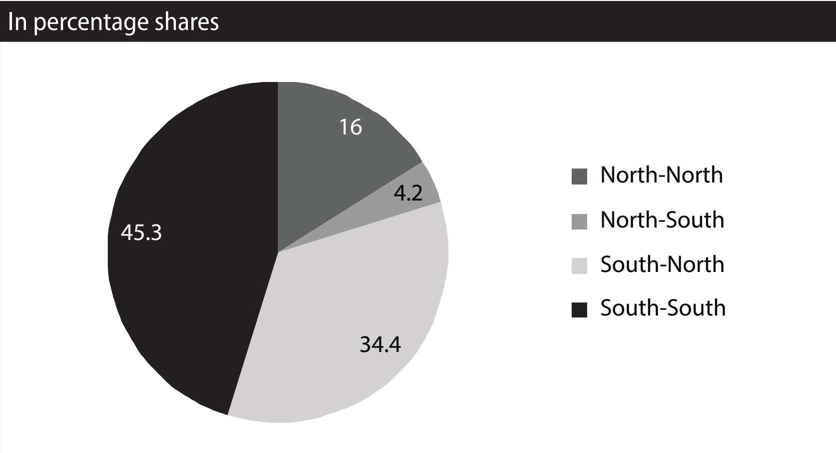
Source: United Nations (UNDESA): International Migrant Stock. The 2008 Revision (http://esa.un.org/migration)

However, when compared with this historic episode, the present migratory flows have four distinctive traits worth highlighting:

- First, the *factors encouraging emigration*: In the past, migration—particularly Atlantic migration—took place between countries with relatively similar developmental levels and came about because it allowed poor Europeans, mostly rural, to move from hierarchical, highly unequal societies to countries with less of a labour force and much greater social mobility. It could be said that inequality within countries was at that time a more significant factor than international inequality. Today, however, the per-capita income differential between countries is a much more important factor in explaining migration. In fact, almost 80 per cent of the migrant population from a developing country chooses a more-developed country as destination (UNDP, 2009).
- Second, the *feminization of emigration:* At the end of the 19th century, migratory flows were primarily composed of men (between two thirds and three quarters of migrants). The presence of women, especially in

Figure 11.3
Composition of migration flows by origin and destination, 2000

In percentage shares



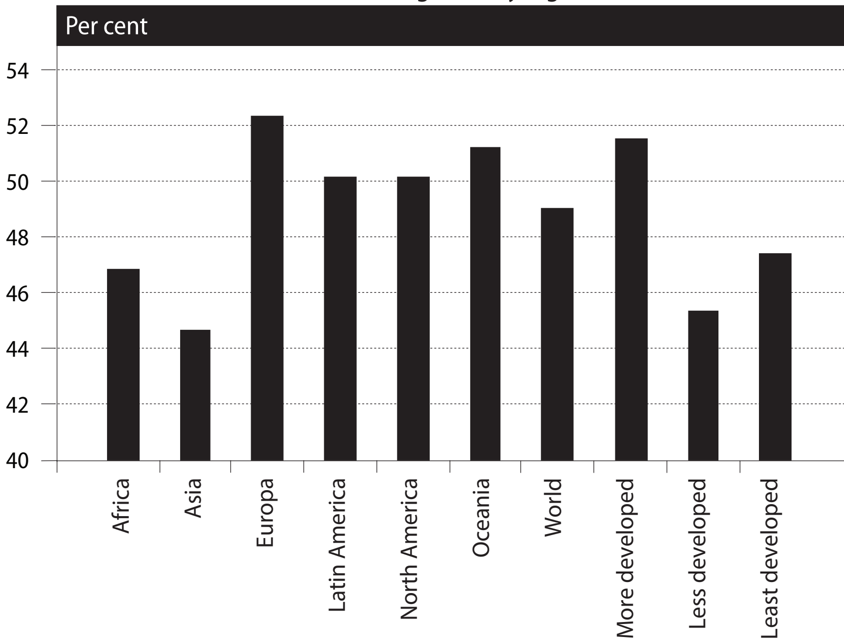
Source: Docquier and Marfouk (2006): International migration by education attainment, 1990-2000" in Ozden and Schiff (eds) International Migration, Remittances and the Brain Drain, Washington, The World Bank and Palgrave Macmillan.

the form of independent migration (as opposed to being part of the family nucleus) was a relatively minor phenomenon. At the moment, however, women make up half the total amount of emigrants—in some cases as a consequence of family-reunion policies, but also as a result of independent migratory strategies (figure 11.4).

- Third, *the presence of undocumented migrants*: In the previous era of mass migration the phenomenon of undocumented migration did not exist; but now, as legislation has become more restrictive, a large number of migrants are living outside the law in their host country. The best estimates suggest that close to 30 per cent of total emigrants are living informally in the United States (Passel and Cohn, 2008), while in the European Union that share ranges between 5 and 15 per cent (Vogel and Kovacheva, 2009). As a consequence, for a large number of people migration takes place without legal protection.
- Finally, a source of *transnational social capital*: Advances in communications technology have meant that contact between communities of origin and those in destination countries occurs almost on a daily basis. There is an entire network of communications, initiatives and undertakings linked to relationships across both communities. Moving

labour across borders helps with the global transmission of ideas. And feelings of national identity are strengthened in the diasporas, creating positive phenomena of mutual support (social remittances, for example), as well as negative expressions (such as gangs and "maras").

Figure 11.4
Share of women in the stock of migrants, by regions and income level, 2010



Source: United Nations (UNDESA): International Migrant Stock. The 2008 Revision (http://esa.un.org/migration).

The effects of the current crisis

One of the most visible consequences of the economic crisis is the rise in unemployment in the OECD countries, the main recipients of migration. Between 2007 and 2011, almost all OECD countries (with the exception of Austria, Belgium, Germany, Poland and Israel) experienced a rise in the rate of unemployment. In some cases—Estonia, Greece, Iceland, Ireland, Spain and the United States—the rate doubled in that period, while in seven of the OECD countries, the unemployment rate reached double digits.[4]

The difficulties in OECD labour markets have doubtlessly affected the migrants in a severe way. In the OECD, in 2010, the average unemployment

rate among immigrants was, on average, 67 per cent higher than the unemployment rate of natives. Only in three countries (Hungary, Czech Republic and the United States) is the former rate lower that the latter. When the information is segregated by gender, it can be confirmed that the differences in unemployment rates between natives and foreign-born workers are higher in the case of women (figures 11.5a-b).

As a consequence of the economic situation, the flows of migrants into developed countries have perceptibly reduced. For example, between 2007 and 2009, the inflows of migrants into the EU-25 decreased by 24.4 per cent, and the number of outflows increased by 19.8 per cent (OECD, 2011). In any case, the data seem to indicate that migrant return is not a generalized phenomenon, at least until present. The huge gap between living conditions in host and origin countries, the temporary public support available to the unemployed in most OECD countries, and the fear of not being able to re-enter the host country later if conditions change are some factors that explain the migrants' resistance to leave host countries.

Apart from this, the economic crisis has had an impact on migrants and their families through other channels. Due to the nature and duration of their labour contracts, immigrants tend not only to have a higher rate of unemployment, but also a lower level of social protection when they become unemployed. And immigrants' families have suffered a reduction in the level of remittances received, although (as we shall see) this phenomenon varies in accordance with the regions. Finally, the crisis has aroused dangerous anti-migration reactions in several host countries and introduced a more restrictive tone in migration regulation.

11.3 Effects on global welfare

Economic theory predicts that international migration will be associated with an improvement in global efficiency, as migration allows people to move from where they are least rewarded (labour–abundant economies) to where they earn more (labour-scarce economies). As a result, this is not a zero-sum game: obviously, not all sectors of society benefit from the change, but the overall result is undeniably positive in terms of potential welfare.

It is interesting to consider how large the benefits might be in the hypothetical case of free movement of people. The first works on this subject (such as Hamilton and Whalley, 1984, or Moses and Letnes, 2004) applied a general equilibrium model (AGE), supposing full labour mobility. The estimated benefits were striking: in the first study, the world GDP could

Figure 11.5a
Ratio of unemployment rate among immigrants over that of natives - Females, 2010

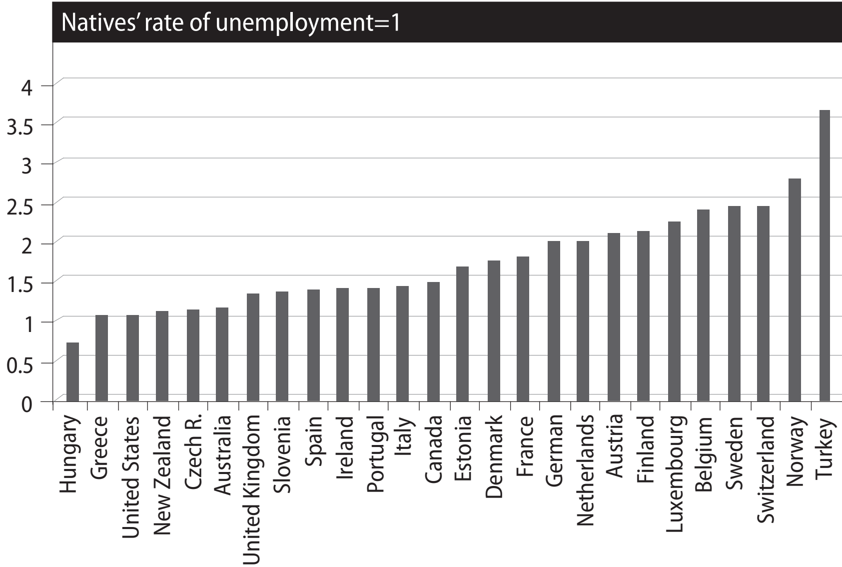
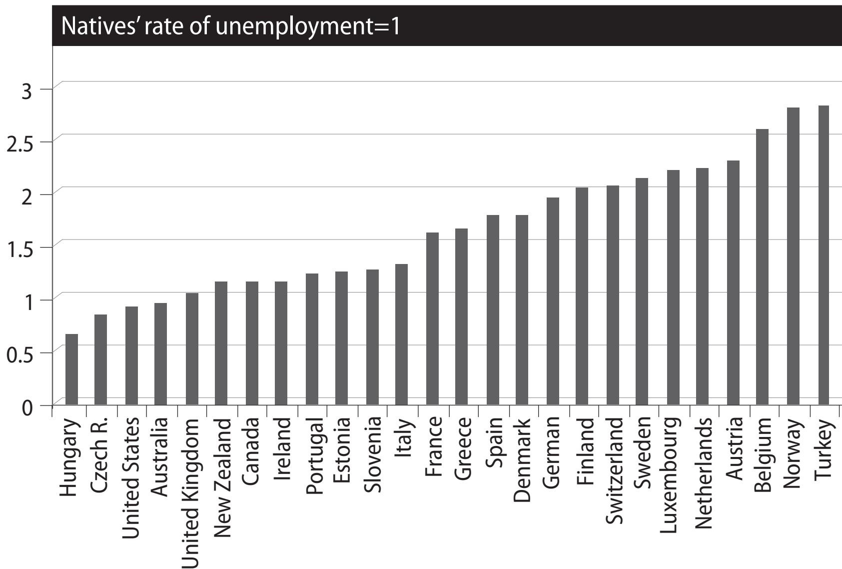


Figure 11.5b
Ratio of unemployment rate among immigrants over that of natives - Males, 2010



Source: OECD 2011: International Migration Outlook.

double as a consequence of completely free migration, and in the second the increase on global efficiency could reach, in the most conservative scenario, a range of between 6 and 47 per cent of the world's GDP.

Other subsequent studies confirmed the tone of these results. For example, Iregui (2005) used a fully developed AGE model with trade and found that migration barriers reduce world GDP by between 13 and 67 per cent, depending on the scenario considered. Klein and Ventura (2007) used a growth model that included dynamic effects and arrived at the conclusion that completely free migration would increase world GDP by 20 to 120 per cent, in accordance with the assumptions. Finally, Bradford (2012) applied an AGE of one sector model with a continuum of skills and confirmed the effect of free migration on the increase of world GDP (by 75 per cent) and on the reduction of poverty (by between 66.9 and 43.3 per cent, depending on the assumptions). Even though the assumption made by these studies (full labour mobility) is unrealistic, a large part of the benefits would be obtained in the first phases of liberalization—a powerful argument in favour of more flexible regulation of migration.

The World Bank (2006) carried out a similar exercise, but with a more realistic assumption: an annual growth rate of 3 per cent of the working population in developed countries between 2001 and 2025, and allowing labour needs to be covered, as required, by immigration. If taking as a baseline the assumption the same proportion of immigrants as existed in 2001, the net gains to welfare from the above expansion scenario would be close to $674 million, or 1.19 per cent of world GDP (table 11.3). If this is adjusted in function with the different costs of living from country to country (translated into Purchasing Power Parity), the benefits would be 0.63 per cent of world GDP. The distribution of these benefits would be favourable to developing countries (including to those who emigrate) since these populations would experience an increase in income of about 1.8 per cent, while developed countries would obtain an increase of 0.4 per cent. The results that the World Bank (2006) obtained are very close to those reached by Walmsley and Winters (2005) and, more recently, by van der Mensbrugghe and Roland-Host (2009).

The fact that migration has a positive effect on aggregate efficiency does not mean that everyone affected ends up winning. Current immigrant and native workers who are substituted by new immigrants may be negatively affected by such an increase in migratory flows. This argument is occasionally used to justify a restrictive migration policy, highlighting the way in which the entry of new immigrants could depress salaries in the recipient country. Empirical studies confirm this effect but find the salary

Table 11.3
Changes in real income due to more free migration in 2025 relative to baseline scenario

	Real income			Real income adjusted for cost of living		
	Private	Public	Total	Private	Public	Total
Billions of dollars						
Natives in developedcountries	139	-1	139	139	-1	139
Former migrants in developedcountries	-88	0	-88	-88	-0	-88
Natives in developing countries	131	12	143	131	12	143
New immigrants	372	109	481	126	36	162
WORLD TOTAL	554	120	674	308	48	356
% of Change						
Natives in developedcountries	0.44	-0.01	0.36	0.44	-0.01	0.36
Former migrants in developedcountries	-9.41	-0.02	-6.02	-9.41	-0.02	-6.02
Natives in developedcountries	0.94	0.44	0.86	0.94	0.44	0.86
New immigrants	584	607	589	198	203	199
WORLD TOTAL	1.20	1.15	1.19	0.67	0.45	0.63

Source: World Bank (2006): Global Economic Prospects: Economic Implications of Remittances and Migration, Washington.

decline to be small. For example, Borjas (2003) finds that immigration to the United States between 1980 and 2000 caused a cumulative deterioration in average U.S. salaries of 3.2 per cent (in other words, an annual reduction of barely 0.15 per cent). An even lower rate is estimated by Ottaviano and Peri (2008), who put the accumulated effect of immigration between 1990 and 2006 at 0.4 per cent (or a 0.025 per cent fall in the average rate). In the opposite sense, wages in sending countries will tend to increase, as Mishra (2007) and Aydemir and Borjas (2007) show in the case of Mexico. As a consequence of both changes, migration tends to reduce wage differentials between sending and hosting countries, which turns migration into a potential factor of reducing international inequalities.

To sum up, estimates confirm that with current migration barriers, labour is highly misallocated and, as a consequence, the potential welfare gains of a less restrictive policy on migration are huge. Moreover, these benefits,

even in their most modest versions, are comparable (or superior) to those that would result from trade liberalization. For example, the increase in world GDP estimated by Anderson and Martin (2005) as a consequence of potential full trade liberalization is 0.7 per cent; however, in the case of a partial removal of migration barriers, that increase could reach between 0.6 and 1.2 per cent in the Walmsley and Winter (2005) estimation, or between 0.9 and 2.3 per cent in van der Mensbrugghe and Roland-Host (2009). These results are sufficient proof that international migration should be a mandatory part of any development agenda (Clemens 2011).

11.4 Remittances

Magnitude

It is not easy to measure remittances due to the levels of hidden transfers. However, in accordance with the best estimates—those provided by the World Bank—migrant remittances sent to developing countries is expected to reach $399 billion in 2012, and $533 billion if remittances to developed countries are added (table 11.4). Most remittances to developing regions go to middle-income countries ($369 billion in 2012), while the remaining $30 billion go to low-income countries.

Viewed in perspective, the rapid growth of remittances destined to developing countries over the past few years is surprising: the figure climbed from barely $31 billion in 1990 to $324 billion in 2008 and from $308 billion in 2009 (as a consequence of the crisis) to $399 billion in the forecast for 2012. This increase is particularly notable in the three five-year periods previous to the crisis, where official remittances grew at an accumulative annual rate of 13 per cent. The average rate of growth of remittances in that period is double the rate of international aid and higher than the rate of exports.[5]

The current crisis has affected remittance flows, but less than expected. In 2009, remittances directed at developing countries fell by 5 per cent: an appreciable fall, but still well below the declines in direct foreign investment or private financial flows. However, remittances recovered in 2010, and they are expected to reach $372 billion in 2011 and $399 billion in 2012.

In any case, the effect of the crisis on remittances has not been the same across regions. The two regions most affected have been Eastern Europe and Central Asia and Latin America, which in 2009 suffered declines in remittances of 20 and 11 per cent, respectively. Declines in the Middle East and Northern/Sub-Saharan Africa were smaller, at 6 and 9 per cent, respectively.

Table 11.4
Trends in remittance flows to developing countries, 1990-2012

$ Billion											
	1990	1995	2000	2005	2006	2007	2008	2009	2010[e]	2011[f]	2012[f]
Developing countries	31.0	56.0	81.0	192.0	226.0	278.0	324.0	308.0	332.0	372.0	399.0
Regions											
Latin American	5.7	13.3	20.1	49.8	58.8	63.0	64.0	57.0	57.0	62.0	66.0
South Asia	5.6	10.0	17.2	33.9	42.5	54.0	72.0	75.0	82.0	97.0	104.0
East Asia	3.1	8.9	15.8	50.3	57.4	71.0	85.0	86.0	95.0	107.0	115.0
Middle East and North Africa	11.4	13.3	13.0	25.0	26.4	32.1	36.0	34.0	40.0	42.0	45.0
Europe and Central Asia	3.2	6.4	10.3	23.2	28.4	39.3	45.0	36.0	37.0	41.0	45.0
Sub-Saharan Africa	1.9	3.2	4.6	9.4	12.6	18.6	22.0	20.0	21.0	22.0	24.0
Income levels											
Lowincome	1.4	2.2	4.1	10.0	12.9	16.6	23.0	22.0	25.0	28.0	30.0
Middle income	29.3	53.1	77.1	181.6	213.3	261.6	302.0	286.0	308.0	344.0	369.0
High income	37.5	46.0	50.2	82.7	91.2	106.3	133.0	120.0	121.0	128.0	134.0
Memo item:											
World	68.6	101.6	131.5	274.5	317.6	384.5	457.0	429.0	453.0	501.0	533.0

Source: World Bank: World Development Indicators (http://data.worldbank.org/migration) and Migration and Development Brief 18, April 2012.

Notes: e estimation; f forecast

Effects

Remittances show two traits that are relevant in development terms. The first is their redistributive allocation pattern, when figures are related to the recipient country's variables. The overwhelming majority of remittance flows to developing countries (92 per cent) go to middle-income countries, leaving a modest 7 per cent for low-income countries (table 11.5). However, the ratio of remittances to the GDP of the poorest countries is almost double that of middle-income countries. And in the same vein, the relative weight of remittances on imports, investment, or consumption is higher in low-income than in middle-income countries. This profile confirms the key role that remittances play as part of international financing in the poorest countries.

Table 11.5
Relative importance of remittances (average 2005-2008)

	Percentage of GDP			Remittances as a percentage of				
	Remit-tances	Foreign invest-ment	Official aid	Foreign invest-ment	Official aid	Imports	Gross capital for-mation	Private consumption
Low-income countries	4.63	2.22	9.10	208.50	50.40	12.60	20.30	5.90
Middle-income countries	1.86	2.20	0.42	84.80	436.50	6.20	6.30	3.50
Lower-middle income	2.51	2.50	0.70	100.30	356.80	7.50	6.90	5.20
Upper-middle income	1.18	1.91	0.14	62.20	819.30	4.40	5.10	2.00
High-income countries	0.25	-0.89	-	-0.27	-	0.80	1.10	0.40

Source: World Bank: World Development Indicators (http://data.worldbank.org)

The second relevant characteristic of remittances is their acceptable stability over time. For example, considering the evolution of the variables from 1990 to 2008, previous to the crisis, the variation coefficient for remittances (0.23) is a little higher than that for international aid (0.09), but it is notably lower than flows of direct investment (0.46) or other private flows (0.43). The greater stability of remittances makes them a more predictable source of financing than other private sources. Furthermore, remittances often demonstrate a counter-cyclical nature, particularly when co-variances among sending and host country perturbations are low (Kapur and McHale, 2005; Yang, 2008).

From a *macroeconomic perspective*, remittances can have positive effects on developing countries: they are a means of relaxing external constraints on growth, helping the balance-of-payments equilibrium, and a complement to private investment or consumption. However, when large volumes of resources are mobilized, remittances can cause appreciation of the real exchange rate, with a subsequent loss of competitiveness for the recipient economy. This effect is more plausible in those economies (generally small in size) that are highly dependent on remittances (López and others, 2007).

Translating these arguments into empirical terms leads to results that do not always match up. Adelman and Taylor (1990), for example, identify a multiplier effect of remittances on the Mexican economy of between $2.69

and $3.17 per dollar received (considering urban or rural environments, respectively).[6] A similar effect was obtained by Dessai, Kapur and McHale (2001) in a study on India, or by Mishra (2005) in a study on 13 Caribbean countries. In contrast, other studies take a less optimistic view of the effect of remittances. Among these, one by the IMF (2005) stands out, observing a rather wide sample of countries and identifying no robust effects of remittances on the growth of GDP per capita.

From a *microeconomic perspective*, remittances can produce a positive impact on recipient families mainly through their effect on asset accumulation (Stark and Lucas, 1988), on easing of family financial constraints (Faini, 2002) and on providing insurance against unexpected events. On the negative side, however, remittances are considered to be predominantly used for consumption (even conspicuous consumption), discouraging labour and saving efforts by recipient families and generating a "rentier-state" culture (Chami et al. 2005 and Görlich et al. 2007).

Measuring the net effects of remittances in a precise way requires defining a counter-factual scenario in which neither emigration nor remittances have taken place, and where the emigrants therefore continue working in their home countries. This approach can be implemented through two methods, either through a cross-country analysis or through case studies based on family budgets. The work of the World Bank (2006) is expressive of the first approach, and its results confirm the positive effect of remittances on poverty. When it is assumed that inequality levels remain constant, the effect of removing remittances generates an increase in poverty of between 1.2 and 20.3 per cent, depending on the volume of the remittances and the initial level of poverty.

Regarding country-specific studies, Adams and Page (2005) and Acosta and others (2007) are among those that allow more generalized results. The former, using data from family budgets in 71 developing economies, confirms that an increase of 10 per cent in remittances leads to a reduction of 3.5 per cent, on average, in the poverty rate in those countries, and this positive effect is confirmed by Adams and Cuecuecha (2010) in a careful case study on Indonesia. Acosta and others (2007) examines eleven Latin American countries, and their results also suggest that remittances have an effect on reducing levels of poverty (an increase of 1 per cent in remittances as a proportion of GDP reduces poverty by 0.4 per cent). The study also finds that remittances have a positive effect on education levels and health indicators. However, these results are slight and subject to notable heterogeneity among countries.

The returns from emigration received by sending countries are not limited to family remittances. Migration creates an international social network that promotes new activities and business (Orozco 2004; Woodruff and Zenteno, 2007). In some cases, hometown associations located in the recipient country send "collective remittances" that finance investment in social projects and infrastructures in their home communities. At the same time, new cultural and political relationships are forged between communities of the diaspora and communities in the countries of origin, creating a kind of transnational social capital. Finally, migrants are also carriers of new values, ideas, customs, attitudes and social relations, which they transfer to their communities of origin through their ongoing communications, frequent visits, and possible return (seen as *intangible remittances*). Not all these changes are useful to the development needs of the countries of origin, but some probably are, thus adding another positive factor to emigration.

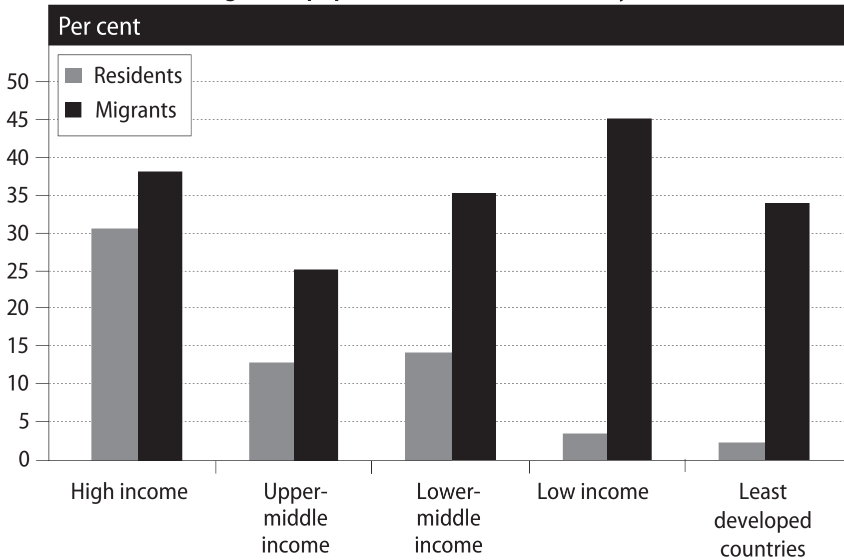
11.5 Migration of skilled labour

Size

As in other fields, it is difficult to estimate the true size of this phenomenon. However, recent works by Docquier and Marfouk (2004, 2006) present a new, much fuller and more reliable database which allows us to examine the migration of skilled labour. The data produce unequivocal results: in 2000, 34.6 per cent of immigrants working in the OECD countries received tertiary or higher education, as compared with 11.3 per cent of the entire labour population worldwide.[7] So, on average, migrants have a higher education level than the population in their countries of origin. This phenomenon appears to be increasing over time, since in 1990 the ratio of qualified workers was 29.8 per cent of the total number of immigrants - almost 5 percentage points less than in 2000. This tendency seems to be encouraged by: i) the technological requirements of current economic growth; ii) the implementation of policies by certain developed countries to attract specialized labour from abroad; and iii) the growing internationalization of higher education in developed countries, attracting students from developing countries that remain in host countries after their graduation (Rosenzweig, 2006, shows that 20 per cent of foreign university students remain in United States).

The difference between the percentage of qualified workers in the migrant population and those in the country of origin tends to be smaller in high-income countries (figure 11.6). In high-income countries, the qualified population amounts to 30 per cent among residents in the country of origin and 38 per cent among emigrants from those countries; these shares are 3.5 and 45.1 per cent, respectively, in the case of low-income countries. In other words, the poorer the country, the greater the differential between the qualification levels of immigrants and their home populations.

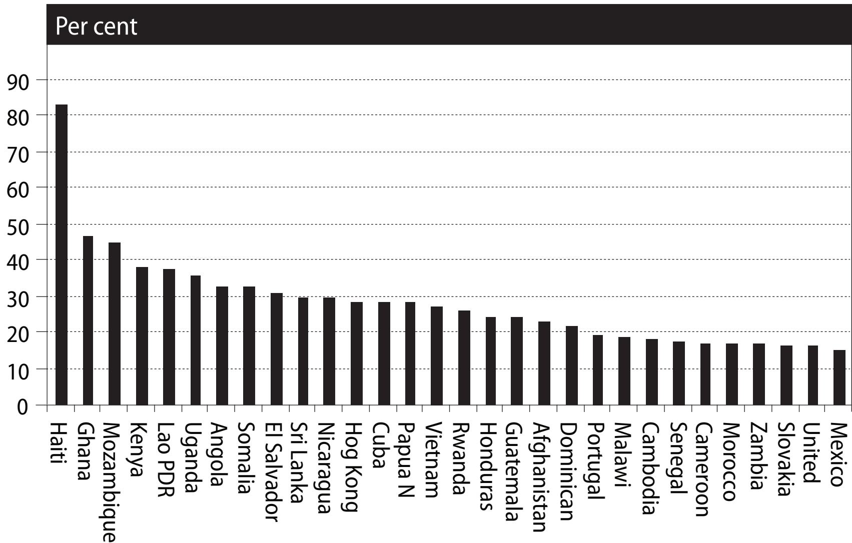
Figure 11.6
Resident and migration population shares with tertiary education, 2000



Source: Docquier and Marfouk (2006): International migration by education attainment, 1990-2000" in Ozden and Schiff (eds) International Migration, Remittances and the Brain Drain, Washington, The World Bank and Palgrave Macmillan.

If the loss of human capital is measured through the proportion of migrants with tertiary education to the likewise educated population in the sending country, the highest rates are found in small countries, most of them islands. When the smaller countries (with less than 5 million residents) are excluded, Haiti, Ghana, Mozambique, Kenya, Laos, Uganda and Angola have the highest rates. Some Central American countries, such as El Salvador and Nicaragua, also show high rates (figure 11.7).

Figure 11.7
Migrants with tertiary education as a share of population in the home country with that level of education, 2000



Source: Docquier and Marfouk (2006): International migration by education attainment, 1990-2000" in Ozden and Schiff (eds) International Migration, Remittances and the Brain Drain, Washington, The World Bank and Palgrave Macmillan.
Note: Countries with more than five million inhabitants.

Effects

The loss of human capital has traditionally been considered a constraint for developing countries. Given the crucial role that human capital has in economic growth, the loss of highly educated workers through migration can harm the development possibilities in sending countries: and the higher the externalities attributed to that human capital, the greater this effect would be (Grubel and Scott, 1966; Bhagwati and Hamada, 1974; Miyagiwa, 1991). It is thought that, through skilled migration, developed countries "siphon off" part of a valuable and scarce resource from developing countries—their highly educated people. The fact that education is frequently carried out with public budgets makes the migration of skilled labour still more unfair, as it can be seen as wasting part of a developing country's efforts toward human capital formation.

There are other possible negative effects of skilled migration. For example, given professional sectors provide a significant base of taxes in any economy, emigration of skilled labour could reduce notably tax collection in

sending countries. For instance, in a study on India, Desai and others (2001) estimate the fiscal loss from the emigration of qualified human resources at between 0.24 and 0.58 per cent of the country's GDP. Additionally, human capital constitutes a basic factor in building quality institutions within a society (Kapur and McHale, 2005; Alonso and Garcimartín, 2013). Since institutions constitute a relevant factor in explaining development, the loss of human capital could therefore affect the development possibilities of the country. In sum, this approach points out the contradiction between the private interests of skilled potential emigrants and the social interest of the country from which they come.

In contrast to this perspective are those who find both interests compatible: they consider education as an endogenous variable and think that the emigration of trained resources could have positive effects on human capital formation in developing countries. If returns from the educational effort are higher abroad than in the country of origin, the possibility of emigration will increase the return on investment in human capital, leading more people to become educated. In that case, the increase in human capital formation can outweigh the negative effect of the brain drain itself. This, then, is a "brain-drain-induced-brain-gain" scenario (Stark et al. 1997, 1998; Vidal, 1998; Mountford, 1997).

Other potentially positive contributions by skilled emigration on sending countries include: i) the skills and assets that migrants bring after their migratory experience, as long as the emigrant returns (Stark et al., 1997; Domingues Dos Santos and Postel-Vinay, 2003); ii) the possibility of creating networks for international business for the sending country (Mesnard and Ravaillon, 2001); and iii) the higher level of remittances from this type of emigration (Cinar and Docquier, 2004). Some of these arguments are questioned by Schiff (2006).

Despite the importance of the question, much of the "brain-drain/brain-gain" debate has long been focused on the theoretical field, with limited empirical information. Only recently have advances been made in empirical studies, from information provided by Carrington and Detragiache (1998, 1999), Adams (2003), Docquier and Marfouk (2004, 2006) and Dumont and Lemaitre (2005). However, the results of these studies are far from conclusive, in part because such analysis needs to tackle the endogenous nature of education and requires the positing of a well-defined counter-factual scenario without migration. As a consequence, the results vary according to the assumptions and methodology adopted. Some argue for

the benefits of qualified emigration and support the notion of "brain gain". That is the case, for example, of Bein and others (2008 and 2009), who find a positive effect of skilled migration prospects on human capital investment (with an elasticity close to 5) in a cross-section of 127 developing countries. This result is confirmed in a quasi-natural experiment, produced as a consequence of Indian migration from Fiji Islands after the 1980s (Chand and Clemens, 2008), and through a household survey in Cape Verde (Batista and others, 2010). Nevertheless, other authors are more sceptical about the supposed benefits, or else condition them on factors of national contexts and emigration thresholds (Schifff, 2006; and McKenzie and Rapoport, 2006).

On the whole, it seems that the effects of the loss of qualified personnel are highly subject to the externalities attributed to the human capital, the rate of emigration considered, and the sensitivity of educational decisions to opportunities abroad. But, even if the "brain gain" argument was confirmed, obtaining a definitive conclusion would require to demonstrate that: i) the balance of the whole developmental effects (not only in terms of human capital investment) of this kind of migration is positive for the sending countries; and ii) there are no other ways to increase returns of education with less cost to the development process. In relation to the first factor, it is worth considering that, far from being homogeneous, human capital is a highly specific asset with a very low degree of substitution between different varieties. And migration possibilities could alter the profile of education investment toward benefiting those skills that are more prone to foster migration (and not necessarily those that the home country needs).

Although it is difficult to draw definitive conclusions from this literature, the studies might support a position somewhere between the two extremes, suggesting that: i) it is possible that the optimum does not coincide with a zero probability of professionals migrating; but ii) an excessive rate of emigration of highly educated workers could make the costs of the process unambiguous (Kapur and McHale, 2005).

Doubtless, none of the reasons given above would support a policy against the international mobility of qualified workers, but they are sufficient to justify both sending and net-recipient countries in trying to limit the most negative effects associated with this phenomenon. Policies could include: i) limiting developed countries' implementation of selective migratory policies designed to attract qualified personnel; ii) greater attention to the labour conditions of qualified workers in developing countries; and iii) policies to stimulate the return of professionals when circumstances allow.

11.6 Migratory policies

National policies

There is a clear contradiction between the needs of developed countries for migrant workers to support growth, and the restrictive approaches with which these countries regulate migratory flows. The result of this contradiction is the creation of a large population—the dimension varies depending on the case—of undocumented migrants living in precarious conditions in host countries.

The problems associated with undocumented migration go beyond the generation of migrants directly concerned and affect their descendants as well. The second generation suffers the segmented social assimilation that derives from the irregular situation of their parents. Their downward assimilation frequently produces low educative performance, school drop-out, adolescent pregnancy and involvement in gangs and illegal activities (Portes, 2008). These problems end up reinforcing social and racial stereotypes associated with migrants and further reinforce the difficulties of the social integration of migrants in host countries.

Additionally, the fact that significant migration operates in a context outside the law makes for an appealing situation for mafias and other illegal groups to take advantage of the vulnerability and uncertainty that many migrants face. Such abuses are especially serious around the routes of entry to destination countries, including transit countries and border crossings. Violence is more extreme in the case of women, who frequently suffer exploitation and sexual abuse.

As a consequence of these manifestations of delinquency, recipient countries end up viewing migration as a security problem, focusing policies on the tightening of borders and persecution of undocumented migrants. Terrorist threats have amplified this tendency, making migration policy still more repressive in tone. This approach is hardly effective in the long term and can foster abuses by police and security forces, not only in host countries but also in transit countries.

If recipient countries are to avoid irregular migration, their governments should estimate labour needs in a more realistic way and create routes of legal access to those jobs deemed necessary. Permanent migrants should be allowed access to public services, residence and, where appropriate, nationality in the host country, thus guaranteeing rewards and social rights in conditions similar to those enjoyed by national workers. It is

also important for governments to flexibly regulate migrant mobility once emigrants are in the host country. Furthermore, it would seem appropriate to establish limits to tethering, which ties the foreign worker to a sponsoring employer, thus facilitating abuses by the unscrupulous.

Sometimes the demands of the labour market lead to temporary jobs (in tourism or agriculture, for example), so it is important for governments to develop adequate regulatory frameworks for this kind of migration. In these cases, the state should guarantee that the conditions of the work, residence, and health and security of migrant workers is up to the standards of native workers. For this kind of programme to work properly, it is best that the authorities in the countries of origin, as well as unions from both countries, be involved—and not merely the employers. In fact, the sharing of responsibilities and obligations by source countries (such as pre-movement screening and selection, facilitation of return, and commitments to combating irregular migration) should be a key element of these programmes.

In sum, the approach should be based on a double principle: i) first, the recognition that it is up to the individual states to define the ways of accessing residence, employment, and nationality in the case of anyone coming from another country; but also ii) acknowledgement that those same states have an obligation to protect the basic human rights of people within their territory, whatever their administrative status. Moreover, in the case of an emigrant who lives legally in a host country, as UNDP (2009) reiterates, the host government should be obliged to guarantee, as a minimum, the following rights: i) equal pay for similar jobs, respectable labour conditions, and social and health protection; ii) collective organization and negotiation; iii) not being subject to arbitrary detention or deportation without judicial process; iv) not suffering cruel, inhuman or degrading treatment; and v) the possibility of free return to the country of origin. All these rights should be guaranteed along with those associated with personal freedom and security.

The form in which recipient countries have implemented their migration policies is highly variable, as the index of immigrant integration (the MIPEX) shows. The range of overall qualification is from 83 points in Sweden to 31 in Latvia, with the potential range being 0 (worst case) to 100 (best case) (table 11.6). The most notable differences were found in the extent of political participation and in the eligibility of migrants to acquire host country nationality.

The current crisis has brought about a more restrictive tone in migrant policies in the OECD countries. Moreover, an increasingly visible anti-

Table 11.6
Assessment of national migratory policies (MIPEX) in selected countries, 2010

100 = best score								
Countries	Labour market mobility	Family reunion	Education	Political participation	Long-term residency	Access to nationality	Anti-discrimi-nation	Total
Austria	56	41	44	33	58	22	40	42
Belgium	53	68	66	59	79	69	79	67
Bulgaria	40	51	15	17	57	24	80	41
Canada	81	89	71	38	63	74	89	72
Cyprus	21	39	33	25	37	32	59	35
Czech R.	55	66	44	13	65	33	44	46
Denmark	73	37	51	62	66	33	47	53
Estonia	65	65	50	28	67	16	32	46
Finland	71	70	63	87	58	57	78	69
France	49	52	29	44	46	59	77	51
Germany	77	60	43	64	24	59	48	57
Greece	50	49	42	40	56	57	50	49
Hungary	41	61	12	33	60	31	75	45
Ireland	39	34	25	79	43	58	63	49
Italy	69	74	41	50	66	63	62	60
Latvia	36	46	17	18	59	15	25	31
Lithuania	46	59	17	25	57	20	55	40
Luxembourg	48	67	52	78	56	66	48	59
Malta	43	48	16	25	64	26	36	37
Netherlands	85	58	51	79	68	66	68	68
Norway	73	68	63	94	61	41	59	66
Poland	48	67	29	13	65	35	36	42
Portugal	94	91	63	70	78	82	84	79
Romaria	68	65	20	8	54	29	73	45
Slovakia	21	53	24	21	50	27	59	36
Slovenia	44	75	24	28	69	33	66	48
Spain	84	85	48	56	78	39	49	63
Sweden	100	84	77	75	78	79	88	83
Swizerland	53	40	45	59	41	36	31	43
United Kingdom	55	54	58	53	31	59	86	63
United States	68	67	55	45	50	61	89	62

Source: Migratory Policy Group and British Council (http://www.mipex.eu).

immigration sentiment has surged in several countries, many of which have long traditions of accepting immigrants. Some are witnessing an increase in the number of political parties wary of immigration, and even an increase in xenophobic messages.

International framework

In order to achieve a suitable regulation of migration flows, national responses are not enough: as a global phenomenon, migration requires a global approach. The reality, as UNDP (2009) pointed out, is that migration falls into an area not covered by any formal international regime. There exists neither a globally agreed regulatory framework nor a specialized multilateral institution. In fact, the only specialized international legal framework in the area of labour migration, the Convention on the Rights of Migratory Workers and their Families (1990), has been signed by only 41 countries.

The Doha Round of the World Trade Organization (WTO) gave an opportunity to build a multilateral framework to deal with a limited set of international migration. Under the General Agreement on Trade in Services (GATS), through its Mode 4, the temporary movements of service providers across borders were negotiated. Unfortunately, few commitments have been made on Mode 4 in the Doha Round, prompting countries to turn their attention toward bilateral and regional agreements.

Besides that, migration lacks a coherent institutional framework at the global level. There are a large number of international organizations that have mandates over issues related to migration, but none in a specialized and comprehensive way (these include, among others, the United Nations Population Fund (UNFPA), the United Nations Department of Economic and Social Affairs (UNDESA), the International Labour Organization (ILO), the World Trade Organization (WTO) and the International Organization for Migration (IOM).

There is not a unanimous opinion on the need to create a supranational institution with enforceable power to manage global migration (Baghwati, 2003, and Hatton, 2007, as opposite opinions). The main barriers to agreement are related to: i) the labour-importing countries' desire to set immigration policies unconstrained by international agreements; ii) the limited room for reciprocity among countries in which the agreement can be based; and iii) the lack of leadership from major migration-destination states to build this international frame.

In spite of that, there is a shared opinion that potential gains produced by international migration could be both increased and better distributed if nations shared a more coherent, liberal set of rules at the global level. The key to achieving this purpose is to find incentives that attract both home and host countries to take part in cooperative action. But it is difficult to find sufficient mutual rewards in the field of migration alone. It may, therefore, be necessary to make changes in other areas of international relations, in order to create mutually beneficial development opportunities. International migration is a consequence of the asymmetries that exist in the international system, and it is impossible to reduce migration pressures if these asymmetries are not corrected through fairer distribution of development opportunities.

In any case, a pragmatic way to increase migratory governance is through more active international cooperation based on networks (like the numerous regional consultative processes), dialogues (such as the Global Forum on Migration and Development), and certain institutions (such as the IOM) (Betts, 2011; Ghosh, 2007; Trachtman, 2009; or Kolowski, 2009). Nevertheless, it would be necessary to integrate these efforts into a more global and coherent framework.

11.7 Final considerations

International migration can be a powerful factor in the development process for both recipient and destination countries, and it opens up significant opportunities for the emigrants. In this sense, emigration is not a zero-sum game; adequately regulated, it can be the source of shared benefits for all those involved. Empirical estimations confirm that the global welfare effect of increased free migration would be greater than that which trade liberalization (or capital deregulation) can create. Of course, emigration can also involve costs, which need to be considered and, to the extent possible, minimized. A basic requirement for a good approach to migration policy would be that: i) sending countries understand that emigration cannot be conceived as a substitute for a development strategy; and ii) recipient countries understand that meeting their labour needs requires offering migrants the protection of the law and a recognition of workers' social rights.

Second, despite the potential benefits of international migration, the laws governing this process are notably restrictive. The result of this regulative framework is the presence of a large group of undocumented immigrants living outside the law in their destination countries. In order to avoid such

an outcome, recipient countries must better balance their need for a migrant population with rules that allow migrant workers to obtain residence (and citizenship, where appropriate) as well as employment.

Obviously, it is necessary to acknowledge that all countries have the right to define the rules around entry into their territories, access to residency and citizenship, and integration by foreigners into their labour markets. However, that regulation must be sensitive to the conditions of the poorest peoples while recognizing the potential of migration as a source of progress for those involved. In any case, if states have the right to regulate conditions of access by non-nationals to their countries, they also have the obligation to protect the basic rights of everyone in their territory, regardless of his or her administrative status.

Third, in an increasingly integrated world, national solutions are insufficient. It is difficult to effectively manage migratory flows without a concerted international effort. Therefore, regulation should support the international instances of dialogue and cooperation currently in effect (such as the Regional Consultative Processes on Migration, or RCPs), promoting more active participation by civil society and the private sector, and encouraging, when appropriate, a tighter link with the process of regional integration. At the same time, more efforts should be made to create an international regime for regulating international labour migration.

Fourth, the remittances sent by migrants constitute an important source of financing that may be useful to development processes in migrants' countries and communities of origin. However, it is possible to improve the impact of this source of financing if sending and host countries work at: i) reducing the transaction costs of remittance transfers (Hanson, 2010, shows that a 10 per cent increase in fees is associated with a 1.5 per cent reduction in transfers); and ii) defining public stimuli to encourage more productive use of remittances for development purposes, while respecting the private nature of the funds.

Fifth, migration is highly selective, most intensively affecting the young, the most dynamic, and the best-trained members of a population. So it is possible that emigration generates costs for developing countries in terms of losses of human capital. To avoid these negative effects, work needs to be undertaken to: i) revise the most aggressive policies that selectively aim at attracting qualified human resources from developing countries; ii) support efforts by developing countries in training, research, and human capital formation; and iii) make greater use of temporary contracts with stimuli for emigrants to return to their countries of origin.

Finally, the current crisis is having multiple effects on international migration. It has increased immigrant unemployment to above the native average in most of OECD countries, and it has reduced the flows of migrants to developed countries. Also, the crisis has generated anti-immigrant sentiments among certain social and political groups in host countries. Such perceptions have often been translated into a more restrictive tone in migration rules.

However, while the current crisis has tended to slow migration flows, it is reasonable to assume that migratory pressures will continue to be part of the contemporary world. Among other factors, this is true because of: i) the persistence of notable inequalities in wages and income between countries (Clemens and others, 2008; Rosenzweig, 2007); ii) the disparity between the demographic dynamic of the developed world and that of the developing world (see chapter 7); and iii) easy communication and transport between countries. In sum, migration will continue because we live in an increasingly interdependent, but highly unequal, world. In this context, a suitable policy on international migration is an obliged part of a development strategy for the future.

Notes

1 A more complete presentation of some of these ideas can be found in Alonso (2011).
2 For these purposes, a migrant is considered to be anyone who was born in a country different from the one in which he or she currently lives.
3 A similar, though smaller, phenomenon was produced as a result of the breakups of Czechoslovakia and Yugoslavia.
4 This is the case with Estonia, Greece, Hungary, Ireland, Portugal, Slovak Republic and Spain.
5 Improvements in system of counting remittances have also contributed to this increase.
6 In urban environments, consumption includes a larger component of imported goods than in rural environments.
7 The Docquier and Marfouk data could overstate the level of skilled migration, since some immigrants may have completed their schooling in the destination country. Bein and others (2006) consider this possibility.

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Chapter 12
The enabling international environment

Norman Girvan and Ana Luiza Cortez[1]

12.1 Introduction

The chapters in this book call for a new approach to development and to development policy. A paradigm of sustainable equitable development (SED) has been proposed with social inclusion and environmental sustainability as integral elements. Along with this is a policy approach that departs from neoliberal orthodoxy—allowing for an activist state and a nuanced approach to trade and financial liberalization, depending on the circumstances of each country. However, the success of alternative strategies is also conditioned by the international environment in which countries operate. Relationships in key areas like trade and finance can help or hinder the attainment of development objectives. Schematically, the role of an "enabling international environment" in supporting alternative development strategies is depicted in figure 12.1. Here, we have grouped its components into those relating to (i) global governance (ii) finance (including aid) (iii) trade, (iv) technology, (v) migration and (vi) the environment. Finance, migration and the environment are the subjects of other chapters; this chapter discusses global governance and international trade and technology rules.

12.2 Embedding alternative development in the international environment

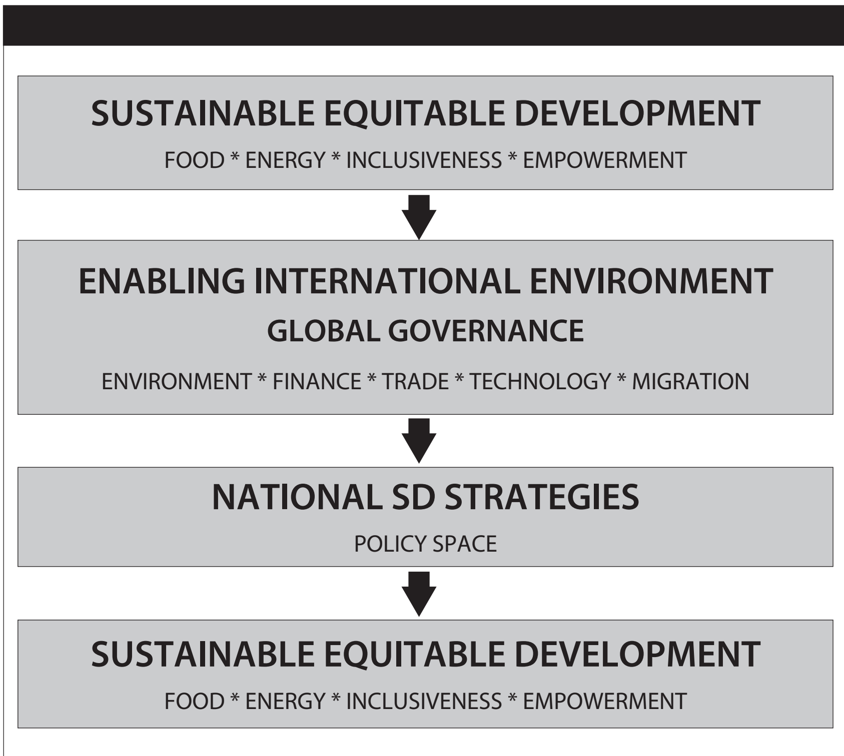
Establishing an international environment that is supportive of SED is not necessarily a straightforward matter. Neoliberal principles are not only embedded in much of the rules, practices and policies of major international institutions; but also in the underlying thinking that informs the work of the global policy community. A common mistake is to fail to distinguish between means and ends. Too often we find an assumption that market liberalization is the right policy in all circumstances; but liberalization should be subject to the test of how far it serves the ends of development. Similarly, growth in the GDP is often assumed to "good" in and of itself; but different kinds of growth have different consequences for equity and for the environment. Neoliberal principles are often reflected in the architecture and content of the World Trade Organization agreements[2] and in the rules and conditionalities of the Bretton Woods Institutions (BWIs). They can underlie WTO/BWI institutional culture, recruitment methods, staff training and socialization and incentives for career advancement as well as the extensive training programmes, seminars and conferences that these institutions run for policy officials and the academic community. To a significant degree, these principles have been assimilated by policy elites of developing countries as a result of professional training and sustained exposure to donor conditionalities. In other words, embedding alternative development objectives and ensuring space for policy heterodoxy in the international environment is a task that will need to be addressed across sectors and at several levels. In this regard, several cross-cutting principles may be suggested.

First, the overarching objective must be the equitable distribution of the benefits and costs of globalization, that is to say, promoting convergence and reducing global inequalities in a sustainable way. Equally important is the guarantee of basic needs and human rights through global safety nets. Governance structures need to be transparent, accountable and democratic. balancing effectiveness with legitimacy.

Second, there is the aforementioned need to make a clear distinction between means and ends. The overarching objective should be applied as the across-the-board criterion for orienting agreements, institutions, rules and policies; and applied in terms that are operational, measurable and capable of being easily monitored. The *means* that are employed to meet this objective, however, will be subject to a fair degree of national variation. As Vos (chapter 1) points out, "the more successful development experiences suggest that the way forward would start with designing national *sustainable*

development strategies tailored to country-specific conditions" (and) "a new balance must be found between international rules-setting and the provisioning of global public goods, on the one hand, and the creation of the space needed by nations to determine their own destiny, on the other."

Figure 12.1
Enabling International Environment for Alternative Development Strategies



Source: Girvan and Cortez.

The third principle, which follows from the above; is that recognition of the diversity of national circumstances and of policy approaches should be embedded in the architecture as an *intrinsic feature* of the global community, not as exceptions to general rules. In other words, the environment should cater to the fact that countries have a variety of initial conditions, and will adopt a variety of pathways to achieve the objective of SED. This applies especially to the rules regarding the relative role of state and market in the economy, and the degree and sequencing of trade and financial liberalization.

A fourth cross-cutting principle we propose is recognition that *true development is locally-driven*. One implication of this is that policymaking should be endogenized, prioritizing the use of local resources and the building of local human and institutional capacities. Hence, external agencies should be supportive of internal effort, not substitute for it.

A fifth follows from the notion that *"learning" is integral to development*. Here we are referring to learning in the formulation and implementation of policies that work in the specific context of time and place; and to associate learning with capacity-building in national institutions. Robust feedback mechanisms need to exist, by which the results of policy intervention are continuously evaluated and lessons are learned and applied to future policies. In this approach, policy mistakes are transformed from an asset into a liability. Hence, maximum opportunities should be provided for national actors to participate in the making and implementation of policies, and in learning from the related policy experience.

Putting all these principles into practice might mean a kind of *paradigm shift* by existing international institutions. At the very least their mandates, rules and policies may need to be recalibrated. A general framework embodying the goal of SED and the principles outlined will be necessary as a frame of reference for key institutions including the United Nations, International Monetary Fund, the World Bank and the WTO. This could, for example, take the form of a Declaration by the United Nations General Assembly in the context of the adoption of the post-2015 Millennium Development Goals. The charter, articles of agreement or founding documents of these institutions and the associated treaties might then be examined to determine their consistency with these principles and the kinds of changes that are appropriate. Alternatively, key institutions might adopt a declaration on their work going forward, derived from a general declaration by the world community. While such declarations are non-binding and are often subject to different interpretations; they provide a reference framework that governments and non-governmental actors can invoke in conducting negotiations and mobilizing for advocacy.

The sections that follow discuss the application of these principles to global governance and to international trade rules.

12.3 Global governance and the "coherence deficit"

Vos (chapter 1) has pointed out that the core institutions and rules for managing the world order, which were set up more than sixty years ago,

are not equipped to manage a world of greatly increased interdependencies resulting from globalization. Global interdependencies have connected the financial and economic crisis with the food and energy crisis and underlie the environmental crisis; but governance remains largely nationally based; and international arrangements are highly compartmentalized. Thus, the 2008 financial crisis spread rapidly from its country of origin to become a global financial and economic crisis that impacted incomes and employment worldwide, reduced international investment and aid flows; and impaired previous development gains. The crisis had its origins in deregulated financial markets; yet policy reforms continue to emphasize trade and financial liberalization; and the conditionalities attached to financial rescue packages privilege pro-cyclical policies. On the other hand, while economic recovery is important, he points out that return to a path of environmentally unsustainable growth is not an option. Policies will need to incentivate adoption of climate-friendly consumption patterns and production technologies. Other contributions to this book show the negative fall-out from global policy fragmentation in food (Von Braun), the environment (Opschoor), finance (Ocampo) aid (Alonso) and migration (Alonso).

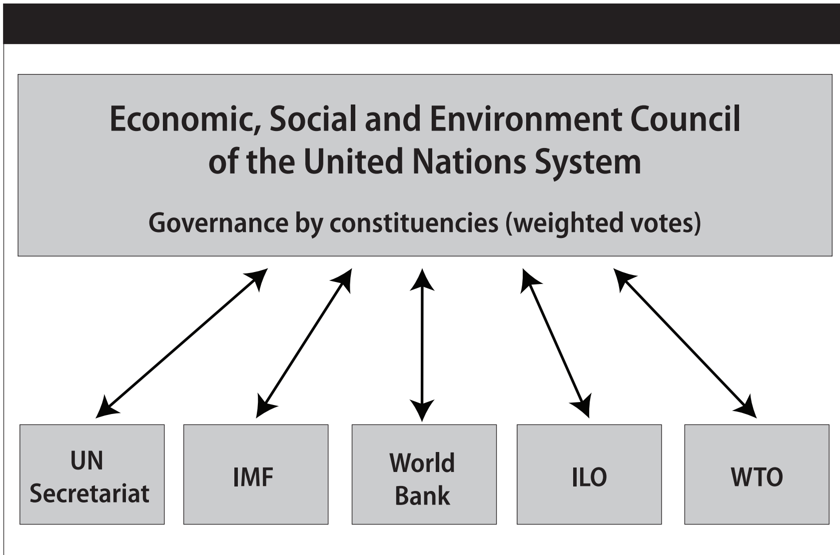
Akyüz (2009a:3) points to several instances of systemic incoherence that undermine sustainable and socially inclusive development. For example, the strengthening of Intellectual Property Rights may inhibit access to public health and to climate-friendly technologies needed for poorer countries to fulfil social and environmental goals. An international financial system characterized by exchange rate volatility is inconsistent with maintaining an open international trading system; in that, exchange rate variation can have as great an impact as tariff barriers on the volume and direction of trade flows. Similarly, there is implicit acceptance that meeting financial obligations should be prioritized over free trade. He also points to the absence of an ILO mandate and jurisdiction over policies affecting the level and nature of employment (Akyüz 2009a: 4-5). These inconsistencies establish the need for trade-offs among different global objectives. Effective coordination at the global level is needed "to strike the right balance among competing objectives and secure compliance and accountability" (2009a:3).

But what form should coordination take? It is important for the overarching mechanism to be representative of, and accountable to, the entire global community; and for its decision-making procedures to be democratic and transparent. Absent these, it will lack universal legitimacy; and its effectiveness will be compromised. Here, the marginalization of the United Nations system from the centre of global economic decision-

making constitutes a governance deficit that needs to be addressed. To be sure, the G7/G8 has been transformed into the G20, incorporating several leading emerging economies and larger developing economies. This is a step in the right direction; but it is not enough. The G20 by its nature excludes the majority of the world's economies; and those who sit at the table have no mandate to speak on behalf of those who do not; nor are they accountable to the latter. In addition, the G20, like its predecessor the G7/G8, remains primarily a forum for intergovernmental consultation with no substantive implementation machinery and no structured links with other key global institutions. Accordingly, the G20 has been rightly criticized as a form of "elite multilateralism" that is lacking both in representativeness and in effectiveness (Ocampo and Stiglitz, 2012). It is self-evident that the United Nations, given its universal membership, institutional mandate and institutional make-up, is the logical place for a global governance system (Akyüz, 2009a:10; Ocampo and Stiglitz, 2011). The main reservation is that the principle of "one country, one vote" will be unacceptable in a world of highly unequal economic players. Hence, it may be necessary to make some trade-off between absolute representativeness and meaningful effectiveness.

This is the central thrust of a proposal developed by Ocampo and Stiglitz (2012). It calls for the establishment of an "Economic, Social and Environmental Council of the United Nations *System*" (see figure 12.2). The Council would be at the head of state level, and its membership would be structured into constituencies; with votes weighted by an agreed formula. The formula would combine basic votes with the economic size and population of countries. While this might create difficulties for countries wedded to the "one country, one vote" principle, it is argued that this is a necessary concession to the realities of power in order to ensure the effectiveness. Importantly, the Council must have "the capacity to interact with and, in fact, direct" all parts of the UN system including the UN Secretariat, Funds and Programs, the ILO, the IMF, the World Bank and the WTO. In addition to having responsibility for global economic coordination, the Council would have a mandate to identify "spillovers" between different areas (such as between trade and the environment) and to make recommendations as to how to address them. It would be supported by an independent secretariat with strong analytical capabilities. The authors believe that such a mechanism would satisfy the requirements of leadership, effectiveness, representation, legitimacy, and of being structured as a system necessary for coherent global governance (Ocampo and Stiglitz, 2012).

Figure 12.2
Ocampo-Stiglitz proposed Global Council



Source: Ocampo and Stiglitz (2012).

In this context, the role and governance of the Bretton Woods Institutions may be addressed. Here the governance deficits arise from the unbalanced composition of shareholding, voting power and decision-making. Still reflecting the geo-economic situation at the end of World War II, changes necessary to reflect the shifting balance of power in the world economy have been tortuously slow (Ocampo, 2010). This has undermined the perceived international legitimacy and credibility of the BWIs. Akyüz (2008) has argued that the underlying obstacle to governance reform of the BWIs is their financial dependence on major shareholders. He proposes new sources of financing including a currency transactions tax, arms trade tax, voluntary contributions from governments, wealthy corporations and individuals. An international agreement on independent sources of finance would be linked to a reform of special majority requirements (veto power) and the distribution of voting rights and (presumably) of shareholding.

It is difficult to address governance reform of the BWIs, therefore, without simultaneously addressing the method of their financing and their role in the provision and regulation of global finance. The IMF is the logical body to play a central role in global macroeconomic coordination and consultation; and in international prudential regulation to mitigate the systemic dangers

of excessive risk-taking (Ocampo, 2010). With a more truly multilateral system of governance; the IMF could also be made the institutional linchpin of an international monetary system centred on its Special Drawing Rights (SDRs) as the principal reserve asset (chapter 9 by Ocampo and Erten in this volume). Under this proposal, the IMF would become a fully SDR-funded institution; and SDRs would be used as an instrument of counter-cyclical financing through IMF loans to deficit countries. SDR-denominated bonds would also be issued as an alternative to other major short-term assets. This could be linked to the provision of greater automaticity of access to low conditionality balance of payments support for countries in difficulty due to external shocks. Such shocks include destabilizing capital flows, commodity price fluctuations, and export income shortfalls associated with international business cycles. In this regard, Akyüz (2008) has argued for both the IMF and the World Bank to retreat from policy lending and instead concentrate on the supply of global public goods. The IMF, as mentioned above, would be responsible for coordination, regulation and provision of emergency liquidity. The World Bank would act as a financial intermediary between private capital markets and the developing countries; with a focus on mobilizing project finance for infrastructural investment. Ocampo (2010) also argues for strengthening the role of regional reserve funds and of regional development banks in the international financial architecture. This would introduce much-needed competition to the BWIs and enhance responsiveness to regional and local realities. Changes of this kind would do a great deal to strengthen global macroeconomic stability, allow greater national space for policy experimentation and innovation, and provide a framework within which BWI lending could be more closely aligned to nationally determined sustainable development strategies.

Democratic decision-making also needs to be strengthened in the WTO, where the problem does not lie in formal rules but in informal procedures. We address this as part of the discussion of global trade rules, in the next section.

12.4 Global trade rules

The rules governing international trade are embodied in the WTO agreements and, increasingly, in bilateral and plurilateral trade agreements between developed and developing countries. The global trade architecture extends to other multilateral institutions such as UNCTAD (commodities and trade capacity building), WIPO (intellectual property), FAO (agricultural

development and food security), among others. Notably, this is the only area of the enabling environment in which a global institution (the WTO) has the executive power to enforce the rules; similar powers are exercised though the dispute settlement procedures in free trade agreements (FTAs). The system has succeeded in establishing a stable legal framework for international trade and has allowed for growth in trade flows and export diversification by a selected number of developing countries over the past decades.

Trade rules impact on several key areas of alternative development strategies discussed in this volume. However, there are serious concerns about the extent to which current trade rules enable development, distribute opportunities equitably among trading partners and are established in a truly democratic and participatory manner. There are also issues of coherence that need to be addressed, particularly in view of the interconnectedness of the current crises in finance, food, energy and the environment. Moreover, the system needs to accommodate smoothly to the rise of new trading powers and their corresponding demands for a greater role in the global governance.

The benefits of trade for development and of having an open, rule-based multilateral trade regime are well established. In the preamble of the agreement that created the WTO, governments stated that their "relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand [...] in accordance with the objective of sustainable development [...] in a manner consistent with their respective needs and concerns at different levels of economic development". Trade is a means to an end (global prosperity) and trade disciplines should facilitate the achievement of that end by providing stability, reducing uncertainty and constraining government actions that would otherwise restrict trade or distribute trade to the exclusive benefit of their countries (Irwin and O'Rourke, 2011). The system has delivered in some accounts, but its current contours may be no longer as favourable and require revision.

Trade rules: enabling enough?

Both the WTO and its predecessor (the General Agreement on Tariffs and Trade, or GATT) are based on the principle of non-discrimination embodied by the Most Favoured Nation (MFN) treatment and the national treatment on internal taxation and regulation. The GATT was conceived at the end of the Second World War as a provisional trade liberalization instrument

while negotiations to establish an International Trade Organization (ITO) were taking place. The ITO ended up stillborn while the provisional agreement remained the only multilateral instrument regulating trade until 1994. The GATT was largely a club of developed countries, initially with a very small membership (23 founding members), established to reduce and bind tariffs on industrial goods (mostly). Membership eventually increased as a growing number of developing countries became sovereign nations and provisions needed to be adjusted accordingly. In the 1950s, the GATT also acknowledged the need for economies that can only "support low standards of living" to deviate temporarily from agreed disciplines and "to grant the governmental assistance required to promote the establishment of particular industries with a view to raising the general standard of living of its people". It was the origin of special and differential treatment (SDT) for developing countries, another principle of the architecture of the multilateral trading system. It was subsequently reinforced by the principle of non-reciprocity by which developed countries "do not expect reciprocity for commitments made by them […] to reduce or remove tariffs and other barriers to the trade of less-developed contracting parties" and the provisions of the "Enabling Clause" which, among other things, introduced the legal basis for the deviation of the MFN treatment on exports of developing countries. Yet, the GATT largely remained an instrument that reflected the trade interests of the developed countries; it excluded products where developing countries had a comparative advantage. At the same time, it did not require developing countries to subscribe to disciplines they were not ready to follow. The Tokyo Round codes embody such practice.[3]

These observations notwithstanding, the Uruguay Round (UR) brought some important changes to the way the principles discussed above are applied. Developing countries had become more relevant actors in global trade, while the UR included 123 negotiating members, most coming from the developing world. Negotiations were conducted under the "single undertaking" approach. Developing countries could no longer opt out of specific agreements as before and were brought under the same disciplines as developed countries. Rules have been adopted for trade in goods (expanded to include agriculture and textiles), services and intellectual property. A strong dispute settlement mechanism was created. A more inclusive membership is undoubtedly a positive outcome towards the transformation of the GATT and its successor into an institution of global governance. On the other hand, widening the agenda beyond trade-specific concerns requires a more cautious assessment.

Furthermore, the single undertaking implied significant additional commitments by developing countries. It also required flexibilities in the implementation of the new trade rules (longer periods, exemptions, etc.) and increased technical assistance (which failed to materialize at the required level) in view of the vast gap in institutional capacities between developing and developed countries. While the SDT for developing countries was maintained, including preferential market access, most of these measures currently aim at facilitating the implementation of the new trade rules. Several of them are nothing more than best endeavours and do not reflect any binding obligation or can be enforced through arbitration. The special rights developing countries had to protect and promote national productive capacities still remain, but many have been curtailed and their use became subject to more stringent discipline. This change reflected the shift in the development paradigm where the role of the state is now largely confined to creating the proper conducive economic environment for the private sector to flourish and thrive (Cortez, 2011).

On several grounds the UR has been a disappointment for developing countries. As regards participation in global trade, while the share of developing countries has increased, this is concentrated in a handful of countries—China, the newly industrialized countries (NICs) and to a lesser extent India. For the majority of developing countries, market shares have stagnated or even deteriorated (see table 12.1). In the case of the least developed countries (LDCs) the modest increase in global market share is largely due to international price increases (oil and minerals in particular) than due to market penetration. Anticipated benefits have not materialized while implementation costs have been high. The latter refers not only to public revenue losses brought about by tariff reduction, particularly important in low- and lower-middle income countries, but also in terms of reduced policy space to implement development-oriented measures. Hawney (2005:16) argues that several "growth-critical" national policies that developing countries may wish to employ are either prohibited, or are at risk of being prohibited, by the WTO agreement. Chang (2002) has shown that several of these prohibited policies were employed by the industrialized countries at an earlier stage of their development with considerable success.

The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), for example, establishes minimum standards that countries are obliged to observe in their national regimes of protection on intellectual property rights. It prohibits practices such as copying, compulsory licensing, and reverse-engineering that were widely used by

Table 12.1
Structure of world merchandise trade, 1980-2010

Shares of world merchandise exports in per cent							
		1980	1990	1995	2000	2005	2010
Developed countries		66.9	73.0	69.6	65.2	59.9	53.6
of which:	Germany	9.8	12.1	10.1	8.5	9.3	8.3
	United States	11.4	11.3	11.3	12.1	8.6	8.4
	Japan	6.6	8.3	8.6	7.4	5.7	5.1
Developing countries		17.4	13.5	14.8	18.2	21.9	27.0
of which:	China	0.9	1.8	2.9	3.9	7.3	10.4
	India	0.4	0.5	0.6	0.7	0.9	1.4
	Brazil	1.0	0.9	0.9	0.9	1.1	1.3
	Rep. Korea	0.9	1.9	2.4	2.7	2.7	3.1
	Taiwan	1.0	1.9	2.2	2.3	1.9	1.8
	Singapore	1.0	1.5	2.3	2.1	2.2	2.3
	Hong Kong	1.0	2.4	3.4	3.1	2.8	2.6
Least developed countries		0.8	0.5	0.5	0.6	0.8	1.1
Sub-Saharan Africa		3.9	2.0	1.5	1.4	1.8	2.2
Middle East & North Africa		4.4	2.2	1.2	1.8	2.0	2.3
Latin America & Caribbean		4.9	4.1	4.3	5.5	5.4	5.7
South and East Asia & Pacific		4.2	5.3	7.8	9.4	12.6	16.8

Source: World Bank and WTO.

some developing (and developed) countries as a means to catch up. The Agreement on Trade-Related Investment Measures (TRIMS) does not allow the use of performance–related measures for foreign investors that have an effect on trade, such as local content and trade-balancing requirements. Export subsidies were prohibited for non-LDCs with per capita income above $1000, except for agriculture. Trends in tariffs have also important consequences for reducing the scope of industrial policy options. These include the increased binding of tariffs by developing countries, their progressive decline overtime and the modalities proposed to reduce them. And, for developing countries joining the organization after 1995, much of the remaining SDT provisions were not applicable, even in the case of the LDCs, which counted on deeper preferential treatment, and despite specific additional decisions to that regard (Cortez, 2011).

In fact, the principles of preferential treatment for developing countries and non-reciprocity—supposedly important pillars of the multilateral trade system—have deteriorated. The value of preferential market access

has been compromised not only by progressive liberalization but also by a wide range of complex rules-of-origin requirements and greatly offset, if not reversed, when preferential treatment accorded to competitors under PTAs (see below) are also taken into account. Meanwhile, conditionalities associated with adjustment programmes by the international financial institutions have constrained the use of some SDTs by developing countries.

However, policy space has not been completely closed. For instance, export and technology transfer requirements are permitted under TRIMS. Flexibilities exist under TRIPS as it leaves considerable discretion as to what kind of knowledge is eligible for patenting, and the issuing of compulsory licenses is allowed under certain circumstances (Akyüz, 2009b). While the Agreement on Subsidies and Countervailing Measures (SCM) restricts the room for government intervention in export promotion, some schemes are still WTO-consistent. Moreover, the SCM does not prevent governments from subsidizing activities—particularly through regional, technological and environmental policies—provided governments have enough ingenuity to present such subsidies as WTO compatible (United Nations, 2006). In reality, besides these envisaged exceptions, members can deviate from WTO disciplines provided no other member initiate legal action (and make the case) against that measure.

The UR has also been considered unbalanced and unfair (Stiglitz, 2004). Tariffs on industrial goods were further reduced by developed countries but tariff peaks and escalation on products of export interest of developing countries remained. In developing countries, binding coverage increased significantly but bound tariff stayed higher than applied tariffs. In developing countries tariff liberalization has been also taking place outside trade rounds, within the framework of adjustment programmes and other instances of "autonomous" liberalization.

In agriculture, developed countries retained the differential and preferential right to support production as commitments to reduce subsidies were established on the basis of a reference period when subsidies had been the highest and implied in very little actual reduction. Additionally, the rules contained loopholes which allowed countries to shift subsidies among different categories, the so-called boxes (Khor and Ocampo, 2011). Thus, agriculture trade continues to be distorted and to undermine the competitiveness of producers in developing countries (cotton is a case in point). It also contributes to limit efforts at food self-sufficiency.

In services, most of the liberalization has happened in modes 1 (cross-border supply) and 2 (consumption abroad) whereas, mode 4 (movement of

natural persons) where developing countries have a competitive advantage, particularly in unskilled labour-intensive services, remains restricted. TRIPS required developing countries to adhere to IPR standards that are not compatible with their level of development and were adopted by the industrial countries only at their late stages of development. Moreover while protecting innovators, TRIPS offers no comparable protection over indigenous knowledge or over natural resources.

In 2001, a new round of trade negotiations was launched. It encompassed an ambitious work programme covering 21 areas (WTO 2001), some of which had been strongly advocated by developing countries (implementation-related issues, operationalization of SDT, etc.), while others had been intensely resisted (e.g. the Singapore issues: trade and investment, trade and competition policy, transparency in government procurement, and trade facilitation) but nevertheless made their way into the final programme due to less than transparent negotiation practices. But with developing countries being more assertive of their interests these issues were eventually dropped from the agenda (except for trade facilitation). Negotiations however have been extremely contentions, ministerial conferences collapsed, and the round came to a halt. The most recent ministerial declaration was issued in Hong Kong in 2005, while latest Ministerial Conference (Geneva, December 2011) produced a statement by the Chair signalling out the few areas of common understanding amidst the numerous issues raised (WTO, 2011b) and no clear indication of how negotiations will proceed.

The principle of single undertaking (nothing is agreed until everything is agreed) is not working. Unbundling could facilitate progress and the conclusion of agreements on areas where negotiations are more advanced or, preferably, on areas of interest of developing countries, if the round is to be indeed a development round. In this regard, issues to be addressed on a priority base include "implementation issues", strengthening of SDTs, Mode 4 of service liberalization and agriculture, in particular domestic support. Meanwhile, non-trade issues such as competition policies, labour and environmental standards should not be included in the negotiations.

Other alternatives to relax the principle of single undertaking include approaches such as "variable geometry", "enhanced integration" or "WTO à la carte" (Cornford, 2004; Negrescu and Trica, 2006; Huang 2011). They would imply a WTO that would serve as an umbrella framework for agreements on trade issues, not all of them binding on the entire membership, but negotiated under certain rules that would not allow small groups of countries to bring to WTO issues that are strongly opposed by

a considerable number of members (Consultative Board 2004). However, it may not be easy to have consensus on how these rules should look like and to reconcile these approaches with the consensus principle. Another possibility that has been suggested—admittedly not suitable for all areas—is the GATS scheduling approach, by which countries establish their own pace for market access and national treatment.

Governance: truly democratic?

More disturbing, perhaps, is the fact that the lack of a true development orientation in the round may reflect the marked asymmetry in economic and political power among members, despite the formal equality in terms of decision-making rights: one country, one vote. Yet decisions are not taken by vote, but by consensus, which would imply, in principle, the right by any country to block any decision. However, there are problems on how consensus is forged in some instances and there is a relative lack of transparency in some key aspects of WTO operations.

In practice, both the GATT and the WTO have been dominated by a few major industrial countries. Often, these countries negotiate and decide among themselves, and embark on an exercise of bringing in a selected number of more influential developing countries, in "informal meetings" (the Green Room process). In the GATT and in the first decade of the WTO, the most powerful members by far were the so-called "Quad" (comprising the United States, European Union, Japan and Canada). In 2004, a new informal "Group of 6" emerged in the agriculture negotiations, comprising the US, EU, Japan, Australia, Brazil and India. China was included in this small-group negotiation in 2008. For the majority of developing countries, participation in real decision-making remains out of reach.

Due to the dissatisfaction of the kept-out majority and the inability of the minority in the inner circle to agree, the Ministerial Conferences have become controversial and unpredictable events. "Mini" Ministerial meetings, with 30 or so countries, have become practice but failed to guarantee an effective decision-making process. Mini Ministerials also collapsed.

These approaches are clearly not working. In this regard, the consensus system should be applied in a manner that fully respects the views of developing country members and procedures should be established for smaller, issue-based meetings, with authorization coming from all members and the meetings being governed by transparent rules. "Green Room"

or “Mini Ministerials” should be called by all members, who should also determine the system of representation. All meetings should be inclusive and transparent, minutes should be kept and subject to members’ approval (Khor and Ocampo, 2011).

Issues of asymmetric power compromising WTO governance are also reflected in the use of the dispute settlement mechanism (DSM), certainly not with respect to the transparency of the process and the independence of its rulings, but rather due to issues of access and actual use of remedies (retaliatory measures) against faulty parties that are unable or willing to act on a given ruling. As of 5 July 2012, 440 cases had been brought to the WTO, 188 of which initiated by the EU and the U.S. Developing countries initiated 182 cases; few small and low-income countries have initiated disputes, while Bangladesh is the only LDC that requested consultations. The costs of using the system are high and require a great deal of awareness and knowledge of WTO disciplines, which is lacking in many developing countries, LDCs in particular (UNDESA, 2011). Moreover, the possibility of imposing retaliatory measures is in practice limited for developing countries and of negligible impact for the smaller countries due to the size of their markets. However, more than half of the disputes are settled during consultations and just few decisions have not been complied with and led to counter measures.

While issues of asymmetric power are not easy to be addressed, trade rules, as a minimum, should not perpetuate or intensify current asymmetries. In this regard, the overall transparency and fairness of the DSM could be further improved if the trade policy reviews—which provide an assessment of the state of trade policies—of member countries with the largest shares of world trade could be geared towards the identification of WTO incompatible practices that are harmful to the export interests of developing countries, in particular of the smaller countries and/or of those countries without established WTO legal competence.

Addressing emerging challenges, improving coherence

As mentioned above, the global trade architecture has been constructed on the basis of the MFN principle. Currently, however, a growing share of world trade is conducted under preferential trade agreements (PTAs) offering preferential market access to signatories, while non-participating countries are excluded.[4] At the same time, some of these arrangements have non-party MFN clauses, that is, the extension of preferential treatment

provisions of agreements contracted with third parties. As developing countries can extend deeper preference to other developing countries, the inclusion of non-party MFN implies that developed countries can also benefit from that deep preferential treatment that was not originally intended for them. Additionally, PTAs often go beyond what has been agreed at the multilateral level (the so-called WTO plus and minus provisions). These concerns assume greater urgency in the case of North-South FTAs, such as the Economic Partnership Agreements between the EU and countries in the ACP group; and between the U.S. and several developing countries (Khor, 2008).

North-South FTAs generally provide for greater reciprocity of market access than the WTO agreements. In merchandise trade, they generally provide for the phasing in of full liberalization and reciprocity of market access (though some exceptions may be permitted), which often replace non-reciprocal market access previously existing under preferential trade agreements. They may also commit developing country parties to widespread liberalization in services; beyond the obligations of the WTO GATS (Kelsey, 2010); and usually involve greater restrictions on policy space by virtue of the inclusion of the 'Singapore" issues (Girvan, 2009). Provisions in these areas generally restrict the ability of developing country parties to favour domestic industry and national firms by means of discriminatory government policies in investment, public procurement and competition. Other areas that developing countries have refused to negotiate in the WTO, such as environment law and labour law regulations, may also be included. These practices raise concerns when PTAs are contracted by partners with asymmetric economic and political power. In fact, a greater number of WTO plus and minus provisions as well as provisions on areas beyond the current scope of WTO (although not all of them legally enforceable) are found in PTAs among partners of different levels of development than in those contracted between partners of similar levels of development (WTO, 2011a). In their quest for greater market shares in developed countries, developing countries are giving up policy space beyond what is envisaged by WTO rules. But it is not clear what they actually gain in return: PTAs tend to exclude products of export interest of developing countries such as agricultural and food products and labour-intensive manufactures.

The proliferation of PTAs coincides with the difficulties in advancing the multilateral trade negotiations. It reflects to some extent the need for deeper integration under a common or similar set of rules due to increasing international fragmentation of production. However, it poses

challenges for the multilateral trade architecture which now comprises an increasing number of entangled parallel subsets of arrangements. PTAs are sometimes of conflicting and/or competing nature, can imply in high costs of compliance (particularly when countries participate in several arrangements), may compromise systemic coherence and undermine progress at the multilateral level if not brought under stricter multilateral discipline and surveillance.

It has been suggested that since it is very unlikely that countries will roll back their PTAs, a way forward would be to "multilateralize" their contents to the largest extent possible in order to improve coherence and bring some order to the pattern of deeper disciplines (Bhagwati and others, 2011). But that would imply having multilateral disciplines that were not originally conceived or negotiated as such and which reflect the interests of selected countries. Thus, it would be more useful to have a standstill on PTAs until clear rules could be agreed on how to have bilateral or plurilateral rules that conform to multilateral norms and not the reverse (Khor and Ocampo, 2011).

There are other issues of coherence in existing rules and between them and domestic policies that need to be addressed as well in view of emerging challenges (Hufbauer and Kim, 2009). Climate change adaptation and mitigation is one of them. Issues of environmental standards and border adjustment measures; the implications of biofuel subsidies for food security and for reducing carbon emissions; the impact of other subsidies for research and development towards the transition to a green economy; the effects of the intellectual property regime and the need to improve access to green technology by developing countries, among others, are few of the pressing issues that come to the fore (DESA/UNEP/UNCTAD, 2011). While it is not for the multilateral trade regime to rule on environmental issues, it should nevertheless maximize its positive contribution to the common objectives of mitigation and adaption. In this regard, its orientation needs to be focused towards promoting and facilitating the development of necessary capabilities in developing countries, including in establishing their own environmental goods sector for the continuous transformation of their economies, rather than punishing (at the border) those who do not have the means to introduce the necessary changes.

Overall, trade arrangements should not impose specific developmental approaches or institutional recipes but rather aim at maximizing the possibilities of development at the national level (Rodrik, 2001). These and other challenges are not insurmountable. But they require political will and leadership. Admittedly, it was easier to agree on multilateral trade rules

when decisions were taken among a smaller group of countries, largely the developed economies, and exemptions offered for developing countries. But the world has changed and some developing countries have become significant enough players in world trade to be granted blank exemptions. On one hand, these would be difficult to justify to constituencies in developed countries. On the other hand, as the name implies, developing countries remain in development. While some countries are more advanced than others, their process of development has not yet been completed. Additionally, smaller countries have been better able to voice their concerns and to have leverage over negotiations (WTO, 2004). WTO governance has yet to adjust to its diverse membership.

Towards a reformed global trade architecture

The current global trade architecture seems disjointed: parts of it have moved forward and pursued the introduction of rules to facilitate an increasing internationalization of production, but the process is also generating outcomes that may not be welfare enhancing for all. Other parts of the system seem unable to acknowledge the political consequences of emerging trends and the need to make space for new actors and reflect their interests; while other elements have not been given sufficient attention and have fallen (e.g., commodities) or will fall through the cracks due to the limits of bilateralism and regionalism in finding solutions to global challenges (e.g., mitigation and adaptation to climate change). While flexible enough to absorb shocks, the global trade architecture should also adjust itself to these underlying shifts in world economic activity and their implications for the global political economy. It should also strive to create opportunities for countries to develop and prosper by designing trade disciplines that are compatible with the needs of the dynamic transformation of all, particularly developing economies, if the vision expressed in the Millennium Declaration is to become a reality.

It is not obvious how and whether the round will proceed and how the WTO will adjust to the changing circumstances. Independently of the potential negative implications of a failed round for the global trading system, it has been far from clear that the round has been moving in the right direction, that is to say, that it would generate disciplines that are development friendly. Developing countries concerns have not been properly addressed. Tighter disciplines are being considered: for instance, according to the latest negotiating text on non-agricultural market access, modalities

being considered would imply in a substantial reduction of the gap between bound and applied tariffs and therefore a much smaller policy space.

Unbundling could facilitate the conclusion of the round. Restricting the scope of negotiations to trade issues and giving true priority to those that are high in the agenda of developing countries would be important as well. In this regard, it could be perhaps more practical to approach the WTO as an instrument for accommodating different economic models and facilitate trade relations among them rather than harmonizing all models into one single business model. But unbundling may not be enough if agreement on the issues that remain on the negotiating table would imply equal disciplines—not all of them necessarily development friendly or preserving much needed policy space in developing countries—are to be applied to unequal parties.

The increased divergence among developing countries does complicate the political economy of finding acceptable solutions to the current impasse. The principle of common but differentiated responsibilities could, in theory, offer some guidance on how to proceed with the negotiations. It is reasonable to argue that, say, Brazil does not need to receive the same differential treatment as, for example, Bolivia, but it is equally fair to recognize that the country is still not at par with, say, Germany and does need space to adopt institutional innovations to address the specific bottlenecks it faces in promoting its productive capacities. However, the operationalization of this principle is far from obvious as attested by the difficulties surrounding the current negotiations under the United Nations Framework Convention on Climate Change.

More importantly perhaps, as far as the trade round goes, is to change the overall approach to the negotiations. As mentioned earlier, trade is a means not an end in itself. Thus, developing countries should be negotiating trade disciplines not with the objective of greater integration into the global markets but with the objective of maximizing development. As Rodrik (2001) eloquently argued, increasing trade flows and expanding market access do not necessarily imply in moving up the development ladder, particularly if greater access is obtained at the expense of policy space. The development objective thus gives further weight to the idea of approaching the WTO as the institution that manages diversity and not as one that imposes uniformity.

Lastly, it is important to recall that the WTO is not the only component in the international trade architecture. Besides the numerous FTAs mentioned above, other institutions take the lead on specific trade issues (e.g., World Customs Organization) and promote trade capacities in developing

countries (e.g., several organizations and agencies in the UN system). These also need to be taken into account and strengthened in the reform of the global trade architecture for development.

12.5 Conclusion

This chapter has discussed the enabling international environment to support sustainable, equitable and inclusive development. It was stressed that globalization has increased the interconnectedness of the global economy while outpacing the institutional capacity of the global community to manage interlinked crises, since governance structures are fragmented and mainly national in scope. Coherence and coordination need to be addressed. Institutions that do have a global reach fall short either in terms of scope (WTO, Bretton Woods Institutions), representativeness (Bretton Woods Institutions, the G20), transparency in decision-making (the WTO), or effectiveness (UN system, ECOSOC). While the historical and political reasons for these shortcomings may be understandable, the costs of failure to address them will rise in the future as the interlinked crises in finance, the economy, the environment, food and energy become more acute and the challenges to international peace and the security of all nations become more intractable. Hence it is important for measurable progress to be made in this direction if achievement of the post-2015 MDGs is not to be compromised.

This chapter has emphasized the need for global governance structures that accommodate to a variety of national sustainable development strategies, in accordance with national circumstances and preferences, particularly as regards the appropriate mix between market and state and the scope and sequencing of trade liberalization. It is important to distinguish means from ends, and to rebalance national policy space vis-à-vis global rules and norms. Reform of global trade rules, and indeed the international trade architecture, will require a special focus moving forward.

Notes

1 The authors acknowledge with thanks the many helpful comments of José Antonio Alonso and José Antonio Ocampo on earlier versions of this chapter.

2 Deviations from full market principles are of course allowed under certain conditions, for example as with domestic support for agriculture and subsidies in other areas.

3 The Tokyo Round codes are: i) Subsidies and countervailing measures, ii) Technical barriers to trade, iii) Import Licensing procedures, iv) Customs valuation, v) Anti-dumping, all of which became an integral part of the WTO under the single undertaking, plus iv) Government procurement vii) Bovine Meat Arrangement, viii) International Dairy Arrangement, ix) Trade in Civil Aircraft, which remained plurilateral under the WTO.

4 According to WTO (2011a), the share of global trade for which preferential market access matters is less than 13 per cent. A significant share of trade is already conducted at zero tariffs under MFN treatment.

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